

Strategic Planning Redux

Linking Strategy to Execution and Funding

“We have a strategy. It’s in George’s [the CEO’s] head,” a manager at a large manufacturing company told us recently. Others in the organization confessed little awareness of the details and were unable to say how the high-level strategy concept should affect their daily activities. One manager did offer to help out: “I’ll show you last year’s strategic plan,” as he reached back from his desk and then realized: “I’ve already put it in storage. Maybe next week we can take a drive out there to retrieve it.”

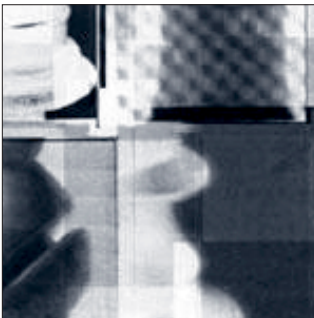
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When strategic planning becomes a sterile annual exercise in template completion, it’s no wonder that the resulting thick binder sits in storage, waiting to get replaced with next year’s version. Ever since General Electric pioneered the discipline in the mid-1960s, strategic planning has gone through cycles of popularity and effectiveness. Many of the growth stories of the 1980s can be attributed in part to management processes that produced superior strategic insights that could be acted on – for example, Home Depot’s rapid rollout of superstores targeting fixer-uppers and small contractors, Microsoft’s relentless pursuit of creating and owning the standard in software, and Southwest Airline’s low-cost, point-to-point network delivering superior value to its customers.

During the “new economy” boom of the 1990s, many executives decided that the rapid pace of market change made strategic planning obsolete. Today, senior executives at most major companies have good intentions and significant resources committed to strategic planning efforts. Yet many consider the process to be burdensome, bureaucratic, vague, and divorced from reality.

Despite such frustrations, companies persevere with strategic planning because there is no substitute. Without a clear sense of direction, companies are unlikely to arrive at where they want to go, as markets move much faster than companies can react. Moreover, without a clear strategy, managers have no guide with which to make tradeoffs, so initiatives proliferate and sap organizational resources.

A handful of best-practice companies, including GE, IBM, Bombardier, Nationwide Mutual Insurance, and Royal Dutch/Shell, have moved beyond old-fashioned strategic planning to *strategic managing*, which links strategy to both execution and funding. Strategic managing is more flexible and more rigorous than the typical planning process, allowing the organization to chart a course to seize market opportunities as they unfold. It avoids the two traps that companies commonly fall into: blue-sky planning and strategy by spreadsheet.



The Two Traps

Blue-sky strategic planning emphasizes a vision with little attention paid to rigorous homework or to the details of how to execute the vision. The strategy falls into the no man's land between vision statement and concrete action. Because the strategy is vague, it does not force the organization to make choices or to build wholehearted organizational commitment. Any initiative can be made to fit, ultimately creating initiative overload.

The blue-sky approach also fails to answer the question, “What do people on the front lines do differently tomorrow?” For example, Eastman Kodak’s strategy “to drive digital imaging to new markets” was first articulated eight years ago. Few would disagree with this strategy given the changes in Kodak’s business, yet it remained elusive even as Kodak’s leading position in its traditional film market eroded. Misguided efforts, a raft of overlapping initiatives, and organizational confusion have created a lot of activity but little progress.

Blue-sky planning also neglects to tie strategy to financial performance. Financial projections might be asserted (usually in the shape of a hockey stick), but the strategic and operational drivers of financial performance are not identified or incorporated into the process. When the economics of the business are not explicit, no one in the organization knows which metrics matter and what to benchmark to see if they are on the right path.

At the other extreme, many strategic planning processes devolve into sterile budgeting exercises focused on yearly or even quarterly financial minutiae rather than looking at the broader market landscape. This is like driving while looking at the speedometer and odometer, not at the road ahead. Come the next curve, a crash is inevitable. The company fails to anticipate changes in customer priorities and the competitive landscape and ends up with merely incremental performance improvements or, worse still, with desperate rounds of cost-cutting.

By requiring all aspects of strategy to be quantified, budget-oriented processes tend to be burdensome and misleading. Despite the apparent precision, few people believe the numbers, and the exercise becomes a political game. In order to meet budget or Wall Street expectations, line managers make unrealistic assumptions that are rarely examined. Forecasting the budget or expected numbers gets managers in and out of strategy review sessions with a minimum of debate about the assumptions.

Back to First Principles

Effective strategic managing, in which strategy is linked to how the business is run, can create a critical competitive advantage. Our research indicates that while there are many approaches to strategic planning, four consistent underlying principles characterize best-practice companies: start with the customer, connect strategy with capital allocation and execution, embrace debate, and keep the process evergreen. It is these principles, rather than any specific processes or tools, that drive success.

Start with the customer. Successful strategies don't arise from a group of people toiling in a conference room for a few weeks, hermetically sealed from the market and from customers. Instead, success requires an outside-in mindset, built on a thorough understanding of customers and how their priorities are changing.

While few major companies develop strategy in the complete absence of customer data, the danger today is more subtle. Most market research, while useful in traditional marketing contexts, is inappropriate and misleading for strategy development; it is the wrong data collected for a different purpose and, therefore, answers the wrong questions. Traditional market research targets current customers with questions about marketing and tactical issues, usually with the goal of incremental improvements.

If customers could tell us what a strategy should be, there would be little use for senior management. How would American coffee drinkers in a focus group ten years ago have reacted to the prospect of paying \$4 for a cup of coffee? Most would have scoffed at the notion. Yet Starbucks has been one of the great growth stories of the past decade by envisioning that a tall (meaning small) decaf dry-blended whole milk low-fat cappuccino could become a widely valued, affordable luxury.

Strategic customer research goes beyond customers' stated needs, which are useful for incremental improvements, to explore the unstated priorities that customers sense but can't articulate fully. In doing so, it raises fundamental questions about the structure of the market and queries not only current customers, but also future-defining customers who might be found in obscure places. In the 1960s, the working class of rural Arkansas proved to be the future defining customers of retailing, around whom Wal-Mart would build a global \$250 billion business. Their priorities were a window into the purchase behavior of American consumers as the nation's suburbs spread out.

Just as there are well-developed methods for market research, strategic customer research has a discipline to anticipate shifts in customer priorities without guesswork, luck, or genius. Customer science techniques help executives understand how customers make decisions, even for a product or service that's truly revolutionary. Mercer Management Consulting's particular adaptation is called Strategic Choice Analysis®, or SCA. (For more on demand estimation and customer choice modeling, see "Economics' Gift to Marketing," *Mercer Management Journal* 15, 2003). The questions may be subtle, the tools sophisticated, and the conclusions extrapolated, but this type of analysis creates major new strategic opportunities.

Consider how a wireless phone service company made the shift from analog to digital technology a few years ago by employing SCA. Previously, mobile executives who could afford to pay high per-minute rates had been the demographic segment that drove profits. As digital technology lowered rates, the industry continued to focus on this customer set by emphasizing national plans and roaming rates. But their purchase behavior defined the profit zones of the past, not necessarily of the future. Some executives hypothesized that another customer segment would define the future – college students and recent graduates who were already mobile and technically savvy. We used qualitative and quantitative



research techniques to determine who the future-defining customers actually would be and what they wanted but could not yet articulate.



An SCA approach helped the company understand customer priorities and tradeoffs, not just preferences. We studied behavior in analogous real-world situations, such as use of pagers and calling cards, and delved into what features delight or annoy customers.

It turned out that the future-defining customer segment for much of wireless telephony were mobile blue-collar workers – for example, construction foremen. They could not afford the high cost of service at the time, but as the price dropped, their usage rose quickly. Their priorities were very different from those of college students and white-collar executives, as they valued reliable coverage throughout their local area far more than national coverage. This was a key future-defining priority that most wireless companies had ignored. They were price-sensitive and most of their calls went to a relatively small circle of people, so they valued “friends and family” discount offers. Mobile blue-collar workers thus became a key channel for the spread of wireless telephony, and the wireless company targeted this segment well before its competitors did.

Connect strategy with capital allocation and execution.

Strategy is not what you say; it's what you fund and what you do. As Lou Gerstner, former CEO of IBM and a champion of effective strategic planning, has said, “Making sure that resources are applied to the most important elements of the strategy is perhaps the hardest thing for companies to do.”

That's true in part because large companies tend to have hundreds of initiatives running at any given time. Many are overlapping, some are conflicting, and no one keeps track of all of them. So finding one initiative that's well aligned with a new strategy is nearly impossible. Initiative overload not only wastes resources, it actively contributes to a company's decline.

One way clear of this mess is to combine strategy development with capital allocation. When Halliburton Energy Services Group, a leading oil field services company, revamped its strategic planning process, senior managers decided that these two processes were in fact one, and they designed their strategic planning accordingly. Halliburton now has one owner of strategy and capital allocation, with clear accountability for ensuring alignment between the two. This senior manager owns the corporate-wide strategic managing process and chairs a “capital committee” composed of a handful of the most senior executives who decide how to fund strategies approved earlier in the year by the CEO and business unit heads. Only initiatives linked to a short list of strategic priorities can be funded. This ensures a balance of long-term strategic goals with short-term financial constraints, even in the highly cyclical oil field services industry (see below).

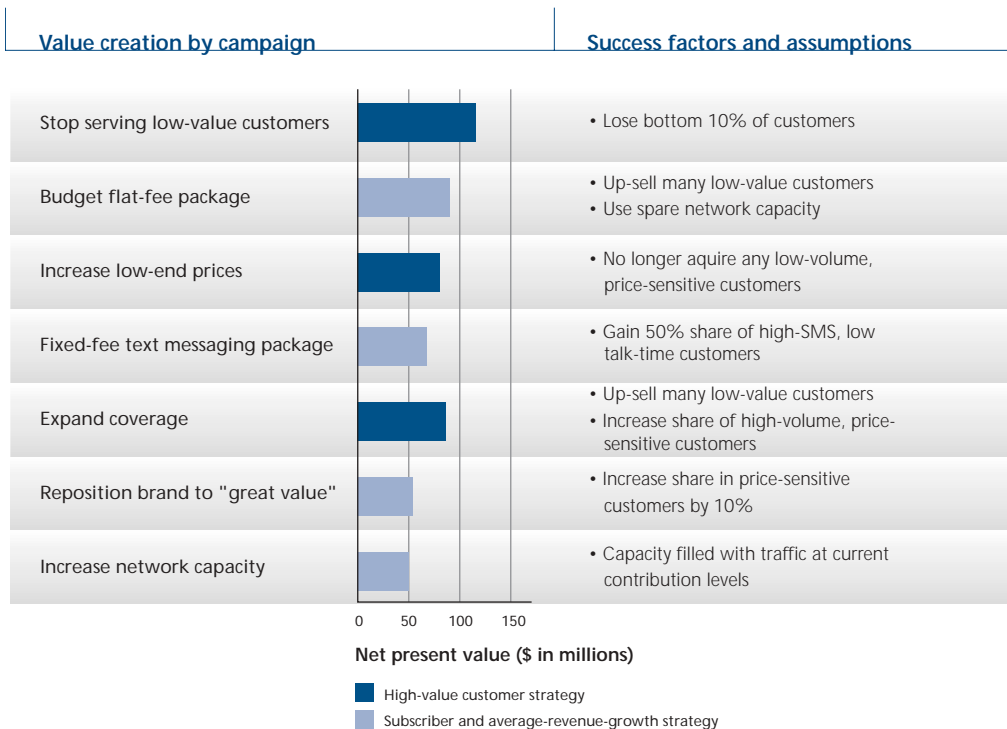
Linking Strategy with Capital Allocation and Execution



"We want to invest in those activities where there will be maximum sustainable growth, but at the same time satisfy shareholders this year," says Lew Watts, senior vice president of strategy and marketing of Halliburton Energy Services. "This means moving from a P&L-based company to a balance sheet company."

Marrying strategy with execution is hardly straightforward. Senior managers have to be able to enforce implementation without getting caught up in the details. Best-practice companies have developed systems to ensure that balance. Once approved, strategies are translated into what we call "strategic campaigns." Winnowing a huge number of initiatives to a handful of campaigns keeps everyone focused on the important strategic goals, encourages every employee to contribute to the success of the strategy, and builds institutional memory to help people learn from mistakes. Exhibit 2 highlights the interplay between two strategies and the resulting campaigns for a wireless service provider (see below).

Strategic Campaigns at a Wireless Service Provider



Executives can monitor this handful of work streams without getting overwhelmed in detailed Gantt charts and the like. By setting milestones and metrics for each work stream, managing the allocation of capital, and tracking the sequencing and results of these campaigns, executives stay engaged with execution and communicate the appropriate urgency.

Embrace debate. A company can put into place a seemingly flawless strategic planning process using the latest tools and still not achieve exceptional performance. That's because process and tools work in the context of a firm's culture.

Yet senior managers rarely devote enough attention to the cultural change required when introducing a new strategic planning process. That change should start with instilling a spirit of debate and productive challenge among middle and senior managers, one that gives people permission to raise uncomfortable truths and question the assumptions on which strategies are built.

Returning to the Halliburton example, senior management there devoted as much time to the cultural change required in implementing a new process as they did to designing the tools involved. Managers borrowed a phrase from plain-speaking investor Warren Buffett—being “in the barrel”—to describe an environment where peers, especially at senior levels, could feel safe to ask tough questions, seek out bad news, and assess strategic plans skeptically.

To complement these sessions, Halliburton designed discussion guides that allow participants to debate assumptions embedded in the plans, not just the predicted outcomes. Previously, if the predicted outcomes matched the financial planning budget or Wall Street's projections, then little debate took place in the board room. Now, once the conversation turns to assumptions instead of end games, senior managers can look across the enterprise and uncover where assumptions are misaligned or even contradictory. Division A has built its growth potential on Customer 1 gaining market share and purchasing 30 percent

more over the next three years. Division B has built its plan on Customer 2 acquiring Customer 1 and wiping out its buying power. In-the-barrel sessions can resolve which scenario is most likely to occur and what decisions the organization should make.

Of course, creating a culture that embraces fruitful debates and tolerates mistakes does not happen overnight, particularly in companies where challenging an executive in a public forum is deemed disrespectful. Thus the cultural change must come from the top and may require changes in personnel as well.

Keep the process evergreen. In many Fortune 1000 firms, strategic planning has become a separate, usually corporate function that's viewed as an annual burden to endure. Templates proliferate, and the urgency to finish the process so that you can return to your real job crowds out thoughtful discussion.



By contrast, companies such as GE and IBM that have been most successful at strategic managing realized that in order to encourage thinking rather than filling in templates, the process must be both simple and a multi-year effort. In a large company, at any given point in time, some business units or divisions should be reviewing the strategy they developed a year ago and making minor mid-course corrections. Others should be refreshing strategies that are in the second or third year of implementation and incorporating new information. Another set of business units should be reinventing themselves completely because their five- to seven-year-old strategy has reached maturity, and future growth requires a new strategy.

Effective strategic managing recognizes these life-cycle distinctions and tailors the research, goals, and conversations for the appropriate dimension of time. This is especially useful for companies that operate across multiple products, value chains, and geographies.

GE's strategic planning process since the late 1980s has consisted of a simple template of five questions, illuminating each of the three strategy horizons. The five questions focus on the market, the future, and the progress on implementation of the current strategy. GE ensures accountability and continuous learning by devoting the first part of the process to reviewing results from the previous year and linking these results to performance-based compensation and talent management.

IBM and Philips have developed additional processes, which we call "strategic conversations," to identify strategic issues via occurrences in the market rather than by time of year. At IBM, for example, managers have assessed Linux, open source software, and the future of online learning, which have produced specific action-oriented recommendations. (For more on strategic conversations, see "Contentious Debate: It Works at Philips," *Mercer Management Journal* 16, 2003.)

Strategic managing should build in explicit times to look back and assess how a strategy developed several years ago has played out. Managers can determine where they came up short, what mistakes they made, and how they can learn from the mistakes.

Expanding the Question Set

Most strategic planning processes focus primarily on answering the question, "What should we do?" The answer, while important, is insufficient for creating value. Putting into practice the four principles discussed here helps companies answer a more comprehensive and powerful set of questions:

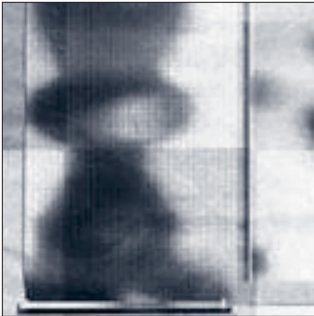
- Why should we do it? What are the assumptions, the risks, and the tradeoffs? How should we react if one of the assumptions changes or turns out to be flawed?

- How do we do it? What is the execution plan, and who should be accountable for which parts of the process?

- What will it cost? How will we fund the strategy, and what is the expected return?

By turning the process into a real capability rather than an esoteric annual exercise, senior managers can gain a clear view of where they are going and why, how to evaluate their progress, and what the payoff will be. Strategic managing also serves as an early warning system by monitoring market and operational data against the plan assumptions. Ultimately, it can influence other critical corporate processes in addition to capital allocation and budgeting, including marketing, manufacturing, human resource planning, performance assessment, and communications.

That's a lot more useful than a strategic vision that collects dust in storage.



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