Strategic Planning: A Broad Overview

Introduction

As the business environment becomes more complex, strategic management has become more important than ever before. As the expression suggests, strategic management deals with the way a company formulates and implements strategy. In simple terms, strategy means looking at the long-term future to determine what the company wants to become, and putting in place a plan, how to get there.

Strategy is both art and science. Strategy is an art because it requires creativity, intuitive thinking, and an ability to visualize the future, inspire and engage those who will implement the strategy. Strategy is a science because it requires analytical skills, the ability to collect and analyze information and take well informed decisions.

Without a strategy, an organization is directionless and vulnerable to changes in the business environment. Strategy acts as some kind of a guidepost for a company's ongoing evolution. Strategy provides a direction for the company and indicates what must be done to survive, grow and be profitable.

In a broad sense[1], strategy addresses three questions:

- Who are the customers?
- What products/services should be offered to them?
- How can the company do this efficiently?

These questions look deceptively simple. But it is the answers to these questions which form the core of corporate strategy.

The term *strategic* is widely used but often in the wrong context. So we must understand the term carefully. We can call an issue strategic if it requires top management involvement, involves major resource commitments, has a long term impact or has organization-wide implications. Though top executives obviously play a critical role in strategic management, people at all levels in the different business units and functions must also be involved. Unless the plans are understood and implemented effectively at these lower levels, the whole purpose of strategic management would be defeated.

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[1] Markides, Constantinos C. "A Dynamic View of Strategy" *MIT Sloan Management Review*, Spring99, pp55-63. Also see "All The Right Moves" by the same author, Harvard Business School Press, 2000.

Strategic management decisions take place at three levels: *Corporate*, *Business Unit* and *Function*. Corporate level decisions tend to be macro level and conceptual in nature. The choice of business, the kind of growth strategy to pursue and the kind of capital structure the company should have, are good examples. Business level decisions cover more specific areas such as plant location, market segmentation, geographic coverage and distribution channels. Functional level decisions pertain to the next level of detail such as choice of plant/equipment, inventory level, etc.

The corporate purpose

The corporate purpose refers to the larger goals of the organization. Going far beyond market share or profitability objectives, corporate purpose refers to that unifying vision which gives meaning to the business that the company is involved in. At its heart it consists of a core ideology and a set of fundamental values that do not change with time. Indeed these values define clearly what the company will do and will not. The truly great companies not only have a clearly articulated corporate purpose but they are also remarkably effective in conveying it in such a way that even frontline employees are able to relate to it. The corporate purpose helps in defining the company's economic goals, from which, strategy emerges.

For example, Google's corporate purpose is to organize the world's information[2] and make it universally accessible and useful. In line with this corporate purpose, Google has focused on the customer, continued to improve the speed of its search engine and introduced features that allow customers to locate information from not only desktops but also from various wireless devices.

IBM focuses on two overarching goals –helping clients succeed in delivering business value by becoming more efficient and competitive through the use of business insight and information technology solutions and providing long term value to shareholders.

Merck believes in developing superior products and services "by developing innovations and solutions that improve the quality of life and satisfy customer needs, and to provide employees with meaningful work and advancement opportunities and investors with a superior rate of return." Microsoft's mission is to help people and businesses throughout the world realize their full potential. Wal Mart has a simple but powerful corporate purpose. "We save people money so they can live better."

[2] Corporate purpose information has been drawn from company websites.

The Economic Goals

Understanding the firm's long term economic goals is the starting point in strategy formulation. As Pearce and Robinson[3] rightly put it, three economic goals must drive the strategy of any organization – *survival*, *profitability* and *growth* even though the relative emphasis may vary at different points of the company's lifecycle.

A firm has to first survive, if it is to serve the interests of the stakeholders. Survival is often taken for granted. But history reveals that the rate of corporate failure is quite high. Indeed, the average life of a Fortune 500 company is only 40-50 years, according to research done by former Shell executive Aries de Geus[4]. Reckless or expedient short term oriented decision making, complacency and quick fixes to structural problems are some of the ways in which the survival of an organization is threatened.

Profitability is the main goal of any business. Not only should the firm make profits but it must also ensure that these profits are sustainable in the long run. Tactical moves aimed at improving short term profitability but at the expense of long term interests must be avoided. Equally important, the profits should come from the core business of the company, not through non operating income (such as sale of assets) or accounting manipulation.

The third goal is growth. A profitable organization which is not growing is a cause for alarm. Lack of growth means the company is not able to identify opportunities to expand its market, compete with other players, develop new products, attract new customers, etc. Lack of growth also implies that competitors are probably moving ahead, thereby weakening the company's competitive position.

Strategic Planning

Purpose defines why the company exists. But purpose is too general and high level for most people in an organization to comprehend fully. Strategic planning draws from the corporate purpose to come up with an actionable blue print in terms of defining the customer segment(s), the products and services to be offered and how to offer these products and services. The essence of strategic planning is to use the past to get a fix on what the company is good at and how to leverage these strengths. It is also about visualizing the future to understand where the company is weak and what it must do to overcome these weaknesses.

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[3] Pearce, John A and Robinson, Richard B. "Strategic Management – Strategy Formulation & Implementation" Richard D Irwin, 1995.
[4] Aries P De Geus, "Planning as learning," *Harvard Business Review*, March-April 1988, pp. 70-74.

In a fast paced environment characterized by Moore's law, rapidly changing consumer tastes and fast reaction time, strategic planning has not become irrelevant. The only difference is that compared to the good old days, planning has to be more flexible and the planning cycle has to be much shorter. Rather than being cast in stone, the basic plan must undergo revision at short intervals.

In many industries, plans must result from a trial and error process. It is difficult to prepare a plan and then execute in sequential fashion. Rather, planning must alternate with execution with corrections being made as the business environment unfolds. In short, as Clayton Christensen mentions[5], deliberate strategy must give way to emergent strategy in uncertain business environments.

In general, strategic plans contain the following components:

- **Purpose/Vision:** the organization's deeply desired future.
- **Mission:** the organization's purpose in terms of products, technology and markets.
- **Core competencies:** the tangible and intangible assets the company will need to build and leverage to gain competitive advantage.
- **Values:** the driving beliefs that define a company's culture and help managers to set priorities and guide day-to-day operations.
- **Strategic objectives:** the targets that allow a company to measure how it is performing in key result areas such as market share, customer loyalty, quality, service, innovation and human capital.

The business environment needs to be analyzed carefully before a strategic plan is prepared. According to Pearce and Robinson[6], the business environment can be divided into the *remote environment* and *operating environment*. The remote environment includes political, economic, social, technological and industry factors. The operating environment has a direct impact on the ability of the firm to sell its products and services profitably. Among the factors to be considered here, are competitive position, customer profile, reputation among suppliers/ creditors and the labor market. The operating environment is much more under the control of the firm, compared to the remote environment. So the firm should be more proactive in dealing with the operating environment.

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[5] The Innovator's solution, Harvard Business School Press, 2003

[6] Pearce, John A and Robinson, Richard B. "Strategic Management – Strategy Formulation & Implementation" Richard D Irwin, 1995.

Improving strategic planning: A McKinsey Survey (Sep 2006)

A survey conducted by consulting firm McKinsey in 2006 concluded that a majority of the executives who responded to the survey were not satisfied with their company's approach to planning. More than three-quarters of the respondents reported that their company had a formal strategic-planning process. But fewer than a quarter mentioned that the process was key to making their most important decisions.

More than half of all respondents mentioned that the important strategic decisions were made by a small group of senior managers, including the CEO. Executives at companies that made good use of a formal process seemed to be more satisfied with strategic planning. Among respondents whose companies had a formal process, more than half mentioned it played a significant role in developing corporate strategy.

Boards were seen to be most active in challenging strategy during the development process and in approving the final strategy. But only 25 percent of respondents felt that their board was actively involved in developing the content of the strategy.

A significant number of respondents expressed concern about executing strategy. Some 28 percent said that their company produced a strategic plan that reflected the company's goals and challenges but was not effective. Another 14 percent said the strategy and plans for executing it were not necessarily aligned with each other. Many respondents felt the need for improving the company's alignment with the strategic plan and developing a method to monitor progress against the plan. Only 56 percent of respondents felt that their company tracked the execution of its strategic initiatives. Many respondents wanted more time to be spent developing suitable metrics.

Strategic planning also does not seem to focus on new opportunities for growth. Fewer than half of all respondents said that their company's approach included identifying growth opportunities outside the core business. Among those who used a formal planning process, just 57 percent said that this process was substantially integrated with their company's business-development function.

Data must be collected for a meaningful range of environmental factors. Such data should be analyzed to determine the implications for the firm in terms of opportunities and threats. Strategic plans should be sufficiently flexible to deal with unexpected variations from environmental forecasts.

During the planning stage, the company will also have to identify key issues, for example, weaknesses to be addressed or opportunities to be exploited with respect to the products and services to be offered to customers, the internal process changes needed to support the company's strategy, and the skills and resources needed to create value more efficiently and effectively. Some of the important issues faced by any organization are costs, service, new markets and products, geographic expansion, acquisitions, divestitures, organizational structure, core competencies and processes, new technologies, training and development, and information systems.

Any plan also involves commitment of resources. Existing resources must be carefully examined to identify gaps, training needs, requirement of new information systems, etc.

Making strategic planning more relevant

As Eric D. Beinhocker and Sarah Kaplan[7] mention, many managers are skeptical of strategic planning. To be effective, a formal planning process must have two overarching goals.

The first is to build “prepared minds”—that is, to make sure that decision makers have a solid understanding of the business, its strategy, and the assumptions behind that strategy. This will enable executives to respond swiftly to challenges and opportunities as they occur in real time.

A key point Beinhocker and Kaplan make here is that companies should avoid combining strategy reviews with discussions of budgets and financial targets. When the two are considered together, short-term financial issues dominate at the expense of long-term strategic ones. Companies good at strategic planning organize two separate meetings: one for deliberating on strategy with each business unit and a shorter meeting, at a different time of year, to set financial targets. The two are then coupled in a rolling annual cycle. The financial plan becomes an input for the strategy discussion, which in turn becomes an input for the next financial plan.

The second goal is to increase the innovativeness of a company’s strategies. Companies can promote creativity by encouraging bottom-up experiments and driving top down initiatives. Strategic experimentation implies pursuing a variety of strategic options in parallel within a given business. Some of the options being tested may compete with current strategies or even be inconsistent with one another. But they can be built around the core competencies of the business and designed to test specific hypotheses about where future opportunities may be found.

[7] “ Tired of strategic planning” , The Mckinsey Quarterly, 2002 Special edition,

All companies periodically face issues that are bigger than their individual business units. Such issues must not be left to business units to deal with, each in its own way. Identifying such issues and persuading the organization to deal with them are important ways in which a CEO and senior managers can drive the company's agenda. Senior corporate leaders must identify issues that call for creative thinking and then deliberately disrupt the normal organizational structures and provoke executives to encourage new perspectives on these issues.

Going beyond operational excellence

Strategic planning should result in stretch goals that lead to genuine value creation, to keep shareholders happy. Shareholders typically discount a rate of growth based on a set of expectations. To make them satisfied, the company must strive for results which exceed the expectations of shareholders. The company must also be seen to be forging ahead of competition. This implies some degree of uniqueness in the strategy.

Chan Kim and Renee Mauborgne mention that companies must look for uncontested market spaces where the water is blue unlike overcrowded segments where the waters have turned red due to cut throat competition. Indeed, strategy should not be confused with operational excellence or with benchmarking against competitors. An excessive focus on competitors leads to funnel vision and a narrow mindset.

As Philip M Natterman mentions in the McKinsey Quarterly[8], benchmarking can help improve operational efficiency but it cannot really be called a tool for strategic decision making. Benchmarking often leads to imitation with respect to product offerings, advertising and spending targets and sales channels. The really smart companies look for new product niches, value added services, sales channels or unexploited price points. These moves clearly involve more risk but also more opportunities to create value and obtain first mover advantages.

The blue ocean approach is strikingly similar to what Natterman mentions. It tries to put the customer at the centre and come up with a new price value proposition that competitors will not find easy to match.

Managing risks

Risk management is an integral part of strategic planning. The term risk needs to be understood carefully. Risk is as much about managing the upside as about the downside with the ultimate objective of creating value for shareholders. Companies should pay

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[8] 2000, Number 2.

attention to both opportunities and threats in the environment. Most corporations run into trouble and indeed are unable to survive long enough because they are unable to manage risks effectively. De Geus's[9] research has revealed that enduring organizations excel simultaneously on various fronts. They are sensitive to their environment. They do not hesitate to move into uncharted areas when the situation so demands. They use money in an old fashioned way, keeping enough of it for a rainy day. In other words, enduring companies manage the risks they face in a flexible way, backed by expertise across functions.

Companies which manage risks well are alert to changes in the environment and are willing to change to respond to them. The Swedish company Stora, for instance, has shown a remarkable ability to formulate strategies according to the need of the hour. It did not hesitate to go outside its core business when the situation demanded. Once it even fought the king of Sweden to retain its independence! To cope with the changing environment, the company diversified into new businesses - from copper to forest exploitation to iron smelting, to hydropower and later to paper, wood pulp and chemicals. In the process, the company mastered steam, internal combustion, electricity and ultimately, microchip technologies. Had Stora continued in one business line, it would not have survived.

Similarly, Nokia, one of the most admired companies in the world today has come a long way since it first started its business. Though Nokia has been in the limelight only in recent times, it is a fairly old company, having been around for more than 100 years. At one point of time, Nokia dealt in wood, pulp and paper. Today, it makes sleek cellular phones loaded with powerful software.

The lesson from Nokia and Stora is that strategic planning is all about positioning an organization to take full advantage of opportunities in the environment while simultaneously reducing the vulnerability to threats. It becomes easier to do this if an organization is prepared for various eventualities. Then, as events unfold in the environment, the company is in a better position to decide which strategy would work best. Strait-jacketed thinking, on the other hand, makes the employees of an organization impervious to external developments. When changes do occur, people are taken by surprise.

Strategic planning accelerates the process of institutional learning by encouraging managers to think of various possibilities. That way they can better absorb and digest

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[9] The living Company

information and most importantly, act as the environment changes. This is especially valid during times of radical change. As Christensen puts it[10]: "The strategies and plans that managers formulate for confronting disruptive technological change therefore, should be plans for learning and discovery, rather than plans for execution. This is an important point to understand, because managers who believe they know a market's future will plan and invest very differently from those who recognize the uncertainties of a developing market."

Lessons from Evolution

In another highly insightful article[11], Eric D. Beinhocker mentions that the evolution of human species has useful lessons for strategic planners. A species thrives through ongoing adaptations and experiments. To understand how populations evolve, scientists use "fitness landscapes". These are imaginary three-dimensional grids with surfaces of peaks and valleys. Each point on the grid represents a possible gene combination of a particular species. The height of each point indicates that combination's fitness for survival. Adjacent points represent gene combinations that are only slightly different.

In the evolutionary struggle, species search for the high points on their fitness landscapes, which can assume various forms. At one extreme, there could be a single steep peak representing a strategy superior to all others. On such a landscape, nearby points (representing similar strategies) have similar altitudes, or levels of fitness. At the other extreme would be a perfectly random landscape of peaks and valleys, where there is no one optimal strategy, and neighboring points, representing similar strategies, might have radically different levels of fitness. Most complex systems have many peaks and valleys, like random landscapes, but nearby points tend to have similar levels of fitness.

A business strategist can be regarded as the leader of an expedition to find the highest elevations on a company's fitness landscape. Fog prevents the "hikers" from seeing more than a few feet in front of themselves. What can be done when things look so hazy? Biologists have identified key rules that evolution uses to find high peaks. Managers too can use them.

The first rule is that evolutionary searches *never stop*. No matter how successful a strategy is at a given moment, a business must experiment constantly to find something better.

[10] In his seminal book, The Innovator's Dilemma.
[11] "On the origin of strategies" McKinsey Quarterly, 1999 No4,

Another key principle is *parallelism.* The entire expedition should not explore the same region. Instead, many search parties should spread out from the "base camp" to explore the shifting terrain and bring back news of discoveries.

Of course, randomly sending out dozens of search parties may not be effective because there is likely to be too much ground. Some of the explorers should therefore embark on an "*adaptive walk,"* by taking a step, peering through the fog for the steepest uphill path, taking a step in that direction, looking around again, taking another step, and so on. This approach works well in regions where high ground tends to lie near other high areas. But once adaptive walkers arrive at the topmost point in the vicinity, they will be stuck there. These search parties should therefore follow a different strategy, using "pogo sticks" to hop to more distant points. Unfortunately, though the pogo stick gives the explorers a chance to find higher peaks, the fog makes it hard for them to predict where they will land. Since the highest peaks tend to be near one another, the farther the jump, the greater the chance of losing rather than gaining altitude.

The best strategy under the circumstances is to intersperse adaptive walks with occasional pogo jumps. Most of the time the explorers head toward a higher level of fitness. Jumps on the pogo stick keep them from getting stuck on local peaks and occasionally yield significant improvements, at the cost of occasional declines in fitness.

In biological systems, a few genetically atypical individuals may survive a sudden environmental change that kills off typical individuals. Similarly in business, a company should use most of its resources to build its current business. At the same time, some resources should also be devoted to riskier experiments, that might sow the seeds of a new business. In an uncertain world, strategy is really about creating options (See later section on real options) and opening up new choices, not shutting them down.

Resources are finite, so trade-offs and commitments are inevitable. Decisions have to be made about where to put the base camp each night and where to send search parties. But these decisions are much more likely to be successful if search parties generate several alternatives.

Many companies have to make big risky bets because they do not send out sufficient numbers of search parties. Companies that avoid this pitfall do things differently. They bet on several small experiments. Such an approach requires a diverse mix of people to contribute ideas. Diversity of experience—as well as of age, sex, race, national origin, and so forth—is therefore crucial.

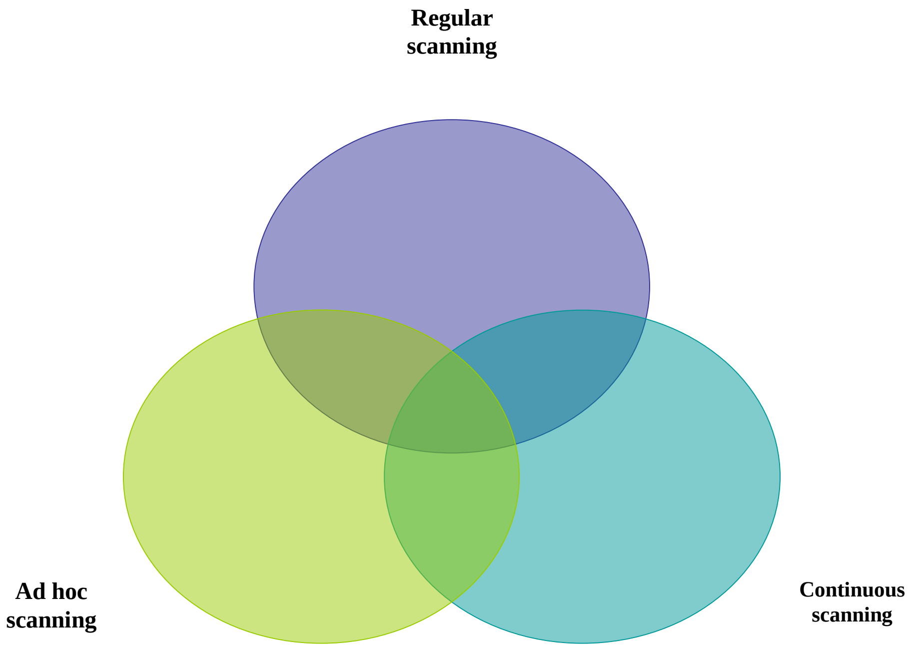
Scanning the Environment

Scanning the environment has assumed critical importance in today's fast paced environment. Competition can come from nowhere and in some cases lead to catastrophic consequences for some or all of the incumbent players. The arrival of Google for example virtually marked the end of many other search engines which had been off the starting block much earlier. So companies must become adept at a kind of environment scanning that is quite different from what they have been good at doing in the past. They must be able to look at seemingly irrelevant phenomena, start ups which might look puny and insignificant at first glance and trends that are currently too weak but which might gather momentum in the years ahead.

In general, there are three types of environment scanning:

a) Ad hoc scanning: There is no serious attempt to understand the environment. The focus is on reacting to events and coping with them, as they occur, in an essentially ad hoc manner.
b) Regular scanning: The environment is scanned at pre determined intervals. The implied assumption is that no major discontinuities will be encountered in between two scanning cycles.
c) Continuous scanning: Data is collected on a wide array of environmental factors on an ongoing basis and analyzed systematically. This helps in understanding whether the current strategy is right and whether changes are called for. Clearly in many industries today, especially the dynamic ones like computer software, biotech, pharmaceuticals, entertainment, business and financial services, continuous scanning is the need of the hour.

Different approaches to strategic planning



Scanning involves looking around and collecting a wide range of data systematically. Data can be collected by any organization. The difference between the nimble and not-so-nimble organizations lies in the way the data is interpreted. Indeed, making sense of discrete data is probably an organization's greatest strength today. That calls for a good understanding of what are trends and what is noise. And most importantly, it calls for a bias for action, i.e., acting quickly instead of getting trapped in "paralysis of analysis." Take the case of Intel. Former CEO, Andy Grove shaped the microprocessor company's paranoid culture. Grove wrote about the need to identify strategic inflection points where the pace and extent of change is about 10 times more than usual. Grove emphasized that senior managers must have the ability to receive unpleasant messages and act quickly on them, instead of going into a state of denial. We now briefly look at some of the commonly used tools in strategic planning.

Scenario planning[12]

From time immemorial, man has had to prepare himself for various eventualities. Just to survive, he has had to ask questions like: What if it snows? What if there is a poor harvest? Indeed, it is this type of thinking which prompted man to store food, build dams, etc. Recall Joseph and the Egyptian Pharaoh. Or for that matter the Indus Valley Civilization. In both cases, food was stored in granaries to deal with a potential famine. Companies too must learn to visualize the future in terms of alternative scenarios. Based on these different scenarios, they can put in place alternative action plans and be ready to cope with the environment as it unfolds. In short, scenario planning is a useful tool for developing long term views of the future.

Formal scenario planning emerged out of the need to reduce uncertainty during World War II, when it was used as a part of military strategy. The countries involved in the war had to prepare themselves for different contingencies and accordingly develop plans of action. Since then, the use of scenario planning has become increasingly popular. The US Air Force, for example, has been conducting war-game exercises for many years with the aid of computer simulations. IBM and GM were among the first companies to adopt scenario planning. Both companies however, failed to use scenario planning effectively. Being industry leaders, they probably overestimated their ability to predict and control the environment. The scenarios they envisaged essentially reflected their existing paradigms. For example, GM totally overlooked the change in consumer preferences in favour of smaller cars and the threat from Japanese car makers. Similarly, IBM failed to foresee the decline of mainframes and the emergence of smaller, less powerful but more user-friendly computers. On the other hand, the oil giant Shell has used scenario planning far more effectively.

Today, many leading companies accept that adapting blindly to external events is not desirable. Learning about trends and uncertainties and how they interact with each other enables companies to prepare for different future scenarios. It also helps a company to identify the scenarios for which the existing strengths and competencies are particularly suited. The company is then in a position to understand how it can influence the emerging trends in the environment through a combination of innovations, managerial actions and alliances. By identifying the scenarios for which it is least prepared, it can invest in building the required competencies. In extreme cases, it can even withdraw from businesses, especially those which do not promise strategic benefits in the long run.

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[12] Draws heavily from Vedpuriswar's book "Enterprise Risk Management – A strategic approach to derisking an enterprise," Vision Books, 2002

Scenario planning can focus attention on change drivers and force the management team to imagine operating in markets which may bear little resemblance to the present ones. Studying other markets which have already seen a shakeout, which are similar in terms of structure and are susceptible to the same triggers can also be of great help. Examining how the same industry is evolving in other countries and regions can also provide useful insights.

Planning for uncertainty[13]

Strategic planning in uncertain situations, poses special challenges. If the prevailing uncertainty is not properly considered, the firm might end up facing threats it is ill equipped to deal with. At the other extreme, the firm may show too much caution and not exploit opportunities that have the potential to yield excellent returns. Many companies take strategic decisions relying totally on their gut instincts during times of uncertainty. Intuition is useful but has to be backed with some numbers for strategic planning to be effective. Here we cover some tools available to deal with uncertain situations where hard numbers may not be available and various assumptions have to be made.

Courtney, Kirkland and Viguerie[14] provide a framework for strategic planning during conditions of uncertainty. They refer to the uncertainty which still remains, after a thorough analysis of all the variables in the environment has been done, as *residual uncertainty*. This uncertainty may lie in a continuum from low to high. In a simple situation, strategies can be made on the basis of a single forecast. At the next level of uncertainty, it makes sense to envision a few distinct scenarios. At an even higher level, several scenarios can be identified. In the most uncertain situations, it is difficult to even visualize scenarios, let alone predict the outcome.

Where uncertainty is less, companies can focus on their competitive position within the industry. They can take the industry structure as given and try to exploit the opportunities available and get ahead of rivals. Where uncertainty is high, firms have two broad strategic options. They can make heavy investments and attempt to control the direction of the market. Alternatively, they can make incremental investments and wait till the environment becomes less uncertain before committing themselves to a strategy. In the intervening period, the firm can collect more information, or form

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[13] Draws heavily from the book, "Enterprise Risk Management – A strategic approach to derisking an enterprise,," by A V Vedpuriswar, Vision Books, 2002.

[14] Harvard Business Review, November-December 1997.

strategic alliances to share risks. In short, a firm has to arrive at an optimum portfolio of investments – heavy risky investments, small risky investments and heavy, not very risky investments[15]. Courtney, Kirkland and Viguerie call a heavy but non risky investment, a ‘no regret’ move. This applies to fairly predictable situations where even though the investment is large, the risk involved is negligible. The mix would depend on the degree of uncertainty in the environment.

This kind of approach makes a lot of sense in industries such as mobile phones. Here, the rapidly changing technology and the phenomenon of convergence are leading to new and different forms of competition. Boundaries are getting blurred and competition can emerge from nowhere. To take an example, is Apple, a PC maker (iMac), an online music provider (iTunes) or a cell phone manufacturer (iPhone)?

Discovery-driven planning

In highly uncertain situations, where many assumptions have to be made, well known scholars Rita Gunther McGrath and Ian C MacMillan[16] suggest the use of discovery-driven planning . As the project progresses, there is a compelling need to incorporate new data and revise these assumptions on an ongoing basis. Take the case of Euro Disney. A key assumption made before the execution of the project was that 50% of the revenues would come from admissions and the remaining 50% from hotels, food and merchandise. After operations started, Disney found that ticket prices were less than anticipated and that visitors did not spend as much as expected. So, in spite of reaching a target of 11 million admissions, profitability remained below expectations. Ticket prices had to be lowered due to the recession in Europe. Disney had expected people to stay in the hotel for four days but people spent two days on an average, since there were only 15 rides, compared to 45 at Disney World in the US. Disney had assumed that there would be a steady stream of people visiting the restaurants throughout the day, as in the US and Japan, but the crowds came in only during lunch time. Disney’s inability to seat all of them during peak hours led to loss of revenue, dissatisfied customers and bad word-of-mouth publicity. Visitors to Euro Disney also purchased a much smaller proportion of high margin items such as T-shirts and hats than expected.

McGrath and MacMillan have summarized the mistakes made by companies while planning new projects with a great degree of uncertainty:

- Companies do not have precise information, but after a few important decisions are made, proceed as though the assumptions are facts.

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[15] ibid

[16] Harvard Business Review, July-August 1995.

- Despite having enough hard data, companies do not spend adequate time in validating the assumptions made.
- Companies have enough data to justify entry into a new business or market, but make inappropriate assumptions about their ability to execute the plans.
- The right data is available and companies may make the right assumptions to start with, but fail to notice until it is too late that a key variable in the environment has changed.

Companies tend to make various faulty implicit assumptions made by companies:

- Customers will buy the product because the company thinks it is a good product.
- Customers run no risk in buying from the company instead of continuing to buy from their past suppliers.
- The product can be developed on time and within the budget.
- The product will sell itself.
- Competitors will respond rationally.
- The product can be insulated from competition.

Motorola's Iridium project is a good example. Motorola's intention was to develop a phone system that could make communication possible between any two points in the world. The company's gameplan was to use orbiting satellites to pick up signals from cellular phones and relay the conversation from satellite to satellite till the signal could be transmitted back to the ground. Iridium, as the venture came to be called, aimed at providing consistent communication signals which would not fade even in airplanes. Motorola felt that Iridium would become a highly profitable venture. Motorola's market research estimated that between 600,000 and 800,000 people would subscribe to Iridium as soon as it was implemented by 1997, the number expected to go up further to 1-1.8 million by 2002 and to 5 million by 2019. The main customer segments were identified as international business managers, high net worth individuals, airlines, international air passengers and marine vessels.

But Iridium was a complete failure. The project which looked futuristic in the late 1980s was clearly outdated a decade later. While Iridium continued to launch satellites, competitors were building extensive and cheaper terrestrial networks and standardising protocols. Iridium was meant for customers in remote locations, but with the service proving to be too expensive for the value it offered, customers were not easy to attract. Many customers preferred cheaper GSM format mobile phones. Iridium was also handicapped by a low data exchange speed of 2.4 kilobits per second at a time when basic modems could handle up to 56Kilobits/second.

Real Options as a planning tool

In the real world, the demand for a product and the price which it can command are uncertain. So, there is considerable uncertainty about the cash flows which will be generated. How do we decide which project should be taken up? Martha Amram and Nalin Kulatilaka[17] suggest the use of real options while evaluating a project. Real options look at both the upside and downside when an investment is being planned. Thus, a timing option, in the form of a delayed expansion in capacity could create value in a situation of uncertain demand. Putting up a plant in an overseas market currently fed by exports may generate new growth options. An exit option in the form of a plant closure increases the value of the investment decision. By looking at strategic decisions in terms of options and then using information from financial markets to value these options, planning can be more effective.

Traditional valuation tools which view business development in terms of a fixed path are of little use in an uncertain environment. A new business or a major investment in capacity expansion may result in a variety of outcomes that may demand a range of strategic responses. Plans to change operating or investment decisions later, depending on the actual outcome, must form an integral component of the projections. Thinking of the investment in terms of options, allows uncertainty to be taken into account.

As Amram and Kulatilaka mention, the real value of real options, lies in the reshaping of executives' thinking about strategic investment. "By providing objective insight into the uncertainty present in all markets, the real options approach enables executives to think more clearly and more realistically about complex and risky strategic decisions. It brings strategy and shareholder value into harmony."

In any investment appraisal process, managers should identify the embedded options, evaluate the conditions under which they may be exercised and finally judge whether the aggregate value of the options compensates for any shortfall in the present value of the project's cash flows. However, options are of value only in an uncertain environment. Thus investment decisions, whose primary objective is to acquire options, must be made before uncertainties in the environment are resolved. As Sharp says[18], "Unlike cash flows, whose value may be positive or negative, option values can never be less than zero, because they can always be abandoned. Embedded options can

[17] Harvard Business Review, January – February, 1999.
[18] Sloan Management Review, Summer 1991.

therefore, only add to the value of an investment. Options are only valuable under uncertainty: if the future is perfectly predictable, they are worthless".

Developing strategic decision making skills

Having scanned the environment, companies must be able to take critical strategic decisions. In fast paced, intensively competitive markets, how can companies develop superior strategic decision making skills? According to Kathleen Eisenhardt, effective strategy formulation is about[19]:

- Building collective intuition
- Encouraging healthy conflict
- Maintaining a pace so that decisions are taken within a stipulated time
- Defusing political behavior.

Building collective intuition means gathering information on real time basis and involving people by holding intensive discussions with them in groups. Through such discussions, the company can get a sense of how it should move ahead.

Inviting and debating divergent views is an important part of strategy formulation. Conflict promotes creative thinking, a healthy debate on the various options available, validation of the various assumptions made and an overall improvement in the quality of decisions. But conflict should not stand in the way of rapid decision making.

Jim Champy's research on high performing companies[20] reveals that while they do analyse situations, they believe in action. These companies have few rules and procedures and value intuition. In such companies, culture drives behaviours and people are trusted to do the right thing at the moment of truth. As Champy mentions[21], "The leaders of these companies did not sit around and debate what would happen if an effort failed. They tried what they thought would work and what the company required. If it didn't work, they changed course."

The companies which are good at strategic planning get into action mode quickly. They encourage debate and bring a lot of energy into the discussions. But they also know when to stop the deliberations and freeze the decision. While trying to build consensus,

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[19] "Strategy as Strategic Decision Making" in "Strategic Thinking for the Next Economy" edited by Michael A Cusumano and Constantinos C Markides, *Jossey Bass*, 2001.

[20] Outsmart – How to do what your competitors can't.

[21] "Out smarting the competition," Business India, March 9, 2008.

they know how to break a deadlock. They take a decision even when people are finding it difficult to agree and come to an understanding. On the other hand, companies with weak management, tend to postpone strategic decisions and end up making hurried last minute decisions.

Strategic decision making has its associated share of politics. Politics must be minimized, if not eliminated, by emphasizing a shared vision and by creating a more balanced power structure which gives different decision makers latitude and scope to contribute. A clear definition of responsibilities may make managers feel more secure, more willing to cooperate and consequently reduce unhealthy competition.

Operationalising the strategy

The difference between the best and the average companies often lies not in strategic planning but in the way strategy is implemented. While this article does not focus on implementation, it is important to understand some of the key implementation challenges even at the planning stage. Indeed the best plans have implementation built into them. The key issues identified in the strategic plan must be translated into action plans, which must include metrics, timelines, important steps involved, resources needed, cross functional collaboration required, etc. Effective implementation demands identification of annual objectives, functional strategies and appropriate policies, which are aligned with the long-term plans/objectives.

Annual objectives are used to break down long-range goals into what needs to be achieved during the year. So they must be focused, specific and measurable. Examples of annual objectives include:

- To reduce employee attrition by 10% by the end of the year.
- To reduce time from order receipt to order execution by 20%
- To increase the number of employees, who are Six Sigma Certified Black Belts by 30%

Functional strategies represent the action plans for the subunits of the company. Functional strategies outline how key functional areas like marketing, finance, operations, R&D and human resources must be managed. Functional strategies must be framed with respect to each key activity. For example, in the case of pricing, the following issues must be addressed:

a) What segment is being targeted – mass market or premium end of the market?
b) How much of price discrimination should be practiced across customer segments?

c) Is the cost structure aligned with the price?
d) What kind of discount can be offered, given the cost structure?
e) Should the price be above or below that of competitors?

Policies act as specific guides for operating managers and their subordinates. By linking policies to long term objectives, strategy implementation is greatly facilitated. Policies are clear statements about how things are to be done. They ensure disciplined decision making without the need for frequent intervention by top management. By standardizing answers to many questions, policies not only speed up the decision making process but also help establish consistent patterns of action and reduce the uncertainty involved while handling routine problems.

Strategy implementation will not be effective without defining accountability. Managers need to determine who will be responsible for the overall effort and, in turn, who will "own," or be responsible for, each of the different steps. Accountability, autonomy and responsibility go together. Managers need to clarify how much autonomy individuals and teams will have in discharging their responsibilities.

Communication is an integral part of operationalising the strategy. Meetings, informal conversations, e-mails, and other communication channels can be used to communicate the importance of the company's strategy and the role of different groups in implementing it. Communication must focus on the following.

- Rationale for the company's strategy.
- How the initiatives that are being carried out, support the corporate strategy.
- The implications if the plans are implemented successfully.
- The implications if the company fails to implement its plans.
- The attitudes and behaviors expected from each person in the team.

Successful implementation of a strategy depends on how managers are evaluated and compensated. So it is important to tie the evaluation and compensation of managers to the progress of major initiatives. Monitoring should be done, not only on the basis of financial metrics, which are at best lagging indicators. What is needed according to Renee Dye and Olivier Sibony[22]is a mix of performance targets that accurately reflect a company’s strategy. For example, compensation can be linked to talent retention, innovation and cross business collaboration.

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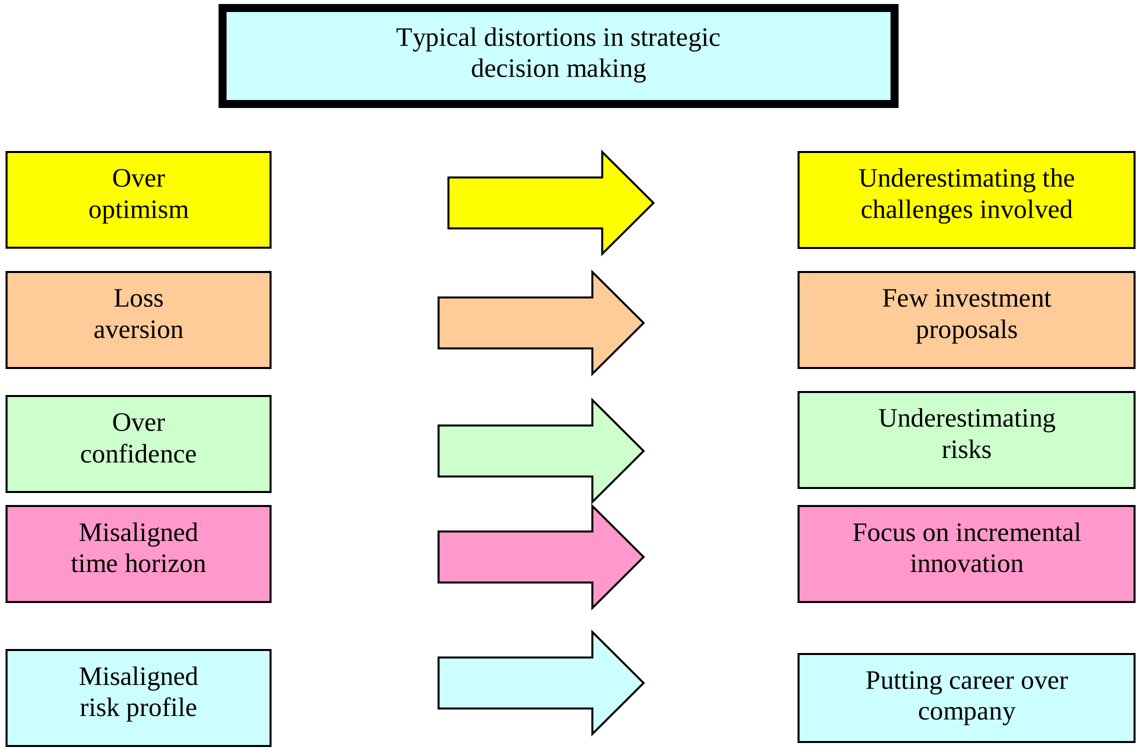
[22] “How to improve strategic planning,” McKinsey Quarterly, 2007 No.3, pp. 40-48



Source: Charles Roxburgh, “Hidden flaws in Strategy,” McKinsey Quarterly, 2003 No.2,

Behavioral issues in strategic planning

There is now plenty of literature to suggest that people do not behave rationally all the time. Corporate executives too are vulnerable to biases, short cuts and simplifications. As Charles Roxburgh writes[23], the human brain can be a deceptive guide for rational decision making. Roxburgh provides eight insights from behavioral economics to illustrate how strategic planning can become flawed.

- Our brains are conditioned to make us feel *over confident*. Related to overconfidence is the problem of *over optimism*. This tendency should be counteracted by examining a wider range of scenarios, taking the downside more seriously and building more flexibility and options into the strategy.
- We tend to treat money and categorize it differently depending on where it comes from, where it is kept and how it is spent. This phenomenon is called *mental accounting*. For example, we show less concern about a restructuring charge as opposed to a traditional P&L (Profit & Loss) item. In short, some items receive more scrutiny while others go through the screening process very easily. But the fact is that every rupee spent is exactly the same irrespective of what category it falls into.
- In general, we tend to favour the *status quo*. This is called the *endowment bias*. We are unwilling to reverse what we have done earlier. To get around this bias, we should subject status quo options to as rigorous an evaluation as change options.
- The brain is also vulnerable to *anchoring*. If the brain is presented with a number and is then asked to make an estimate, it tends to be anchored on the older number. One key implication is that we should not allow past performance to be used as the predictor for future performance.
- We tend to be influenced heavily by *sunk costs*, i.e., how much has gone into the project instead of *relevant costs*, i.e., what it takes to keep the project/operations going. We must apply rigorous cost benefit analysis to incremental investment decisions, to combat this bias. Strategic investments must be reviewed closely and additional funding sanctioned only after previously agreed targets have been met.
- The *herding instinct* can also stand in the way of good strategic decisions. The desire to conform to the behavior and opinions of others is a fundamental human trait. None of us wants to be singled out as the only person in the industry to make a strategic blunder. So we avoid moves that break out of the crowd. Instead of following me-too strategies, we must summon courage and boldly embrace new options. If these experiments fail, they can be killed easily. But if they succeed, there can be huge pay offs.

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[23] McKinsey Quarterly, 2003 No.2, “Hidden flaws in Strategy,”

- We are usually not good at estimating how much pleasure or pain we will feel if their circumstances change dramatically. We actually adjust surprisingly fast. We must take this into account while preparing for a major upheaval/change such as a takeover. We must learn to take a perspective and not overreact to a potential change in circumstances.
- We also tend to overestimate the extent to which others share our views, beliefs and experiences. *Confirmation bias* is the tendency to seek out opinions and facts that support our own beliefs. *Selective recall* is the habit of remembering only facts and experiences that reinforce current assumptions. *Biased evaluation* is the tendency to accept evidence that supports our hypotheses while rejecting contradictory evidence or subjecting it to rigorous evaluation. To counter this tendency, we must value open and constructive criticism. Strong checks and balances must be imposed on the dominant role models. Contrarian hypotheses must be encouraged and "challenger teams" set up to identify flaws in strategy.

Understanding the various flaws in our thinking processes, can help reduce the chances of wrong strategies being selected.

Concluding notes

The classical views of strategy have focused on understanding industry structures and developing suitable capabilities to position the firm effectively in relation to competitors. But in today's complex and changing environment, when the very boundaries of many industries are being constantly reshaped, does it make sense to try and understand the evolving industry structure? Are ad hoc short-term movements the only way to cope with the uncertain environment? Is long term strategic planning no longer relevant?

The short answer is that strategic planning is as relevant as ever and is necessary to provide direction. As John Hagel III and John Seely Brown[24] mention, speed without a sense of direction may result in random motion. Without a sense of direction, companies may become reactive and sometimes spread their resources thin, by pursuing too many options simultaneously.

To strike a balance between speed and direction, two different time horizons are needed – a long term horizon for setting the direction and a short term horizon to focus on operational initiatives. Hagel and Seely Brown have come up with a frame work

[24] John Hagel III and John Seely Brown. "The Only Sustainable Edge", *Harvard Business School Press,* 2005.

called FAST – Focus, Accelerate, Strengthen, Tie all together. Focus refers to long term positioning, and specialization and capability building in the chosen area of business. Accelerate means moving fast in the short term. Strengthen means removing road blocks that prevent faster movement in the short run. This includes building shared meaning and trust and making appropriate investments in information technology. Tie it all together means integrating these three components across networks of organizations to amplify learning and accelerate capability building. As they mention[25]: "The sequential approach of traditional strategies simply cannot generate the rapid learning and capability building that one from moving quickly back and forth between a very short-term operational horizon and a much longer term strategic horizon".

Even in fast paced industries, "a long term view plays a critical role. In a recent article in the Harvard Business Review[26], "Reverse Engineering Google's Innovation machine." Bala Iyer and Thomas Davenport identified strategic patience as one of Google's virtues. "The company's managers are strategically patient. CEO Eric Schmidt has estimated that it will take 300 years to achieve the mission of organizing the world's information. His 1200 quarter forecasting might invite smirking, still it illustrates Google's approach to building value and capability." At the same time, Google does not have a 300 year view for everything. "If Google's expressed mission is to organize the world's information, it has a somewhat less exalted but an equally important unexpressed commercial mission! to monetize consumers' intentions as revealed by their searches and other online behaviour. Search based advertising is the first highly successful instantiation of this mission."

The rise of the knowledge economy and the growing importance of knowledge workers are putting pressure on companies to change the way they formulate and implement strategy. The three Ss, Strategy, Structure, Systems are giving way to the 3 Ps, Purpose, Process and People. The 3P doctrine developed by Christopher Bartlett and Sumantra Ghoshal[27] emphasizes that the focus must shift from enforcing compliance to facilitating cooperation among people and valuing initiative more than discipline. Top management must establish a sense of purpose within the company. Purpose allows strategy to emerge from within the organization at different levels. Purpose generates energy and alignment. Instead of emphasizing structure, the top management should focus on building the core organizational processes that will promote an entrepreneurial mindset that in turn can help in creating and leveraging knowledge to create value. Finally,

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[25] ibid

[26] April 2008.

[27] Ghoshal, Sumantra; Bartlett, Christopher A. "The Individualized Corporation," *HarperCollins*, 1997.

instead of building systems, top management should develop people and help them in fully exploiting their potential. Senior managers should play the role of mentors rather than rule enforcers.

The basic principles of Porter's competitive strategy largely remain valid even today, like Newton's laws of motion in Physics. But they need to be reinterpreted in a fast paced business environment. Arnoldo Hax and Dean Wilde[28] suggest, in addition to cost leadership or differentiation, other options. The "customer solutions" option involves offering a wider range of products and services that satisfy most if not all customer needs. This strategy emphasizes bonding with customers, anticipating their needs and working closely with them to develop new products. The "system lock in" option considers all the meaningful players in the system that contribute to the creation of economic value. The company concentrates on nurturing, attracting and retaining complementors' share to lock out competitors and lock in customers.

As the new millennium gets under way, there is little doubt that strategic planning will play a key role in companies across industries. Flexibility, shorter planning cycles, the ability to gather data in real time, rapid midcourse corrections and efficient execution will hold the key to success in the coming years.

[28] The Delta Model: Adaptive Management for a changing world.

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