



THE BEST LAID STRATEGIC PLANS.

The goal of long - term planning is not to strategize but; to prepare key minds to make sound decisions.

By: Sarah Kaplan, Eric Beinhocker and Nick Pollice.

Background.

Most companies invest a significant amount of time and effort in a formal annual strategic planning process but, many executives see little benefit from the investment. One manager told us, “our planning process is like a primitive tribal ritual; there is a lot of dancing, waving of feathers and beating of drums. No one is exactly sure why we do it but, there is an almost mystical hope that something good will come out of it.” Another said, “it's like the old communist system. We pretend to make strategy and they pretend to follow it.”

Management thinker Henry Mintzberg has gone so far as to label the phrase Strategic Planning an oxymoron. He notes that real strategy is made informally, in hallway conversations, in working groups and in quiet moments of reflection on long plane flights, even on the golf course but, rarely in the panelled conference rooms where formal planning meetings are held.

Our research on strategic planning supports Mr. Mintzberg's observation. We found that few truly strategic decisions are made in the context of a formal process. We also found that when approached with the right goal in mind, formal planning need not be a waste of time and can in fact, be a real source of competitive advantage. Companies that achieved success used strategic planning not to generate strategic plans but as a learning tool to create "prepared minds" within their management teams.

A former senior executive at GE Capital explained the logic of such thinking. Business is often unpredictable. Two competitors merge, another develops a new technology, the government issues new regulations and market demand swings in a different direction. It is often during these real time developments that a company's most important strategic decisions are made. Too often however, companies react poorly under the pressure because they are not well prepared for these unpredictable events. Discussions among top managers are often based more on opinion than fact, and the subsequent decisions end up being based on gut instinct rather than thoughtful analysis. GE Capital however, believes it gains a competitive advantage by following a disciplined strategy process that focuses on preparing it for the uncertainties ahead.

As our analysis makes clear, real strategy is made in real time. It follows then the goal of a formal strategic planning process is to make sure that key decision makers have a solid understanding of the business, share a common fact base and agree on important assumptions. These elements of the prepared mind serve as a foundation upon which good strategic decisions can be made throughout the year. One of the most important ways of building that foundation is by getting the central elements of the process right.

How to create prepared minds?

Most strategic planning processes are built around a set of annual or other time period meetings in which the chief executive officer and senior corporate team review the strategies of the company's business units or divisions. The chief executive and top team typically meet separately to discuss corporate strategy as well.

We found the key to transforming these review meetings from “dog and pony” shows into effective vehicles for learning was to view them not as reviews by the chief executive but as conversations. The difference is that a conversation is a two way street in which participants learn from and challenge on another. The goal is for everyone to leave the room much better informed than when they went in. Achieving that outcome requires a lot of preparation by all the participants.

Who should attend reviews?

At the E.D. Smith Company in Canada, they believe real conversations take place in groups of three to ten people, no more. E.D. Smith simply do not believe that effective results will be achieved in large groups for both logistical and political reasons. Llewellyn Smith, the former President and Chairman of the E.D. Smith board believes that once the group grows, it is difficult to ensure that everyone can participate meaningfully so hierarchical forces are more likely to come into play. Rather than frank discussion, in larger groups one is more likely to see posturing and politicking. Some companies in our study tempted by the values of inclusion, brought in groups of thirty or more to their strategy reviews. These discussions were inhibited and people came away feeling the exercise had been more of a show than a real dialogue about critical business issues.

In reality, there are only two essential participants in a business unit strategy review; the chief executive officer and the business unit leader. Everyone else is discretionary and should be included only if he or she is truly a decision maker. The number of decision makers varies from company to company but typically includes the corporate chief financial officer, the group executive that the business unit reports to, the head of human resources, one or two senior corporate executives and two to three senior members of the business unit team. The corporate head of strategy also usually attends as the person responsible for making sure the conversation is effective. Thus, the total number of participants can be kept to between five and ten, with twelve as the maximum. People will fight to be included in these meetings but, other forums can be set up to keep them informed and get their buy in.

How long should reviews be?

It's not possible to have an in depth strategy discussion about a significant business in less than a day. There are simply too many topics to cover such as customers, competitors, technology, regulation, risks, investments, market segmentation, resources and more. Spending less time in these areas prevents the careful poking and prodding of issues required to get the full benefit from the effort. It may sound like a lot to commit a full day to each major business unit, but most chief executives we interviewed said they wanted to spend about a third of their time on strategy.

Given two hundred and forty working days in a year, that leaves eighty days to devote to strategy. In that context, it seems reasonable to expect the chief executive to spend ten to thirty days in intensive, well - prepared strategy discussions. As one Emerson Electric executive told us, "At first I resented the Emerson process because it was such a large commitment of time, but then after a few cycles I realized it was making me and my team better managers. The process of preparing for it and the meetings themselves made us realize things about our business we wouldn't have found out in any other way." Former chief executive Charles F. Knight said that "more than half my time each year is blocked out strictly for planning," a commitment to strategy that has been carried on by his successor, David Farr.

Where should planning meetings be held?

It is best to hold planning meetings off site. Holding the meetings off site will minimise the distractions of day - to - day business at corporate headquarters, allow participants to focus on the task at hand and allow for free time for participants to caucus in an environment free of the daily challenges.

What should be discussed?

Many companies combine their strategy reviews with a discussion of budgets and financial targets. That is a big mistake. When the two are combined, the discussion is dominated by a focus on the numbers and short-term issues; long term strategy questions receive only cursory attention. Likewise, if there is no other forum in which to discuss the financials, they will inevitably come up in the strategy meetings. Ideally, companies should have two clearly demarcated meetings: one full day on business - unit strategy and another meeting at a different time of the year to set financial targets. The two should then be linked with a common, rolling three to five year financial plan that ties together strategic initiatives with budgets and financial targets. Such strategic linking is crucial.

Focus on long term trends, opportunities, challenges and decisions are crucial. In businesses where decisions have a long lifetime and are difficult to reverse, such as aerospace or telecommunications, long term might mean five to ten years. In those where commitments have a shorter life, such as software or consumer goods, it might mean two to four years.

The discussion should focus on questions over the appropriate time horizon such as: What are our aspirations? What are the critical trends regarding customers, competitors, technology and regulation? How is our business model performing and how will it likely evolve? What are the key challenges and opportunities we face? What capabilities do we need to build for the future? What are the key risks and uncertainties we face? What can we do to ensure our adaptability, flexibility and profitability?

How should the conversation be conducted?

The main purpose of the discussions is to challenge the strategy by testing assumptions about the market, checking that a full range of strategic choices is considered, exploring potential opportunities and risks, and forcing an honest assessment of the business's strengths and weaknesses.

An organizations culture will dictate the tone of the discussions, and there is no one right culture for planning. Good strategic planning can emerge from the in - your - face culture of Emerson Electric or the more genteel culture of Hewlett - Packard. There are however, certainly some wrong ways to conduct strategic planning conversations. Sometimes business - unit heads, resentful of what they see as "interference from corporate," try to reveal as little information as possible; on the other side, senior corporate leaders at times turn the meetings into a game of "gotcha," seeking all the skeletons in the business unit's closets.

Exploring the strategy's boundaries and pushing the business team to explore worst case scenarios.

The conversations can be hardnosed, but it is important to create an environment that does not become an "us verses them." In a firm such as Emerson, where staff are able to challenge one another, it is done by exploring the boundaries of the strategy - pushing the business team to explore worst - case scenarios and understand what might make them come true. Testing to see if aspirations could be ratcheted upward; or investigating the competitive implications of a radical cost reduction or product performance improvement are a given.

It is also fine to create an collegial atmosphere, as long as it does not devolve to the point where uncomfortable issues are glossed over or buried. One company we studied never made an effective strategic plan because it was so consensus oriented. Tough issues simply were postponed until another meeting because the members of the management team were not able to confront one another and an empathetic management relationship evolved.

How much preparation is necessary for these meetings?

Preparation by the principals is the key to making a full day strategy discussion pay off. The tasks should not be outsourced to staff people. A document detailing the strategy should be sent out at least a week before the meeting, allowing participants the time they will need to study it. That will prevent people from having to take the time to read and understand the slides for the first time. Instead, participants will come ready to ask questions and debate the issues.

The corporation should provide the business units with a template that serves as a guideline for analysis. Templates should define the company's current position in terms of customers, products or services and market segments; assess the future direction of industry, including customer trends, competitor actions, technology changes and globalization; and determine major opportunities and threats facing the business. It is also helpful to share with units the best plan of the previous year to create a gold standard of what is expected.

Each unit should be given a lot of latitude. Every business unit is different, and one size does not fit all because, in some cases templates can obscure more than they reveal. Also, strategy reviews are a great way for a chief executive to check out the quality of the company's managers. If there is too much corporate guidance, it becomes harder to tell the real strategists from those who are merely good at filling out templates.

What follow - up is needed?

Disciplined follow up is essential. Long term strategic goals should be tied to shorter-term budgets, financial targets, operating plans and human resource strategies. In companies that had a good process, the chief executive personally took detailed notes; wrote a three to four page memo to the business unit or division management summarizing the main themes, implications and commitments; and used the notes as a starting point for the next review. The goals should also be incorporated into the compensation plans of the unit management team. Follow - up assures the strategic plans do not lie ignored on the executive bookshelf. Rather, they are living documents that drive actions and performance.

Prepared minds in action.

How does one judge the success or failure of the strategic planning process? Not by whether the written plans are good, or whether everyone felt good afterward, or even whether any big decisions were made during the meetings. The ultimate criterion is whether all the participants came out of the process better prepared for the real job of strategic decision making. In our research, we saw many examples in which the right process led to that result.

Consider how rigorous planning helped a multi - business industrial goods firms expand internationally. Unexpectedly, its automotive parts division faced the opportunity to acquire two large businesses in Germany, where it had not been a significant player. Because the company was new to the market and would need to commit significant resources in order to succeed in it, the decision was risky.

Fortunately, the chief executive, the corporate team and business unit team members had engaged in extensive strategy discussions and therefore already had a point of view on the German market and the strategic fit presented by the opportunity. As well, a thorough understanding of the economics of the product area in question was solidified. The company was able to make a decision quite quickly and out negotiate a slower rival that was not as well prepared. The acquisitions were critical to the success of the company's growth strategy.

Similarly, Stryker Canada a medical device company used its strategic planning efforts to focus on a new growth area. The strategy review revealed the divisions core business, while enjoying a large market share and excellent profitability, was slowly becoming commoditized. Looking at demographic factors, company executives realized orthopaedics applications would be increasingly important. More weekend athlete Baby Boomers were blowing out their knees and hips. Over the course of a few years, the company engaged in various activities as a result of that insight. It generated material breakthroughs in the lab that suggested innovative ways of creating orthopaedics devices, acquired a business that could be a home for further sports - medicine activities, and pursued licensing opportunities to extend the product offering. The management team was bale to put the pieces of the puzzle together because it was clear on the scope of the growth opportunity and the need to act in the face of potential declines in its existing business.

Diligence is key to prepared minds in action.

The reverse of the two above scenarios are clearly illustrated in the E.D. Smith, Canada acquisition of GEM, Mississippi. Senior management officials at E.D. Smith were told by reliable food industry sources that they had to expand to the United States in order to stay abreast with customers as they expanded their market and became more global in their strategic challenges. Llewellyn Smith, then President and Chairman of the Board for E.D. Smith left the task to one man to make all decisions as it related to expansion. Not well prepared for the task (through no fault of his own), the person committed E. D. Smith to purchase GEM Industries in Byhalia, Mississippi from a Toronto business man.

Few, if any business unit team members were engaged in strategy discussions. Strategic acquisition analysis was none existent and a thorough understanding of the economics of products, technology, market for labour resources and geographic cultural was not evaluated. As a result, after spending approximately ten million dollars and various corporate resources in a two year period, E.D. Smith sold all of its interest in the company and went back to Canada.

Although E. D. Smith did solidify the WalMart, Sams Choice and HEB. jam business for the Southern United States, Llewellyn Smith later stated that this could have been accomplished by using the Canadian resources at the existing plant in Winona. The company eventually recovered and managed to return to profitability but, at a significant cost.

Prepared minds can also help companies reject moves that do not make sense. A company with a large aerospace and defence division invested a lot of time in its strategy reviews to ensure top managers understood the economic implications of consolidation in its industry. Instead of accepting the standard line from the industry press and pundits, the participants looked in detail at what it meant for their specific subsectors of the industry and their own future economics.

They were not gullible when their investment bankers came to town arguing that the company needed greater economies of scale to survive and proposing a specific acquisition target that would soon be for sale. Armed with an appreciation of the business and aware of the strengths and weaknesses of competitors, top management chose not to do the deal - which in hindsight proved to be the right decision. Their preparation enabled them to sort out sensible deals from foolish ones and avoid a potentially costly and distracting mistake.

Contrast that outcome with events at an agrochemical firm where poorly prepared leaders were required to respond to market challenges. Growth in the company's industry had come primarily from the development and sale of genetically modified seeds (GMS).

At one point, the company's seed division held a brainstorming session to talk about new growth opportunities. European colleagues raised the possibility of a backlash in their home countries against food grown from GMS but, a corporate senior executive who had joined the discussion was unhappy with this negative view of the business and took the topic off the table.

Later, European consumers did indeed object to GMS foods and the company was blindsided by the rapid decline of its European seed business. That outcome might have been avoided if the company had a formal process for fact based, open minded discussions of business unit risks among senior corporate and business unit leaders. In the absence of such a process, the whim of one senior executive overrode the concerns of the business unit.

Summary.

As these examples suggest, there is no reason strategic planning should be the butt of cynical jokes. It is one of the most important tasks for corporate and business unit executives.

Companies whose processes look more like tribal rituals waste valuable executive time at a minimum and more seriously, they may leave corporate leaders unprepared to respond properly when the inevitable moments of truth arise. When repositioned as a learning process, formal strategic planning can help managers make solidly grounded strategic decisions in a world of turbulence and uncertainty.

About The Authors.

Sarah Kaplan, formerly an innovation specialist with McKinsey and CO., is a doctoral candidate at the MIT Sloan School of Management. Eric D. Beinhocker is a principal in McKinsey's London Office. Paper research and interviews were conducted by Ms. Kaplan and Mr. Beinhocker. Nicholas Pollice is the President of The Pollice Management Consulting Group in Ancaster, Ontario, Canada. Mr. Pollice provided relevant and actual real life applications of the research material.

September, 2005.