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Strategic Planning

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Strategic Planning

Academic Director of Edinburgh Business School, The Graduate School of Business, Heriot-Watt University, Alex Scott is an economist and has published over thirty research papers into efficiency in education, efficient use of energy, energy and the environment and the cost to the taxpayer of government industrial aid programmes. He is a pioneer in developing and carrying out research into new educational techniques, particularly economic and business simulations. He invented and developed the Profiler which is a central feature of the EBS Learning Websites.

Alex Scott's executive teaching includes running strategic planning sessions for groups of senior managers, widening the perspectives of functional managers, and teaching financial specialists the principles of how economies function in today's highly complex and interdependent world. Among the companies for which he has run management programmes are American Express, British Rail, British Telecom, Cathay Pacific, Fiskars, Hewlett-Packard, National Health Service, ScottishPower, Scottish Widows, Swiss Bank Corporation.

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Contents

Using the Course Package

It is widely accepted that strategic planning is extremely difficult to teach effectively. This is because, at the MBA level, it is not sufficient to know about the subject – it is necessary to be able to apply ideas in order to carry out strategic analysis of real problems. While there are many strategy models on which analyses can be based, the strategic approach also requires the application of a great many ideas and models drawn from the core business disciplines; this is what gives substance to strategic analysis and this integrative element is why strategic planning is typically regarded as the capstone course in MBA programmes. The Strategic Planning course has been written to be stand alone but you will find it a much richer learning experience if you have already studied the other six core disciplines. From the pragmatic point of view experience has shown that the failure rate for students who tackle Strategic Planning first is relatively high.

A further problem is that strategy solutions are to a large extent a matter of personal judgement. A strategic planning analysis is judged on the structure and approach of the analysis and the justification for policy proposals rather than the proposals themselves. While it may be possible to recognise that recommendations are unlikely to be successful because of misunderstandings about the basic business tools which are applied, it is usually difficult to judge how good or bad the results of a particular set of recommendations are likely to be because no one really knows what is going to happen in the future. In real life strategy is undertaken in a constantly changing environment which is full of uncertainty, and it is difficult to replicate these conditions in the classroom. But it is obvious when students are using analytical ideas rather than adopting a subjective and unstructured approach.

The approach adopted in this course is based on cases. There are review exercises, short questions and a simulation which are intended to reinforce your comprehension of specific topics, and the overall objective of the course is to enable you to apply strategic analysis to real life issues.

Cases

The case method is the most widely used technique for teaching strategic planning, and was pioneered at Harvard Business School. The case is a powerful teaching tool in class because it enables students to tackle real life examples, which have been abstracted and structured by teachers, and to present, discuss and defend their analysis. The case method as used in class teaching cannot be implemented for distance learning because it is based on interaction among students and between students and teacher. In this course each case has been analysed fully by the professor, and many of the cases have been used in a similar form in examinations and the analysis has benefited from the wisdom of large numbers of students. Each case has been analysed using a variety of business models, and as you work through the course you will learn by analysing the cases and comparing your solutions with those of the professor. It may often be the case that you consider your analysis to be superior to the professor's; this is all to the good, particularly if you can justify your position.

The case method is a static approach, in that you analyse a given situation, but cannot then experience how a proposal might work out in practice, and how it might need to be adjusted as time proceeds. Strategic planning is a dynamic process in real life, and no case can capture this fully. A drawback of the case method is therefore that you will not have to live with the consequences of your strategy recommendations.

Feedback on student performance presents difficulties when using cases in the distance learning mode. The professor's analysis provides a benchmark against which you can evaluate your own answer, but it cannot be regarded as a 'perfect answer' to the case. This is because there can be legitimate disagreement on the weights to ascribe to different aspects of the issue, such as the relative importance of different types of risk. Therefore the professor's analysis can be regarded as an analytical framework within which you can judge the quality of your own thinking. The Profiler Cases enable you to judge your strengths and weaknesses on the basis of a large number of cases which, taken together, provide a more accurate indication of your comprehension and analytical ability than individual cases.

One of the difficulties in using real life cases is that they typically touch on many issues. Several of the cases in the course attempt to focus on particular topic areas, but the cases in the earlier modules will be difficult to analyse fully because you do not have many of the analytical tools available with which to tackle them. It is, however, a useful exercise to attempt cases without having the benefit of a full framework because there are still many lessons to be learned from applying what you do know.

Because strategic planning is about applying ideas to the real world it is important that you tackle the exercises, in the form of cases, review questions and short questions, and assess your analysis in relation to the model answers provided. You will find that many issues are elaborated on and reinforced in the model answers and these are an essential complement to the ideas developed in the text. In fact, the text and the exercises must be regarded as a single learning tool.

The Timeless Nature of Strategy: The View from Now

The cases have been developed since the MBA was launched in 1990. **An important feature of these cases is that they are not based on privileged information or in-depth analysis of the organisations concerned; they have been constructed from information freely available in the public domain (i.e. newspaper reports, magazine articles, television programmes and company reports).** You will find that the cases are much shorter than those typically used in business school courses, and those of you who are familiar with Harvard Business School cases may at first feel that they are 'too short'. However, it is not the sheer amount of information in a case which is important rather than what you can make of the information available. The cases demonstrate that strategic problems recur and that events which happened in the past are as relevant and informative as those happening right now. The point of the strategic analysis is to demonstrate how strategic tools are used at a given time; subsequent events may or may not be quite what was expected as changes in the environment, both internal and external, unfold.

The View from Now appended to each exercise and case solution provides a current perspective on how events actually transpired and the extent to which the strategic analysis of the case was borne out by future events. You may wish to consider what this section is likely to contain before reading it.

> That men do not learn very much from the lessons of history is the most important of all the lessons of history.
>
> Aldous Huxley

> Those who cannot learn from history are doomed to repeat it.
>
> George Santayana

The Simulation: Stratship

This simulation can be downloaded from the Strategic Planning course website (http://coursewebsites.ebsglobal.net, 'Downloads' section). Stratship was originally developed to teach shipping industry executives about the main strategy issues in the liner market. As time progressed it became clear that Stratship captured many of the generic strategy problems confronting all companies, independent of their industry. In the past two decades Stratship has been run in seminars for senior managers, middle managers, functional specialists, MBA students and business undergraduates. It consistently generates high levels of enthusiasm and commitment and, in the hands of a skilled teacher, has the capacity to test management skills to the utmost and demonstrate how and why strategic tools are used. It has to be recognised that the group dynamic is impossible to duplicate for the individual user so that is why a great deal of additional material has been built into the simulation for use as a distance learning tool. Automatic tutorials appear at key points to replicate as far as possible what is done in the classroom in a participative manner and the final tutorial demonstrates the power of strategic thinking in getting to grips with and resolving a highly complex and dynamic problem. It is necessary to inject a word of caution here: while the benefits of running Stratship can be significant you have to be prepared to put in a great deal of time to reap these benefits; if you are not prepared to do so then it is possibly preferable not to start.

Your Learning Style

As you are probably well aware different teachers have different styles and these styles can be equally effective in their different ways. There are no strict rules for being an effective teacher – although there are many pitfalls that need to be avoided; teacher training courses are designed to provide potential teachers with the tools of their trade, but how they implement these is a matter of individual discretion. Apart from this there is the issue of how the learning experience should be structured. For example, when teaching Strategic Planning on campus we use the Stratship simulation: but should it be run at the beginning of the course or at the end? If it is run at the end students tend to say 'That was fantastic, but if it had been run at the beginning I would have had a better understanding of the strategic context and where the course was heading'. If it is run at the beginning students tend to say 'That was fantastic, but if it had been run at the end I would have been much better equipped to deal with the problems involved and would probably have learned much more'. The fact is that different students learn in different ways and no single class formula will suit everyone perfectly. Some students learn by participating in class while others are unwilling to make a contribution; some students learn from small group interaction while others find the experience difficult to deal with.

So whether you are an independent learner or attending classes it is up to you how you decide to learn about strategy. Bear in mind that even if you attend classes they will rarely exceed one quarter of the recommended 200 hours of study time so most of your learning will be on your own. Two totally different learning models reported by students were equally successful for them. One student worked through each module and spent a lot of time on each case or review question both analysing the problem and comparing the outcome with the analysis provided before proceeding to the Short Questions, the Profiler Cases and the Practice Final Examinations. Her intention was to build up comprehension in an incremental fashion. Another student started by reading Module 1 to Module 8 without attempting the cases or review exercises with the intention of gaining a general perspective; he then went back to the beginning and worked through the cases and exercises before attempting the Short Questions, etc. in the same way as the previous student. Each felt that this approach was right for him or her. Whichever approach you adopt bear in mind that strategic planning is not an individual discipline which is unrelated to the core courses; when ideas from the core courses are used you may often find it worthwhile to revisit the relevant text to refresh your mind on ideas which are discussed and applied in the strategic context.

But there is one important piece of advice which you should keep in mind whatever your learning style: **do not get obsessed with detail.** For example, some of the cases contain numerical information relating to company accounts and market position; you might make a computational mistake when using these numbers but that is not important for the course, although it would be important in real life. What is important is that the conclusions you arrive at are consistent with whatever numerical answers you have produced. Strategic planning is about the big picture and the quality of your thinking; if you lose sight of that you will find yourself in the classic position of not being able to see the wood for the trees.

Module 1

Introduction to Strategy, Planning and Structure

Contents

Learning Objectives

- The meaning of strategic planning as it is used in business.
- To visualise strategy as a structure of thought that can be applied to the complex strategy process.
- The role of the scientific approach.
- The different strategy concerns at the corporate and business levels.
- How the major approaches to strategy have developed.

1.1 Strategic Planning: The Context

It has been mentioned that strategic planning is usually the capstone course in MBA courses; it is therefore useful to look at what the core courses are concerned with and how strategic planning fits with them. Because the core courses are taught individually it is easy to get the impression that they are independent of each other, but this is far from the case. The following story shows how the core courses contribute to implementing a new product launch; it also demonstrates that lack of understanding of any one core discipline can lead to failure on its own.

- **Organisational behaviour**: this subject should come at the top of the list of requirements for any management course because if you cannot handle people then you are not a manager. It is as simple as that. The fact is that organisations are run by people, and if you have no understanding of what motivates people and how they interact in the organisational setting then you are unlikely to get an efficient response from the people you are managing. A new product launch typically involves organisational change and if the organisation is unable to adapt to new requirements in terms of working practices and different customer needs there is little chance of the product launch succeeding. Organisational change is unlikely to happen by itself and unless you have a grasp of the organisational culture, understand how to motivate and influence people and are able to design appropriate reward systems and job designs, you will have little control over what happens.

- **Economics**: everything that happens in business is related to economic influences and these operate at three levels. At the highest level it is necessary to have some understanding of how the economy operates. Every business is affected by the business cycle, the rate of interest, the exchange rate and government economic policies; therefore you need to ask whether the product should be launched now, when all the signs are that the economy is heading for recession, or should it be delayed until there is an improvement? This is particularly important for consumer products that are greatly affected by disposable incomes. The next level concerns how markets operate and how prices are determined. What types of competitive forces prevail in the industry? Does the new product have any monopolistic characteristics that will enable relatively high profits to be made or is it entering an already highly competitive market where it is unlikely that profits higher than the opportunity cost of capital can be generated? If the competitive environment is not understood it is quite possible that the product will be doomed to failure from the outset. The third level concerns ideas about efficiency, primarily based on marginal analysis. Rational decision making is based on an understanding of relevant costs and benefits, and serious mistakes are often made because efficiency ideas are not understood. It is not just a question of whether the costs of developing and launching the product will eventually be repaid; it is also necessary to make decisions on how much to spend on marketing and other activities. Without a firm grasp of efficiency principles such decisions are likely to be random. Taking the three levels together, launching at the wrong time, into the wrong market with an unnecessarily costly product is a certain recipe for failure.
- **Marketing**: there is little point to being able to manage people and make rational economic decisions if you cannot sell effectively in markets. Marketing is often mistakenly thought of as advertising, but advertising is simply one of many marketing tools. Marketing is the complex process of relating product characteristics to market demand and attempting to win competitive advantage in a dynamic competitive setting. Why is it that some brands of detergents are much more successful than others, despite the fact that the majority of people cannot say if one brand performs better than another? If the new product is priced about the same as competitors but has no particularly distinguishing features is it likely to succeed? Unless the new product is positioned so that it is relatively attractive to potential consumers there is little likelihood of success.
- **Finance**: you may be running your company well and selling effectively, but managers always have to bear in mind that perhaps they should have been doing something different which is more profitable than the new product launch. How is the choice among competing courses of action made in a world of uncertainty? Finance takes all available information on projected future cash flows and subjects them to rigorous evaluation; the choice here may have been between

revamping an existing product or launching a new product; the projected cash flows both in and out are totally different while the risks associated with each are also different. The tools of financial theory provide you with a quantitative solution to such problems, and this takes you a long way towards deciding on the most appropriate course of action. In the absence of this analysis it is possible that the decision will not only fail to create as much value as possible but may result in the destruction of value; in other words it would be a failure.

- **Accounting**: you may have decided on the best course of action using financial techniques, but that decision in turn is dependent on available accounting data. In a company which produces more than one product it is difficult to isolate relevant costs, so it is quite possible that the wrong costs may have been used as the basis for the decision in the first place. Further, if the cost of the new product is not known the price may be set such that it makes a loss. Clearly the application of inappropriate accounting principles is a sure road to disaster.
- **Project management**: while it may appear to be a good idea to embark on the new product launch on the basis of initial marketing research and cost estimates, unless you understand how to implement projects effectively there is a good chance that the launch will fail. The success of the launch will depend on meeting criteria centred on time, cost and quality because the product will have to be on the market by a certain date, the development and production costs will have to be maintained within budget and the quality has to be as good as competitors'. There are therefore strong links between project management and the other core disciplines: organisational behaviour techniques are used for team building, finance and accounting techniques are used to ensure that the appropriate costs are measured and financial evaluation carried out and, possibly most crucially, marketing needs to be consulted about the connection between quality as it affects differentiation and market positioning. Therefore the time, cost and quality trade-off cannot be carried out in isolation. In addition, the launch of a new product generates risk. As the launch progresses project management tools map the risk profile and monitor it and tools such as earned value analysis and trade-off analysis enable different combinations of time, cost and performance, both at present and at the projected end condition, to be assessed. Clearly, the lack of the project management approach can result in a haphazard product launch. A major problem confronting organisations is that they do not realise that their approach to managing change is haphazard because they are not aware that most change activities are projects in their own right and should be managed as such.
- **Strategic planning**: the areas covered by the six core disciplines can be identified quite precisely and it is clear that they all have a crucial role to play in running a company. Strategic planning is less easy to define, and the content and role of strategic planning is what the rest of this course is about.

1.2 What Is Strategic Planning?

Strategic planning is a complex activity and before attempting a definition it is useful to compare its degree of complexity with another complex activity: economic policy making, which has a general similarity with strategic planning in that strategic planning is concerned with running a company and economic policy is concerned with running the economy of a country. The study of macroeconomics reveals the complexity of fiscal and monetary policy and the many ideas and theories which are involved; furthermore, there are no completely right or wrong economic policy decisions because information has to be interpreted and conflicting theories reconciled. Although the scale of a company is very much less than that of an industrialised country such as the UK or Japan the job of business policy making is probably just as complex. That is one reason why effective CEOs are as rare as effective Presidents, Prime Ministers and Central Bank Governors; in fact, effective CEOs are typically paid much more than government ministers. The complexity of economic policy becomes apparent when a list of the issues involved is compiled together with an example of how the government attempts to influence each.

Issue	Government action
Growth of GNP	Stimulate innovation
Unemployment	Reduce taxes
Inflation	Increase taxes
The budget balance	Increase taxes
The role of markets	Reduce regulation
The trade balance	Stimulate exports
The rate of interest	Increase the money supply
The exchange rate	Sell currency reserves
Income redistribution	Increase welfare payments
Pollution	Tax polluting firms
Government expenditure	Control government departments
Business investment	Improve confidence in the economy

This list is by no means complete; in fact, the list could be extended to fill this page. The government is involved in a wide variety of actions in attempting to influence these issues and there is typically disagreement about which action is most appropriate. When we turn to strategic planning it is not difficult to generate a list of equal length; the entries in the following list are accompanied by the type of question that is posed by the core disciplines.

Issue	Question	Core discipline
Profitability	Are we creating value?	*Finance*
Growth in sales	Where are we on the product life cycle?	*Marketing*
Market share	Are we in an oligopoly?	*Economics*
Relative costs	Have we an efficient management accounting system?	*Accounting*
Competitive position	Do we have a competitive advantage?	*Strategic planning*
Pricing	What is the elasticity of demand?	*Economics*
Environmental scanning	What is happening to the economy?	*Economics*

Issue	Question	Core discipline
Human resource management	Why is our attrition rate so high?	*Organisational behaviour*
Timing new product launch	Are we clear about the time, cost and quality trade-offs?	*Project management*
Dividend policy	Are our shareholders happy?	*Finance*
Company culture	Why are we resistant to change?	*Organisational behaviour*

This random list of issues leads to questions that involve the core disciplines but it is not necessarily immediately evident to managers which core discipline will be useful in addressing the issue and the question. Many real life business discussions flit among these issues and questions without any structure and in ignorance of the fact that there is a body of knowledge that can be brought to bear in resolving the questions. One of the main outcomes of this course is that you will be able to structure strategy discussions and identify how concepts can be applied.

The theories of microeconomics and macroeconomics are used to make sense of the relationships among the many variables involved in the economy and to provide an understanding of how economies operate; this provides the basis for interpreting government economic policy making. The approach in strategic planning is to bring together business concepts and ideas in order to understand how companies (and other organisations) operate in a competitive environment, develop an understanding of the inter-relationships involved, and hence provide the basis for arriving at explanations of why companies have succeeded or failed in the past and how they might operate successfully in the future.

Looking at the list of strategic planning issues there is an item called 'environmental scanning'. This activity is concerned with monitoring the environment within which the company operates and assessing the extent to which current and potential changes in that environment are likely to impact on the company. But the macroeconomic environment is largely determined by the state of the economy, which in turn is greatly influenced by economic policy making. Thus to make sense of the macroeconomic environment it is necessary to have some understanding of economic policy making and its implications. The need to understand economic policy making is not confined to government policy makers and it is subsumed into strategic analysis. In other words, managers are fooling themselves when they claim that issues such as government economic policy have no relevance to their decision making: everything is relevant to strategic planning.

Ignorance of the business disciplines means that we often do not understand the world round about us. For example, take the case of Madonna, the singer and actress. Madonna is an entertainment phenomenon: she is recognised worldwide and has been the world's highest paid female entertainer; but it is generally accepted that her singing does not compare well with a properly trained voice, her dancing does not appear to be significantly better than the dancers in her chorus line and her films have not been particularly successful, suggesting that her acting is not of the highest calibre; she does not play a musical instrument. Looked at from this perspective, we must be missing something because it is not obvious what gives

Madonna her competitive edge that kept her in the top rank for over two decades. It is not just that she was successful, she maintained that success and appears to have achieved that enviable state: sustainable competitive advantage.

One way of tackling this is to think of Madonna as a business enterprise rather than an individual performing on stage or screen. The overall objective of the Madonna business was to achieve stardom and resources were mobilised to achieve this. The contribution of the core disciplines can be identified as follows.

Core discipline	Contribution to Madonna Inc
Organisational behaviour	Select a group of musicians, dancers, songwriters, directors, producers, etc. to build an effective team
Economics	Carve out a monopoly position
Marketing	Change image in line with changing consumer preferences; develop brand loyalty
Accounting	Implement effective cost control system
Finance	Ensure the availability of financial resources for major investments in recordings, films and stage shows
Project management	Stage amazing personal performances efficiently

Madonna's long-term success now starts to make sense: what she did particularly well was to exercise business skills rather than performing skills. So what is to stop other highly competent performers imitating Madonna? That is a difficult question, but she has the brand (hence attracting fans, who might not like this analysis) and the resources to move fast in line with public tastes.

The point here is not to denigrate Madonna, who is beyond doubt a fine performer, but to try to understand what confers competitive advantage on her. It cannot be her innate performing skills because these are not unique, so it must be the 'something missing' that we have attempted to identify using business ideas. While another singer who behaved in the same business fashion as Madonna might be successful, there are many other factors at work. These include the business ability of the singer, the effectiveness of the business team built up, the selection of the correct marketing approach in relation to the singer's characteristics and the ability to adapt to changing preferences. Thus while **behaving** like Madonna may **increase the chances** of success for a particular singer, there is **no guarantee** that it will do so. In addition, relatively few singers (and this applies to the population generally) have the vision to conceive of themselves as a business and to apply business principles to what they do. So to a large extent most singers would not be able to act in the same way as Madonna even if it was pointed out to them that this was the route to success.

Now you should be starting to think more deeply about the world around you: nothing is as it appears to be.

1.2.1 Managers' Definitions of Strategy

Over many years I have posed the question 'What do you understand by strategy?' to experienced executives attending management programmes, and each time the groups have responded with a wide range of answers including the following:

1. Knowing where you are going and how you are going to get there.
2. Setting a clear set of objectives and mobilising resources to achieve them.
3. Thinking in the long rather than the short term.
4. Working out how to do better in the market place than your competitors.
5. Deriving and selecting a course of action.

There are some common threads running through these definitions, but individually they could lead to different courses of action. For example, definition 2 focuses on objectives, but does not differentiate between short term and long term as in definition 3; definition 4 is the only one explicitly concerned with markets; definition 5 is the only one which explicitly considers choice.

It is not unusual to obtain ten different definitions from a single group. These managers are typically involved in formulating and implementing strategy so it might appear strange that there is such apparent confusion about what is meant by the term. One of the main outcomes of this course is that you will emerge with a clear understanding of what is meant by strategic planning and you will be able to converse with your peers in a meaningful manner. It would be very difficult for the five individuals who provided the above definitions to have a sensible discussion because they would all be focusing on different things.

1.2.2 Academic Definitions of Strategy

If you were to visit a large or medium sized company, chosen at random, and attempted to identify and track the formulation and implementation of a 'strategic plan', you may well find the task to be elusive and perplexing. In pursuing the strategic planning process some questions which you might ask, in no particular order, include: 'Was the strategy ever written down?' 'Where did it originate?' 'Why was it selected rather than alternatives?' 'Who was responsible for it?' 'Who knew if it was working or not?' In many cases you would find it difficult to elicit answers to these seemingly straightforward questions. Despite this, individual companies may consider that they have a well-developed, although informal, strategic planning process. In a few companies you would find a formal planning system complete with clearly specified objectives, responsibilities and control procedures. You would therefore encounter a wide diversity of activity which individual companies would consider to be strategic planning. Some additional questions might include: 'Is there a payoff to the company from the resources devoted to strategic planning?' 'Which is more appropriate, the informal approach or the structured formal plan?' You would probably find that managers offered a variety of views on both the effectiveness of planning in general and the most appropriate approach to planning.

One reason that questions relating to strategy are difficult to answer unambiguously is that strategic planning takes place in a complex and ever-changing business environment. One academic description of strategy is

> A pattern in a stream of decisions; the pattern may not be comprehensive, unified or integrated.[1]

This raises the question as to whether strategic planning is a conceptually valid concept in business; the study of strategic planning may merely be an attempt to impose a structure on events after they have occurred. The central question is whether strategy is a rational process, in the sense that it was carefully thought out by senior management and then put into practice, or whether it is emergent, in the sense that it develops over a period as the result of many influences from all levels in the organisation.

The following are more academic definitions of strategy, each with its own particular focus.

> The decisions taken over time by top managers, which, when understood as a whole, reveal the goals they are seeking and the means used to reach these goals. Such a definition of strategy is different from common business use of the term in that it does not refer to an explicit plan. In fact, by my definition strategy may be implicit as well as explicit.[2]

> The determination of the basic long term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals.[3]

> The pattern of objectives, purposes or goals, and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or should be in and the kind of company it is or should be.[4]

> What determines the framework of a firm's business activities and provides guidelines for coordinating activities so that the firm can cope with and influence the changing environment. Strategy articulates the firm's preferred environment and the type of organisation it is striving to become.[5]

The point of reproducing these definitions is to demonstrate that there is no more agreement regarding what is meant by strategy among academics than practising senior managers. Each of these quotes can be interpreted as saying different things. The first definition seems to suggest that strategy can only be understood after the event, and is revealed by studying what management actually did. The second claims that strategy is a proactive process where long term goals are determined before the event and resources deployed accordingly. The third portrays strategy as a pattern of objectives which define what the company is and intends to be in a broad sense. The fourth presents strategy as a set of guidelines which will help it operate in a changing environment. The fact that there are such different perspectives on the issue suggests that some observers will see strategic behaviour where others will not.

A different perspective on strategy can be derived from economics: the forces of competition ensure that, on average, successful companies are those which, by chance or otherwise, choose the most effective strategies. As a result it might be expected that successful companies would tend to exhibit various characteristics of strategic planning contained in the definitions, such as identification of objectives, plans and guidelines for dealing with the unexpected, and effective allocation of resources. Since many companies have a record of success stretching over decades, it is reasonable to conclude that there is scope for distilling lessons from their experience and formalising these into a set of generally applicable principles.

1.2.3 Three Approaches to Strategic Planning

Since strategy is such a troublesome concept to define it is to be expected that there are several ways of approaching the idea. In theoretical terms strategy can be regarded as a purely planning exercise, or a course of action which emerges over time, or as the outcome of the resources which are available to the company.

Given that there are three theoretical approaches to strategy it is perhaps not surprising that executives and academics arrive at a variety of definitions. As would be expected the academic journals contain a great deal of discussion regarding the precise meaning of the three approaches and their relative merits so the following account is only an outline.

The Planning Approach

This approach is based on the notion that once a set of objectives has been determined and the business environment analysed and forecasts made, a plan can be worked out by senior management which is then passed down for implementation; this plan is then adhered to over the planning time scale. This is usually thought of as the strategic planning approach, and it has been claimed by its supporters that this prescriptive form of strategy is rational and objective; but as Mintzberg[6] and many others have pointed out, it makes a number of assumptions about the world which are highly questionable.

- *The future can be predicted accurately enough to make rational choices.* It is in fact a widespread fallacy that the future can be predicted with any realistic degree of accuracy. At the macro level economists disagree quite markedly on the economic prospects for any given country during the course of the next year; such forecasts can never take into account unforeseeable events such as the collapse of the Russian financial system in 1998 leading to the crisis of the hedge fund LTCM, on whose board were the finance gurus Myron Scholes and Robert C Merton. The Black-Scholes valuation method is world famous and is dealt with in the *Finance* course. At the micro level market innovations can have fundamental effects which are also impossible to predict, such as the introduction of direct telephone insurance selling in the UK in the early 1990s and the emergence of eBay and Google in the early 2000s. One reason that many market changes are impossible to predict is that they are dependent on the unique vision of individuals; if such unique vision did not exist there would be virtually no scope for competitive action in the first place. At the macro level the collapse of the Icelandic banking system in 2008 and of the Cypriot banking system in 2013 happened in spite of the efforts of the major European countries to contain the financial crisis.

- *It is possible to detach strategy formulation from everyday management*. In arriving at a strategy it is necessary to have a full set of data which can be subjected to analysis and from which conclusions can be drawn. But this assumes that there is some technique whereby the relevant information is extracted from the organisation, and from individual managers, and presented to strategy makers in a tidy bundle. This dodges the question of who is to decide on which information is relevant, and indeed whether the information is readily available. Furthermore, as events unfold information is continually evolving and can go out of date very quickly. As a consequence everyday management is closely tied in with strategy formulation because it is in everyday events that information is generated.
- *It is possible to forego short-term benefit in order to gain long-term advantage*. In a situation of uncertainty, and lack of knowledge about the future because of the difficulties of forecasting mentioned above, it may often appear preferable to reap short-term benefits that can be achieved with a high degree of certainty rather than waiting for highly uncertain returns. It can also be extremely difficult to convince those who lose in the short term that the trade-off is worthwhile. Trading off the short term against the long term implies some form of discounting which in turn involves quantifying the cash flows associated with both short-term and long-term actions; the implicit discount rate for many companies may be so high that short-term benefit will always be preferred to highly uncertain long term gains. As a result many companies may find it virtually impossible to undertake action which relates to the long term when there are viable short-term options.
- *The strategies proposed are capable of being managed in the way proposed*. Any strategic initiative which involves change is dependent on company personnel adapting and working in alignment with company objectives. One of the major lessons of *Organisational Behaviour* is that change management is one of the most problematical areas of strategy implementation and it cannot be taken for granted. Time and again it is found in practice that prescriptive actions simply do not take the human dimension adequately into account.
- *The chief executive has the knowledge and power to choose among options. He does not need to persuade anyone, nor compromise his decisions*. This takes a naive view of leadership and how it is exercised. In reality, very few business leaders can behave like dictators, and certainly not for very long. It is necessary to achieve consensus and broad agreement at all levels of the organisation to achieve objectives effectively. The fact of selecting one option implies that some individuals will be made better off and some worse off (or perceive that this is the case) than they otherwise would have been so compromises are inevitable during the implementation process.
- *After careful analysis, strategy decisions can be clearly specified, summarised and presented; they do not need to be altered because circumstances outside the company have changed*. This is perhaps one of the greatest and most potent fallacies: it is never possible to avoid ambiguity completely, and it is potentially lethal to ignore changing competitive circumstances. One of the most important reasons for company failure

is the lack of a feedback mechanism and the channels of communication that make it possible for decision makers to adapt to changing circumstances.

- *Implementation is a separate and distinctive phase that only comes after a strategy has been agreed*. This assumption is possibly a reflection of the fact that the implementation stage of strategy has always received much less attention than the more glamorous and exciting areas of objective setting and strategy choice. In reality nothing 'just happens', and an essential part of strategy making is to evaluate the feasibility of different courses of action. It may well be desirable, on financial grounds, to close a factory, but the actual process of achieving this may have widespread and damaging effects on the company as a whole.

During the early 1960s the notion of prescriptive planning was quite popular and many corporations set up corporate strategic planning departments. However, experience has revealed that the attempt to drive corporate strategy in this restrictive fashion is unproductive. A major problem arises when individuals become committed to the strategic plan and not to the success of the company; this can occur when performance measures have been expressed in financial terms and the pursuit of favourable financial reports takes precedence over longer term issues.

Emergent Strategy

This approach starts from a different premise: that people are not totally rational and logical. The extent of this irrationality has been the subject of research and the general findings accord with common sense.

- Managers can only handle a relatively small number of options.
- Managers are biased in their interpretation of data – in fact any data set can be interpreted in a number of legitimate ways, and it is not surprising that managers often select the interpretation which backs up their previously determined views.
- Managers are likely to seek a satisfactory solution rather than maximise profits.
- Organisations consist of coalitions of interest groups. The implementation of decisions depends on negotiation and compromise between those groups, leading to unpredictable outcomes.
- When making decisions, managers pay as much attention to a company's culture and politics as to factors such as resource availability and external factors.

According to this approach strategy is not planned before the event but emerges over time in an unpredictable manner and hence may appear to have little structure; it is therefore argued that the claim of a cause and effect relationship between analysis and strategy choice and implementation is fundamentally flawed.

There is another very good reason why there is a limited use of information in decision making: the world is actually too complex to be understood by the human brain. Rationality has to be seen in the context of what is possible in the real world, rather than what might be done in an ideal world. The term used to describe rationality when it is impossible to take into account the complexity of real life is 'bounded rationality'; the decision maker is rational given the information available, but is quite aware that more information could be obtained at a cost. In economics it is argued that decision makers act in accordance with profit maximisation, but it is impossible to reconcile strict profit maximisation with bounded rationality. This means that a different view of decision making has to be taken and the term 'satisficing'[7] was invented to reflect the fact that decision makers collect information and defer selecting a course of action until the costs of further delay and information collection are considered to be greater than the potential benefits of searching out a better option. Thus rather than simply attempting to maximise profit, the decision maker satisfies himself that there is nothing more to be gained from further delay. This helps to explain why decision makers are so eager to find out what management gurus have said and are continually searching for ways of making sense of the real world. To decision makers any information is better than no information, and it does not matter very much to them that the information they are acting on does not accord with accepted views of proper scientific enquiry.

Another way of looking at this is to make up a list of things which the company does not know with any certainty when about to launch a new product; for example

- how customers will perceive quality;
- how far it will be possible to meet production cost targets;
- how competitors will react;
- when a substitute will appear on the market;
- the impact on sales of a one-year delay in launch.

It is certainly possible to collect some information on such issues, but it will not be complete and is likely to be unreliable. In fact, it turns out that you cannot actually get hold of the really important information and it is always necessary to make assumptions and to take many things on trust.

However, it can be argued that just because the world is a complex and changing place does not mean that decision makers should simply sit back and let things happen and that there is still a role for the proactive approach. The arguments for proactive action include the following, in no particular order.

- While there are bound to be adjustments to corporate objectives as time goes on, the company can still be directed along the general lines of a broad mission. The board need to do more than simply react to changing circumstances.
- There is a need for efficient resource allocation; if this is not tackled resources might as well be allocated randomly.
- While compromises need to be made with interest groups within the organisation, this is more of a constraint than a barrier to action. Decisions still have to be taken, and it is nonsense to avoid this simply because people are difficult to manage.
- In many cases investments take a considerable time to reach fruition, therefore a degree of long term planning is inevitable.
- Satisficing is in itself a rational basis for choice, since it is better to make an informed judgement on the basis of some information than no information at all, or to ignore information altogether.
- The act of attempting to plan at least makes the basis for management action clear.

Therefore there is some middle ground between trying to plan for all eventualities and simply reacting to events as they occur.

Resource Based Strategy

This approach lays emphasis on the internal resources available to the company. While it does not overlook the importance of the competitive environment, it starts from the basic premise that strategy is primarily concerned with the search for competitive advantage and to a large extent the source of competitive advantage rests within the company's resources. The resource based view does not focus so much on the actual labour and capital deployed by the company, but rather on the way in which these resources are utilised. A successful company is not a passive collection of resources which reacts to changes in the competitive environment, but one that develops the ability to take advantage of opportunities as they arise and to create the opportunities themselves by innovative behaviour.

The resource based approach uses various terms for different types of resources. Without going into detail at this stage it is important to distinguish among them. **Resources** include physical resources, human resources, financial resources and intellectual resources. **Competences** arise from the continual deployment and integration of resources over time and across activities. **Core competences** are necessary for successful performance. **Distinctive capabilities** are competences superior to competitors. Taken together these can be regarded as the company's **strategic capabilities**.

The role of strategic capabilities in creating sustainable competitive advantage depends on several characteristics, including the following.

- *Rarity*: some resources and competences are so scarce that only a few firms have access to them. This raises the question of how companies acquire such resources and competences when they are rare; they would clearly command a high price on the open market.
- *Complexity*: competences are nurtured from many linkages among resources and activities that are mostly impossible to identify and replicate.
- *Causal ambiguity*: because of the difficulty of attributing cause and effect the causes of superior performance are unclear, even to company insiders.
- *Culture*: competences may be embedded in the organisational culture and cannot be replicated outside the context of the particular company.

A major problem with the resource based approach is that it shrouds success in mystery. It would appear that core competences are so rare and difficult to imitate that sustainable competitive advantage is unique to every company that possesses it. The question that then arises is how sustainable competitive advantage arises in the first place. It may be the case that successful companies are not necessarily there because anyone has superior insight in organisational design or strategic fit. Instead there are typically many views in the company regarding the capabilities a particular activity requires and it is the market, rather than the visionary executive, that selects the most effective match. It can be argued that strategic capabilities are established by market forces rather than being designed, which is consistent with the economic perspective on strategic success discussed above.

The implication is that, by definition, there is nothing to be gained from analysing successful (or unsuccessful) companies. That is not the view taken in this course. There are, of course, many things that cannot be fully explained. But there is a great deal that can be explained by the application of appropriate strategic concepts and tools.

1.2.4 Rittel's Tame and Wicked Problems

It should be clear from the preceding discussions that strategic planning, or strategy, is a complicated subject. If you think of strategy as being a problem to solve, say for a particular company, it does not take long to realise that it is incredibly complex; the trouble is that there is a lot of confusion about what the terms 'difficult' and 'complex' actually mean. At one time, for example, it was thought that the problem of running an economy efficiently was solvable in the sense that a sufficiently powerful computer program could work out all input requirements for feasible outputs and allocate resources accordingly. The planners in the old Soviet economies fell into this trap, and were of the opinion that it if you worked at it long enough it would be possible to plan the economy. But what if the basic premise were totally wrong, i.e. it is not possible *even in principle* to plan an economy or a company with any degree of precision? The implications of this are quite profound because if the notion that a 'perfect' plan is mistaken in principle we move into different conceptual territory.

Here is a warning before you tackle the rest of this section. Some students find this argument somewhat academic and feel that it merely defines the difference between 'scientific' and 'non-scientific' problems. However, this is not the case because the distinction is between different **types** of problem, whether they are defined as scientific or not. It is usually felt that strategy problems are difficult because they are complex, but the shortcoming of focusing on complexity becomes clear when problems are classified as 'tame' or 'wicked' in the sense used by Rittel[8]. In this scheme, wicked means much more than incredibly complex. For example, consider Fermat's Last Theorem; in about 1637 the mathematician Fermat noted that he had a proof for the proposition that there were no three numbers which would fit the expression

$$x^n + y^n = z^n$$

where $n > 2$

The trouble was that he claimed not to have sufficient room in the margin to elaborate the proof. The search for the proof occupied many mathematicians for the next three hundred years, and it was not until 1993 that Andrew Wiles, after many years of effort, found the solution using highly refined and abstract mathematical concepts. There is no doubt that Fermat's Last Theorem is an incredibly complex problem, but consider it in the light of Rittel's distinction between tame and wicked characterised in Table 1.1.

Table 1.1 Tame and Wicked problems

	Property	Tame	Wicked
1	Ability to formulate the problem	Can be written down	No definitive formulation
2	Relationship between problem and solution	Can be formulated independently of solution	Understanding problem is same as solving it
3	Testability	Either true or false	Solutions good or bad relative to each other
4	Finality	Clear solution	No clear end and no obvious test
5	Tractability	Identifiable list of operations can be used	No exhaustive identifiable list of operations
6	Level of analysis	Can identify root cause	Never sure whether a problem or a symptom
7	Reproducibility	Can be tested over again as in a laboratory	Only one try: no room for trial and error
8	Replicability	May occur often	Unique

Is Fermat's Last Theorem a tame or wicked problem? The following classification suggests that it is overwhelmingly a tame problem, despite its great difficulty and complexity. You may disagree with some of the individual classifications, but it is unlikely that more than two categories can be unambiguously classified as wicked.

Classifying Fermat's Last Theorem as Tame (T) or Wicked (W)

1	Fermat's Last Theorem can be written down unambiguously, and in fact it is quite simple to understand.	T
2	The fact that it took over 350 years to find a solution is indicative of the fact that the problem can be formulated independently of the solution.	T
3	There is no such thing as partly solving the Theorem: it is either true or false.	T
4	While Wiles' solution is not clear to anyone but a highly sophisticated mathematician, it is clear in the sense that the proof is accepted as the final word.	T
5	The Theorem was solved using a battery of mathematical tools. It is possible that it could be solved in a different way, just as many mathematical problems have more than one solution.	T
6	The root cause of the problem is the difficulty of finding a general proof which will fit all cases.	T
7	No matter how many times an attempt is made to find a solution using arithmetic the general finding will always emerge: no power greater than two can provide a solution.	T
8	The problem is unique, but the issue arises in many circumstances.	T

When an attempt is made to classify strategic planning it emerges that there is a clear difference between mathematical problems and strategic problems.

1. It is difficult to formulate the problem not only because it is complex, but because the same information can be interpreted in many ways. W
2. The process of formulating and understanding the problem goes a long way towards solving it. This is partly because there are so many dimensions to strategy issues. W
3. The scientific approach cannot be used to test solutions (see later). W
4. It is not clear where the problem ends because of real world dynamics. It is impossible even to visualise the time frame over which a proposed solution will prevail. W
5. There are many techniques which can be applied, and no agreement on which is most effective in which circumstances. This is characterised by management 'fads' which come and go regularly. W
6. The cause is usually not clear, and symptoms are often confused with problems; for example, a falling market share may be a symptom of diminishing competitive advantage. W
7. Opportunities typically only present themselves once, and it is impossible to go back in time and try again. W
8. Each business problem is unique, although it may share common features with other situations. W

While there is room for discussion on the extent to which each issue can be classified as tame or wicked, there is no doubt that strategic planning emerges overwhelmingly as a wicked problem. Managers may feel that they understand strategy problems better than Fermat's Last Theorem, and that they could never remotely understand the solution to the Theorem; but in fact it is meaningless to compare the two types of problem because they are intrinsically different.

For example, consider the case of a company that is losing market share. What is the root cause? The type of argument and suggested solutions that might be submitted by different managers are as follows.

Manager	Argument	Solution
Marketing manager	The product is no longer sufficiently differentiated compared with competitors so customers are no longer willing to pay our price	Reduce price
Production manager	The marketing department does not give us sufficient warning to meet orders	Improve communications
R&D manager	Not enough has been spent on development in the past few years at a time when competitors have been improving their products	Spend more on R&D
Finance director	Because of falling profitability it has been necessary to economise and it was decided to cut back R&D rather than attempt to slash budgets across the board	Reallocate resources
Accountant	Funds could be obtained if investments were financed by borrowing instead of by retained earnings, which have largely disappeared	Borrow from the bank
Strategist	Falling market share is a symptom of a deeper problem, which is that company management is reactive and unstructured	Company management is both the problem and the solution

This discussion, variations of which occur repeatedly in real life, touches on all eight Rittel properties. There is no agreement on formulating the problem (1). Each formulation suggests its own solution: lower the price, increase R&D expenditure, borrow money, or whatever; but if the strategist is right, then understanding the problem is the solution (2). None of the suggested solutions provides a full answer (3). It is not possible to test which solution will solve the problem (4). There is no agreement on how the problem can be solved (5). The strategist claims the problem is a symptom (6). There is only one opportunity for action before the company goes bankrupt (7). The set of circumstances facing the company is unique in its experience (8).

It was stated earlier that there is no agreement among executives or academics about the definition of strategy. Given the intractable nature of many business problems this does not now appear surprising.

1.2.5 The Origins of Strategy and Tactics

The roots of the word 'strategy' lie in the Greek *strategos*, meaning a general, *stratos* meaning an army, and *agein* meaning to lead. Some dictionaries define strategy as the planning and implementation of military campaigns; its meaning has widened in common use to include activities such as gaming and business, in which planning and the implementation of plans are undertaken. In the expression 'strategic planning' the term 'planning' is therefore tautological, since it is already included in the concept of strategy. Despite the tautology, the term has now been accepted in general use, particularly in business schools and in the literature relating to strategic activities in business. Given the origins of strategy, it is not surprising to find that many of the ideas of military strategy have been carried over to business strategy;

these include setting objectives, identifying strengths and weaknesses, organising resources accordingly and evaluating outcomes.

Tactics is a notion which is closely related to strategy. Again, the meaning can be clarified by the Greek roots: *taktikos* meaning fit for arranging, and *taktos* meaning ordered. The military definition relates to the science or art of manoeuvring in the presence of the enemy. Thus, in the military context, strategy is deciding what is to be done, and tactics is deciding how individual objectives are to be achieved.

The attempt to transplant these military ideas into business has led to some degree of confusion. The basic reason for this is that running a business is not truly analogous to fighting a war, although there are many similarities in a competitive environment. Figure 1.1 is by no means definitive, but it gives an impression of the difference between military and business strategy.

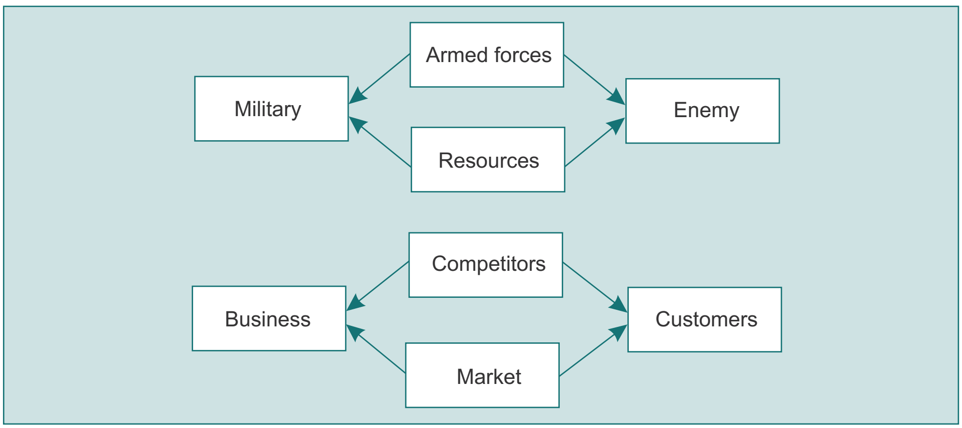

Figure 1.1 **Business and military strategy**

The primary objective in military strategy is to defeat the enemy, and this is done by direct attack on the enemy's forces and/or by destroying the enemy's resources. However, in business the objective is to get people to buy the company's products and make a profit in so doing. The company does not attack competitors directly in the sense of killing their sales forces and burning their factories. The path to success lies in activities such as capturing market share and controlling costs. This may lead to the weakening of competitors, but their destruction is not a precondition of success; competition never really goes away, and the manager who thinks that the removal of a major competitor will permit profits to be made without interference does not really understand the market place. There is always the possibility of new competitors appearing.

In practice the difference between strategy and tactics is not clear cut in the business context, and the term strategy tends to be used in relation to any action with long term implications. Decision makers usually tend to think in terms of formulating strategies to achieve objectives decided at the level above them. Thus in business strategic planning is a combination of strategic and tactical decisions, and it is probably pointless to attempt to distinguish between them. Given the imprecision of the terminology, and the activity itself, it is not surprising to find that various terms are used to describe the process: they include strategic management, business strategy, business policy, corporate planning and long range planning.

1.2.6 Strategy and the Scientific Approach

The social sciences are concerned with analysing and explaining human behaviour in the areas of economics, behavioural relationships, social interaction, and so on. The business disciplines are largely concerned with applying the methods of the social sciences to the running of companies. For example, the idea of economies of scale originates from economic theories relating to the combination of the factors of production, and has been subjected to a great deal of empirical testing. It is well known that economies of scale can lead to lower average costs, possibly up to some point beyond which costs no longer fall; however, the theory underlying economies of scale is quite subtle and does not lead to the expectation that decreasing average cost with size will actually be observed even in those industries where economies of scale exist. This is because of the concepts of short run and long run adjustment to different levels of output; economies of scale will only be observed where firms have made 'long run' adjustments to their factor inputs. As a result, it is necessary to take a sample of firms in order to carry out statistical analysis because, for any given size of firm, there is likely to be a range of unit cost; the statistical analysis takes account of the random variations from the underlying relationship between size and unit cost.

Those who have been trained in science will recognise elements of what is known as the scientific method in the description of how economies of scale might be estimated: a theory is developed based on ideas relating to costs, a hypothesis is derived from the theory (i.e. something which can be tested), data are collected, subjected to appropriate analysis, and the hypothesis is accepted or rejected. This rigorous approach appeals to the ordered mind, and is usually used as a benchmark as to whether a subject ought to be deemed scientific. Disciplines are often (explicitly or implicitly) ranked according to where they lie on the scientific spectrum on the basis of whether the scientific method is applied. Physics lies at the top end of the scientific spectrum and the social sciences lie near the bottom and above the arts; among the social sciences economics is typically regarded as the most scientific. But it is important to be aware that philosophers of science do not agree on what the scientific method actually is. It is not necessary to go into the subject in detail, but a brief outline of the main strands of thought gives an impression of how scientific thinking itself has developed.

The best-known view, advanced by the philosopher Karl Popper, is that hypotheses or theories can only ever be falsified; it is impossible to verify a theory because the possibility that it might be falsified always exists. The trouble is that, by the same token, it is not possible to falsify a theory either, because the reverse is also true. In other words, it is never possible to arrive at a definite answer on the basis of the evidence available. A wider view, associated with Kalakos, is that it is not the testing of individual theories that is important, but the overall research programme; individual projects only have relevance in the context of the programme and there is no such thing as falsification. Finally, a contrary view expressed by Feyerabend is that the scientific method is unduly constrictive, and the major discoveries have not been made as a result of following it. In fact, this view holds that discoveries are much more the result of lateral thinking and chance events, and that subsequently they are made respectable by framing the discoveries in the scientific manner. Thomas Kuhn pointed out that the prevailing mode of thought, or scientific paradigm, determines what is thought of as science, and the paradigm itself is subject to change over time. The scientific paradigm that the earth is flat and is orbited by the sun was only overturned after a great deal of controversy; similarly, the scientific approach outlined above is just a paradigm of thought, and is not even rigorously applied in physics, a discipline in which there is a great deal of speculative thinking.

It is intuitively attractive to apply the scientific method to strategy making and, by following the approach used to estimate economies of scale, identify criteria for effectiveness which can be applied in a variety of circumstances. But when attempting to apply the scientific method to the question of what course of action is likely to lead to success for a company, we are faced with several intractable problems.

- As indicated above, there are different views on what strategic planning actually is; for example, many studies have attempted to measure the impact of planning systems on company performance, but planning systems and strategic planning are not necessarily closely related.
- The types of company, the environments in which they operate, and the problems facing them, are so different that it is difficult to do more than draw general similarities among companies and situations. In other words, the range of variables which would have to be controlled for is enormous.
- There may be significant interactions among variables; for example, economies of scale may only occur in certain circumstances, and the use of company size on its own as an indicator of potential economies of scale may be misleading. Another way of expressing this is that the company as a whole is more than the sum of its individual parts, and undue emphasis on disaggregating the functions and characteristics of a company can obscure the overall picture.
- Companies and their markets change with the passage of time, and combined with the inevitable lags between actions and outcomes, it becomes impossible to disentangle cause and effect. In other words, it cannot be inferred with certainty that a company succeeded either because it made the right decisions or because circumstances turned out to be favourable in relation to what it did. It is easy to fall into the trap of *post hoc, ergo propter hoc*, i.e. the fallacious reasoning of being *after* this, therefore being *because* of this.
- The wicked nature of many business problems means that the scientific approach cannot be applied (testability, reproducibility, replicability).

So there are two levels of problem in trying to find out anything about the real world. First, the scientific method cannot provide definite answers; at best it is a rigorous approach which identifies the necessary steps in an investigation. Second, the data available in real life do not make it possible to test hypotheses about strategy.

The problem of dealing with large numbers of interacting variables subject to lags is not unique to the analysis of strategic planning; research into education is another example where student, teacher and social characteristics are notoriously difficult to measure, and interaction effects between teachers and students are likely to be important. Researchers have to make a choice between two approaches to educational studies: concentrate on relatively few institutions in depth, or carry out a large-scale survey on many institutions. The large-scale study cannot take into account as many variables as the in-depth study, and may omit many potentially important variables; furthermore, those variables included in the study may not be the most important but merely those most susceptible to measurement. However, the results obtained in the large-scale study are likely to be of general applicability; while the small-scale study can take into account many more variables the results cannot be generalised because they may be particular to the cases studied. There are therefore costs and benefits associated with both large-scale and in-depth methodologies.

Research into strategy is dominated by the in-depth approach, which means that any prescription for 'best practice' strategy is usually corroborated by reference to relatively few cases. A feature of the strategy literature is that it is heavily spiced with anecdotes, and evidence in favour of hypotheses comes in the form of what is sometimes known as *casual empiricism*. But if there is no scientific proof in favour of different courses of action, how is it that experts in strategy command very high fees for telling companies what they should be doing? To some extent there is a degree of fashion in strategy advice. There is no doubt that experts have offered different prescriptions for strategy approaches: that consistency of delivery is the key issue; that striving for higher quality is a major success factor in its own right; that diversification is an essential aspect of company growth; that company success depends on the identification and exploitation of core competencies; that internationalisation is the engine of growth; that a strong home base is a prerequisite for international success. The scientifically trained may find it puzzling that so much credibility is attached to prescriptions which have no empirical foundation. On the other hand, managers point out that they have to operate in an environment in which the scientific approach cannot be applied, that the anecdotal approach is better than nothing, and it is necessary to use what we do know in order to introduce rationality into decision making.

One of the best-known attempts to identify the company characteristics which lead to strategic success is contained in the book *In Search of Excellence*.[9] The authors' quest for the characteristics of excellent companies was based on a non-random sample of 43 US companies which fulfilled stringent market conditions for success; these included three measures of growth and long term wealth creation over a 20 year period, three measures of return on capital and sales, and the view of industry experts on the company's innovative track record. With the resources at their disposal it was possible to interview 21 of the companies in depth, and conduct less intensive studies on the remainder. The research identified eight attributes which characterised the excellent, innovative companies as defined. Without going into the details of these attributes, the authors acknowledge that 'Most of these eight attributes are not startling.' They also acknowledge that the eight attributes were not present to the same degree in all of the companies studied; however, the authors claimed that there was a preponderance of the eight in each company, and that the general traits of the companies were obvious. This is something which we have to take on trust. The point here is not to criticise the research, but to use it as an example of how difficult it is to find out anything from the experience of actual companies.

The authors also acknowledge that they cannot guarantee that the companies will remain in the excellent category, but they do maintain that these companies will cope with adversity better than companies which do not have their attributes. This brings us to the logical problem in interpreting the research findings: the companies were defined as being excellent on the basis of being good market performers and having a good innovative track record; another way of looking at this conclusion is to say that successful companies stand a better chance of being successful in the future, and the attributes identified in the research may have little to do with future success. It does seem rather odd that *all* of the excellent companies exhibited the identified attributes; there is clearly a danger here of having identified companies as being excellent on the basis of the attributes in the first place, because that was what the researchers were looking for. Because business conditions are continually changing, it is difficult to falsify or verify the authors' claim of continuing success; there is no doubt that the 43 companies in the study have gone in different directions: Wang Laboratories failed as did Digital Equipment, and General Motors' market share in the US dropped from 55 per cent to 25 per cent, the company losing $4 billion in 1991; on the other hand companies such as Disney Productions have continued to be highly successful. But this is not the whole story, since Disney found it extremely difficult to transplant its successful US operations into France – the troubled history of Euro Disney is discussed in Practice Final Examination 2.

An important issue is whether they have performed, and will continue to perform, as a group better than companies which did not exhibit the excellent attributes; this would be the subject of another research project. On balance it seems that the research did not identify all the attributes of successful companies, nor can we be confident that those which it did identify were relatively important. For example, it may be that the history of these companies since 1982 can be explained by changes in competitive conditions, and the degree of competitive edge conferred on them by the identified attributes had only a minor impact on their performance.

An attempt to determine whether strategy making processes rather than other company characteristics make a difference to company performance was carried out by Hall and Banbury.[10] This was a large-scale study which obtained responses from over 300 companies, and it is interesting for the light which it sheds on the problems of carrying out research in the area rather than in the statistical findings themselves (which are hedged with qualifications because of the limitations of the study). The objective of the study was to concentrate on whether a strategy process was followed rather than what it was; for example, the split between the rational and the incremental approaches was considered too simple to be useful. What the authors considered important was the accumulation of strategy skills over time, or the development of a strategy making process capability; this is clearly a subjective variable and is open to interpretation based on the information provided by the respondents. They pointed out that the one variable which cannot be used as a performance measure is current profitability, because of lagged effects; this means it is necessary to use measures such as new product development, innovation, social responsiveness and growth, all of which are also subject to subjectivity and may be irrelevant in certain cases. By and large, it was found that strategic process capability counts: that the more firms in the study were able to develop competence in multiple modes of strategy making processes then the higher their performance. But the authors make a telling point which makes it impossible to draw specific lessons from the study: the direction of causation may be the other way round, and it may be that successful firms adopt processes which accord with the definitions of strategic process capability. This is a particular problem when looking at a cross section of companies at one time, where it is not possible to pursue the dynamics of strategy making and performance. So even a well specified and conducted study which produces statistically significant findings may contain little more than a description of the way the world is.

The main problem in trying to relate cause and effect is that strategy is also concerned with the behaviour of competitors. Decisions are not only taken in the context of unpredictable outcomes, such as market growth and the business cycle, but have to take into account confrontation with other companies, each of which is trying to achieve a competitive advantage. If one company is capable of carrying out an analysis of market conditions, it stands to reason that other companies can do so also, and may well have exactly the same information at their disposal. Strategy decisions may then become something of a guessing game, where managers attempt to predict what competitors will do rather than analyse options derived from financial and economic appraisal. As a result an elaborate and sophisticated strategy based upon the latest thinking in the business disciplines may be associated with failure because a major competitor did something totally unexpected. Another way of looking at this is that strategy is about the **unknowable** as well as the **unpredictable**.

This account is by no means a full review of the research that has been carried out in this field or the continuing research programme. But it serves to demonstrate the intractable nature of research in the strategy area and why the research has little impact on practising managers: it is virtually impossible to prove or disprove any hypothesis relating to strategic decision making. You may wonder why, in that case, anyone would bother to carry out academic research in such a potentially unrewarding area. In the academic arena the fact that it is difficult does not mean it is not worth trying to understand how the world works; at the very least, appreciating the insights into the difficulty of testing hypotheses provides managers with a perspective on which to judge unsubstantiated assertions made by business gurus who charge very high fees for extolling platitudes.

It is not usually appreciated how the lack of an appreciation of the scientific approach affects everyday discussion and decisions. For example, the board of directors of a large company enrolled the services of a world famous business guru to advise on the appointment of a new CEO. The guru advised that the main characteristic of the new CEO should be decisiveness because the previous CEO had allowed the focus of the organisation to become blurred. So the hypothesis underlying this assertion is that there is a causal relationship between decisiveness and company success. The following demonstrates the sequence of steps that could be taken to determine the truth or otherwise of the assertion.

Start by framing research question	*Does a decisive CEO lead to success?*
Is the converse true?	*A non-decisive CEO leads to failure*
Since this is not necessarily true qualify the statement	*A decisive CEO leads to higher success than a non-decisive CEO*
This is too deterministic: qualify further	*A decisive CEO has a higher probability of success than a non-decisive CEO*
But the conditions need to be controlled	*A decisive CEO leads to a higher probability of success than a non-decisive CEO, all other things being equal*
Is this a testable hypothesis?	*Necessary to measure variables*
Define terms	*Decisive; Non-decisive; Success; All other things*
How do you achieve all other things being equal?	*Collect masses of data*
Which direction is causation?	*It could be that success makes leaders appear to have been decisive*
Consider a functional relationship	*Success = f(decisiveness, price, competitors, first mover, etc.)*
Rittel	*It may be a wicked problem not amenable to this kind of analysis*
Anything can be 'proved' depending on the use of evidence	*Select variables, measurements, specification, lags, statistical techniques, etc.*

By the time these steps have been worked through it is obvious that the original statement is no more than an assertion and does not lend itself to systematic proof. In fact, using any of the steps to frame a question is probably sufficient to expose the weakness of the argument. For example, a Director could ask the guru 'Can you define your terms?' or 'What is the direction of causation?' A major benefit of understanding the scientific approach is being able to ask the right questions.

But this is not the end of the story. The advice was based on lack of organisational focus, so is the real causation that decisiveness leads to increased organisational focus leads to success? We now have two research questions instead of one, with the link between decisiveness and success becoming increasingly tenuous. This is an example of Rittel's property 6 – we are having difficulty identifying the root cause. This analysis provides additional insight into why strategy discussions tend to appear haphazard; for example, there are unrecognised hypotheses and terms are not defined.

1.2.7 Strategic Planning and Strategic Thinking

So far we have seen that strategic planning is a complex activity, that it has many definitions, that there are at least three different approaches to strategy, that strategy has the characteristics of a wicked problem, and that the scientific method cannot be applied to strategy. By this time you might well feel that we have not been able to pin down exactly what strategic planning is, but all is not lost. We can in fact arrive at a useful definition of what strategic thinking is about.

It emerges from the discussion in Section 1.2.2 that functional specialists tend to regard business issues from their own perspective. Take the case of a new product launch. To the organisational behaviour manager a new product launch means internal change and its management; to the marketer it means market research and consumer behaviour; the economist is concerned with whether it is the right time to be investing in expansion; to the accountant it means break-even analysis; to the financer it means discounted cash flow and the rate of return; to the project manager it means making time, cost and quality trade-offs. Therefore to visualise the implications of a new product launch for a company it is necessary to synthesise the business disciplines.

To complicate matters the fact that business problems are wicked means that they tend to be loosely defined and it is not always clear what the problem is and it is never quite clear whether a satisfactory solution has been arrived at. A company may embark on change for a variety of reasons; at one level it may be because it seems like a good idea to launch a new product, while at another level the company is at a stage when it needs to diversify its portfolio because its existing products are nearing the end of their product life cycles. Furthermore, the competitive environment is dynamic and constantly changing, with the result that yesterday's answers may be overtaken by today's competitor reactions. This means that it is necessary to bring very high-level evaluation skills to bear in choosing among competing courses of action.

So at this stage we have identified two skills which are fundamental to strategic thinking: synthesis and evaluation. These two skills can be plotted as in Figure 1.2.

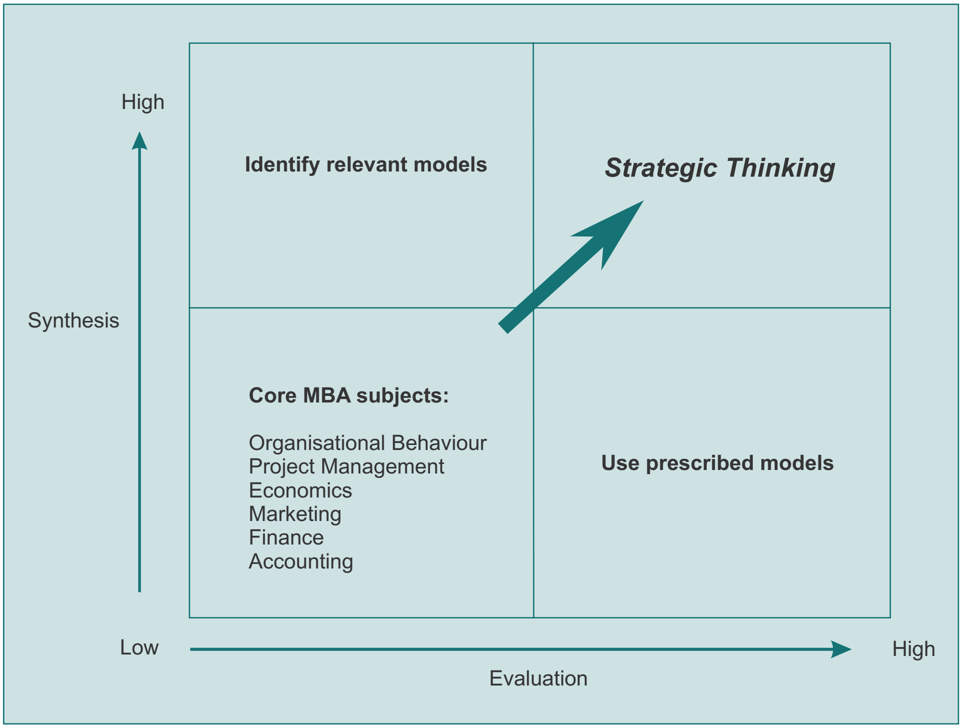

Figure 1.2 **Strategic thinking**

Subject specialists are able to synthesise and evaluate in the bottom left hand corner within the context of their own disciplines. The trouble is that a strategic problem cannot be resolved by the application of only one business discipline. The strategist's job is to bring these together (moving up the vertical axis) and identify the relevant models to apply to a particular issue. That is why it is necessary to have a sound knowledge of the core business disciplines before undertaking the study of strategic planning.

The strategist then has to weigh up the pros and cons of potential courses of action and arrive at a reasoned conclusion (moving along the horizontal axis). Thus the strategist has to think more widely and deeply than the individual functional specialists. This is an extremely difficult game to play and it goes without saying that unless you practice you will never get into the top right hand box. This course provides the structure within which the disciplines can be synthesised and evaluation skills developed.

1.3 The Process of Strategy and Decision Making

Strategy decisions are by their nature complex, and involve many imponderables. The selection of a course of action depends on the availability and interpretation of information, analysis, intuition, emotion, political awareness and many other factors. Different individuals and groups emphasise different aspects and, in the sense that a strategy decision is an advance into the unknown, there is no correct course of action; all that can be done is to interpret the current situation, form expectations about the future, and act according to personal views on risk and the likely course of events. It is usually possible to identify courses of action which are unlikely to be successful, and in that sense understanding the strategy process can have real benefits in helping to avoid disastrous courses of action. It must be stressed at the outset that it is naive to suggest that strategy decision making can be expressed in a mechanistic fashion, where the optimum course of action is identified solely on the basis of an analytical investigation. However, it would be defeatist to conclude that strategic planning is not susceptible to structured analysis.

1.3.1 Strategy Dynamics

It is important to stress from the outset that strategy problems cannot be analysed and resolved and then more or less forgotten about. In real life the day never comes when strategy decisions are made and all problems are solved. This is because the environment within which the company competes is constantly changing: products move through the life cycle; new companies enter the market; consumer preferences change; government regulations change; major political events alter markets both domestically and internationally. Thus the functional view of management, i.e. the view that there is a set number of objectives to be tackled by individual managers which, taken together, determine the effectiveness of the company, is a limited interpretation of the strategy problems which companies face. Strategy can only be properly understood in a dynamic rather than a static setting.

It is only relatively recently that scientists have discovered the peculiar properties of complex interdependent non-linear dynamical systems. The best-known examples are in weather forecasting, where the models are so complex that changes in the inputs have unpredictable effects; in fact, the patterns over time produced by such systems are highly sensitive to initial conditions. It was discovered that a great deal of what was thought to be random was in fact deterministic but chaotic, in the sense that it could be described mathematically but exhibited what appeared to be random behaviour. This led to renewed interest in modelling the behaviour of the stock market, the behaviour of which has always defeated attempts at prediction. Needless to say, this has not been at all successful (or if it has been no one is saying). A company can be regarded as a complex dynamical system interacting with its environment; this can be modelled in such a way that relatively small changes in the environment will at times cause significant changes in company performance. If the performance of companies is chaotic it is impossible to model them or to predict their behaviour; the firm itself can be regarded as a complex adaptive system which attempts to develop rules which will enable it to function in the complex environment. At first, this might seem to be a bit theoretical, but it is as well to bear in mind the possibility that the business system itself is possibly not capable of being explained or predicted because of dynamical effects.

To pursue the dynamic dimension of strategy the following example examines the process by which a Mythical Company arrives at a strategy decision. It is not derived from a specific 'real life' company example because it is designed to bring out many facets of strategy without relating it to a specific case; it is partly based on discussions monitored in management groups running simulations of companies and analysing company cases.

The CEO of this Mythical Company is cast in the role of strategic planner, and every day he comes into work he asks himself questions like the following:

- How well are we performing?
- What should we be doing in the future?
- How can we achieve successful change?

1.3.2 The Mythical Company

The company is engaged in the production of electrical components for both consumers and companies. It has been in existence for five years, and currently produces three products which are related to each other both in their productive and market characteristics (Plugs, Switches and Fuses). Current sales amount to about $350 million per annum, and the company employs about 300 people. Of these, 250 are employed in manufacturing, and the remaining 50 in research, development, administration and marketing. The company is organised into three product divisions.

From now on we follow the CEO as he pursues his role in strategic management by tackling his three questions.

1.3.3 How Well Are We Performing?

CEO'S STATEMENT TO THE BOARD

> The company has been making a profit for the past three years, but there are signs of increasing competitive pressures in existing markets; the research department has some products under development which at this stage seem to have the potential to generate profits, but might entail some change of direction. The first step is to get reports on current activities from each functional area in the company; these reports should be expressed in non-numerical terms because we are concerned with the overall view at this stage rather than the precise details.

ACCOUNTING REPORT

> The company is currently making 14 per cent return on assets. But the Plug, which was launched last year, is currently making a negative contribution to overall performance, and profitability would be increased by abandoning it. While our overall operating surpluses generate a good return on assets, our cash flow position is not good because of current expenditure on research and development. Are we convinced that there is a long term payoff from continued expenditure on research and development at the current level?

RESEARCH AND DEVELOPMENT REPORT

> We currently have four products under development which will be ready for launch in the next year. These will complement our existing product lines, and one of them represents a major technological breakthrough. Furthermore, we

have a highly productive team engaged in the search for new ideas, and we are confident that we shall continue to produce a stream of potentially profitable prototypes in the future; these are, after all, the life blood of our company, since without new products we shall not last very long. The company should not adopt a short-sighted and restrictive approach to our budget.

MARKETING REPORT

We are in a highly competitive market, and the product life cycles are quite short, and may become shorter in the future. We have two cash generating products in the Switch and the Fuse, and a potentially profitable product in the form of the Plug. At the moment the Switch and the Fuse are subsidising the Plug, but the prospects for the Plug are very good in the longer term; we cannot make decisions on abandoning the Plug on the basis of its historical contribution. It is essential that we not only keep the Plug on the market, but that we continue to search for new products. We need to increase our product portfolio if we are to accommodate the combination of life cycle effects and increased competition. However, we should be wary of diversifying into areas where we have no experience of selling, and where production skills may be different. While market shares are reasonably secure for the Switch and the Fuse, our technological advantage in both has been undermined by imitators from abroad; it looks as though we can expect the selling price of both to fall by about 20 per cent over the next couple of years as competition intensifies.

FINANCE REPORT

The marketing department has provided projections of demand for the four products which are in the development stage, and the accounting department has provided details of likely cost. A detailed financial appraisal suggests that only two of the four projects currently being developed seem capable of generating an adequate rate of return. Development of the two poorest products should be abandoned, and we should devote more resources to basic research, i.e. to identifying new market opportunities. The marketing department has pointed out the problems of moving into new markets; however, there may be some advantage to diversifying our portfolio of risks.

ECONOMIC REPORT

The economy has been in a depression for the last couple of years, but the government's more liberal monetary policy seems likely to cause a substantial stimulus to economic activity. In fact, if the economy had been in better shape we would have been more profitable than we have been. We should be looking forward to buoyant demand in most sectors during the next year. However, the international sector has become increasingly uncertain. It is likely that the currency will depreciate and this would be to our advantage in export markets. However, there is a move towards protectionism which could have serious consequences for our sales in some countries.

PRODUCTION REPORT

We have not coordinated production and orders very well, and we have built up substantial inventories of Switches and Plugs, while we have backlog orders for Fuses. We should be diverting resources to the production of Fuses at the expense of Switches and Plugs. However, if we switch manpower about we may adversely affect productivity. It may be more cost effective to sacrifice sales of the Fuse because of the increase in unit cost which would result from reducing, even temporarily, output of the Switch and Plug. Furthermore, I have some reservations about the accounting department's conclusion that the Plug is a liability; we have been producing a substantial proportion of output for inventory; the problem is not that we are incurring high production costs, but that we are not actually selling what we are making. We currently have a poor system for communicating production requirements.

MANPOWER REPORT

We have now developed a skilled and motivated labour force, and this is reflected in the fact that unit labour costs are now 10 per cent lower than they were three years ago. We have been able to provide stable employment for the labour force and a general feeling of confidence in job security with the result that the attrition rate is minimal.

CEO'S SUMMARY

We now have information on which to base an analysis of our strengths and weaknesses. Our strength is that we have carved out profitable markets for two products, and there are some signs that our third will make a contribution to profits in the future. We have a company which has a structure and workforce which provides us with a potential cost advantage; we also have a productive research department. We have some internal weaknesses, such as the fact that we are not always coordinating production and sales, with consequent inventories and backlogs. Our main weakness is external; there are ominous signs that competition is increasing in our established markets and if we wish to grow it may have to be in a different direction. We may not be equipped to do this.

1.3.4 What Should We Be Doing in the Future?

CEO'S STATEMENT

There are three broad strategies which we could follow. First, we could carry on doing the same things as in the past, and accept that our markets are likely to come under increasing competitive pressure. We can rely on the invention of new products to carry us into new markets as the old ones disappear. Second, we could attack our existing markets more aggressively, attempt to maintain or increase market share, and accept that this will lead to short-term reductions in profitability. However, over the longer period this has the potential to pay off. Third, we could combine the second option with expansion into new markets to diversify our activities. I have had some informal discussions with Easy Turbines, who would welcome a friendly takeover because of their cash flow problems. This would give us a relatively painless entry into the turbine market, but carries the risk that we do not know much about making turbines or the turbine market. However, this will provide us with a basis from which to grow in the longer term. We now require a report from each functional area on potential future courses of action.

RESEARCH AND DEVELOPMENT REPORT

Given the four products we are currently developing, and the number of ideas which we have for prototypes, we see the possibility for significant diversified expansion in the medium term. All we need is an additional $5 million over the next year to speed up the launch of our development projects.

FINANCE REPORT

Our colleagues in research are being a bit optimistic, because only two of the products they are working on seem capable of generating a positive NPV at the current cost of capital, even on the most optimistic marketing estimates. Furthermore, we have not been explicit enough in the past in relation to the measurement of risk, and our attitude to risk taking. The risk adjusted rates of return suggest that we should stay in the markets we have already developed, and only venture into new ones as a last resort. However, the fact that Easy Turbines has cash flow problems at the moment means that we might be able to acquire it at a bargain basement price.

ECONOMIC REPORT

The prospects for the economy are good, and profitability will increase next year even if we do not change our current marketing strategy. However, it is likely to be difficult to increase market shares because the price elasticity of demand for our products is quite low. The new products should be highly successful on launch, because they are mainly aimed at export markets and there are signs that the currency is going to depreciate significantly in the next few months. Longer term prospects will be partly dependent on diplomatic solutions to increased protectionism.

MARKETING REPORT

There is a limit to how long we can stay in our established markets. Our Cash Cows could come under competitive attack at any time. We need to diversify to stay alive in the long run, and the four products which the research department have on the stocks would fit the bill perfectly. Some of them may not seem financially attractive, but the financial analysis takes a very narrow approach to the benefits of developing a new range of products. I am not sure about the proposal to enter the turbine market through acquisition because at this stage I do not know much about that market. I would like to know if Easy Turbines' cash flow problems have been due to sales problems.

ACCOUNTING REPORT

If we try to follow a strategy of diversification we shall quickly run out of cash, because the pay back period of the new products on the stocks is quite long, even assuming that the marketing department is not being overly optimistic in relation to expected sales. Furthermore, the measures of return on investment and capital employed will be adversely affected, and this is likely to affect our share price, perhaps making us susceptible to takeover, never mind us taking over Easy Turbines. I think the idea of taking over another company is far too speculative and is not a realistic option.

PRODUCTION REPORT

At the moment we have spare factory capacity, and there is no problem in recruiting more labour, given the current state of employment in the local area. However, if we do embark on expansion into new products we shall have to undertake a major training programme.

MANPOWER REPORT

Any attempt to diversify must take into account that an infusion of labour, and a change in what people are doing, may have substantial implications for morale. The attempt to exploit new markets will require a change in what people do, and we shall have to ensure that we have the backing of the complete workforce to achieve success. There is little doubt that we shall be faced with many problems in implementing a growth and diversification strategy, and we may be faced with much higher attrition rates and lower productivity growth than in the past. In this situation there is a real productivity payoff from better communications, incentives geared to performance, and the development of a company culture.

CEO'S SUMMARY

The immediate threat facing us is that we are in danger of isolating ourselves in declining markets where competition is becoming increasingly fierce. The potential threat facing us is that if we decide on expansion we are moving into unknown markets which have a high degree of risk; this move may make us open to takeover. While we could pre-empt this by taking over Easy Turbines, I do not think the idea of diversifying through takeover is appropriate at this stage: as far as I know, the chances of such a venture being successful in the long run are not high – in any case it would take a long time to set up the financial infrastructure necessary even to think about making a friendly bid for a company.

However, there are clearly many opportunities. We have the resources to exploit our existing markets, and we have products which can be used to broaden our portfolio. The price of the company's shares on the stock market has been reasonably stable for some time. However, the board feels that our shares are undervalued, and that the market has not taken into account the recent relatively large expenditures on research and development. One of the board members recently received this confidential report on us from his stockbroker.

MARKET ANALYST'S REPORT

> This company displayed strong growth for the first three years of its existence. Since then it has tended to rest on its laurels, despite the fact that it is in a highly competitive and changing market. Recent expenditures on research and development have tended to depress profitability, and to some extent this has been reflected in the share price. But there is no guarantee as yet that the company management has the vision to maintain its current market position, or to diversify into related markets which will lead to continued growth.
>
> It is therefore time that we shed the image of conservatism and proved to the market that we have the ability to grow and generate profits in the long run.

There are clearly different views on what course the company should pursue. For example, the finance department is opposed to expansion because of reservations about the new products, but do think that an acquisition might be the way forward. The marketing department is in favour of expansion because of optimism concerning future prospects for a diversified company, and the economics department is in favour of expansion but has reservations about the marketing strategy. The CEO's job is then to arrive at a decision which will be supported by the functional managers, since without them nothing can be made to work; he must acknowledge the fact that while each of the functional managers is able to offer a reasoned exposition of how things are and what the company should do, each is preoccupied with his or her own viewpoint. You will notice that each functional manager tends to talk his or her own 'language'. If the CEO is not educated in management he might find some of the discussion baffling; for example, the marketing manager referred to product life cycles, the accountant to return on assets, the finance manager to a positive NPV, the economist to monetary policy and so on. In the course of a discussion like this each manager cannot keep asking the others to define terms. So in order to develop a strategy from the range of views it is essential that the full implications of what might appear to be innocuous statements are appreciated by everyone concerned, and in particular by the CEO who is charged with the responsibility of deciding what to do next. The process by which the decision is arrived at would be a story in its own right, but suffice it to say that the management team is persuaded by the CEO's vision of shedding the company's conservative image, and agrees to pursue an expansionary, diversified strategy but without attempting to acquire Easy Turbines.

1.3.5 How Can We Achieve Successful Change?

The CEO set the functional managers to work to prepare a programme for change. Based on their understanding of what needs to be achieved in their individual areas the team arrives at a five point plan.

1. Attempt to attain a higher degree of competitive advantage in existing products and step up research and development efforts.
2. Improve resource planning by introducing 'just in time' techniques and co-ordinating more closely with marketing.
3. Improve market intelligence and improve economic analysis.
4. Introduce more rigorous control systems to monitor company performance.

5. Communicate company goals to everyone; develop an incentive system and company culture so that individuals can identify with the company's objectives.

The exact details of how the new company objective is attained will depend on how events unfold.

1.3.6 Strategy and Crises

Why do managers find it so difficult to get together to devise and implement company strategy? Part of the answer is that there are many pressing problems that must be dealt with on a day to day basis which divert attention from strategy, which is perceived as not bearing on the immediate problems facing managers. Imagine that the outcome of the strategy discussions is circulated on Wednesday. By Friday the following incidents have occurred.

CASH FLOW

A major customer has run into problems and will not be able to settle current accounts for six months. This means that cash flow for the next six months will be negative.
MEMO from Accounting Department to CEO. In view of the additional cash flow strains which the proposed strategy changes will involve, the strategy changes should be shelved.

JAPANESE INVASION

In a surprise announcement, the Japanese have revealed the development of an electrical device which will reduce market share of the Fuse by about 5 per cent, unless a strong marketing offensive is launched.
MEMO from Marketing Department to CEO. All marketing resources will have to be diverted to meet the Japanese challenge for the next few months; the strategy changes should be shelved.

HEAD-HUNTED

The finance director has been head-hunted.
MEMO from Finance Department to CEO. In view of the many complex financial issues which will be raised by the proposed strategy, we must have a finance director of experience and vision; until we can recruit a replacement the strategy changes should be shelved.

DEVELOPMENT COST OVERRUNS

Some unexpected problems have been encountered and the development department will not be able to bring the new products to the market within the original projected budget.
MEMO from Development Department to CEO. We need to re-evaluate our options but, given the turmoil in the Finance Department, this will not be possible for some time; the strategy changes should be shelved.

LABOUR RELATIONS

The first attempt at communicating the new strategy was disastrous. After a preliminary discussion labour representatives interpreted the proposed changes as an attempt to increase productivity at the expense of a deterioration in working conditions; the notion of a new incentive system was criticised severely.

MEMO from Personnel Department to CEO. It looks like it will take more time than we thought to sell the proposed strategy to the workforce; the strategy changes should be shelved until such time as we can achieve progress on this front.

No doubt more issues will crop up the following Monday, and will continue to emerge. The salient point is that even though the individual managers have agreed with the overall interpretation of the current state of the company and what it should be doing in the future, their own immediate concerns naturally appear to be more urgent than the implementation of a course of action which has no obvious short-term payoff. This is an example of one of the problems identified with the planning approach to strategy: *It is possible to forego short-term benefit in order to gain long-term advantage*. In this case it is turning out to be very difficult to make that trade-off.

The CEO now has several options.

- He can agree with his managers, and shelve the changes until times are more favourable; he will be aware that this is likely to be a fond hope.
- He can attempt to amend the proposed changes to take account of what has happened; in this case he will find himself attempting to hit a target which never stops moving.
- He can point out that the strategy is based on an agreed vision of the company as it exists and the necessity to adjust to the changing market place; the crises are evidence that the company does need a strong sense of direction so that management is not merely a series of reactions to everyday events. The job of the managers is to achieve the general objectives given that these crises are always going to occur.

But there is another way of looking at the problems which have arisen and the individual managers' reaction to them. The CEO decided on a course of action and set his managers the specific task of determining what should be done. But it seems that no one was given the job of determining how the five point plan would actually be implemented. Thus the CEO's approach was strong on identifying objectives and courses of action, but weak on implementation; as a result the overall plan was vulnerable to the types of crisis which occurred.

It must be accepted that no plan can be inflexible, and that it should be modified as additional information becomes available; the crisis events can be regarded as new information to take into account in refining the overall strategy. For example, the Japanese invasion is indicative of the fact that competitive pressures are changing more quickly than anticipated, and that some resources should be diverted to protecting the Fuse; where these resources should come from is a problem for the management team.

1.3.7 Elements of Strategic Planning

Apart from recognising that some degree of forward thinking is important, is it possible to extract any lessons of general applicability from what happened? The CEO asked various questions of the specialist managers, they generated a lot of information and opinions, and finally a course of action was decided on. In fact there are five aspects of what happened which are important to recognise. First, individual managers used a structure of thought to tackle problems within their area. Second, managers applied this structure to the analysis of data. Third, the CEO integrated the different types of analysis presented by the managers in order to arrive at a decision. Fourth, a control system was devised to monitor the allocation of resources. Finally, the door was left open to modify the strategy as events unfolded. These components of strategic planning are worth considering in some detail.

Structure

The first thing the CEO did was to ask functional managers to provide information on the current state of the company. He expected to get different information from each because the functional managers bring different types of expertise to the issue. For example, the finance manager used the theory of finance to evaluate alternatives; the marketing manager used the theory of competitive advantage to work out marketing strategies; the economist used macroeconomic theories to explain and predict the impact of government policies on product markets; the manpower manager used theories of group behaviour and motivation in drawing up work schemes. These theories provide functional managers with a **structure** within which to tackle problems. This structure is comprised of a body of theory which introduces order into the complexities of the real world; without a structure the answers which any of the functional managers produced could have been based on completely irrelevant factors, and this would not have been apparent. That is why it was noted earlier that each manager appeared to be speaking a particular language.

In order to make sense out of the complexity of life it is necessary to impose an intellectual structure on events and processes. A theoretical structure makes it possible to tackle new problems in a systematic manner; the lack of general principles which can be applied to seemingly different issues leads to inconsistency, and to an impartial observer decisions may appear to be taken at random. When there is no structure, managers will not appreciate that apparently different situations share common themes and are susceptible to similar types of analysis and solution. It is something of a paradox that while most companies would like to have a system for allocating resources in the long run, i.e. a means of seeing how things fit together, which potential opportunities should be pursued, and how resources should be mobilised to take advantage of them, it is not necessarily appreciated that this presupposes structured thinking. For example, everyone is aware that prices vary over time. But what is not always obvious is that **relative** prices often change significantly, because changes in relative prices are often masked by general price changes, i.e. inflation. A manager needs to be aware of the difference between nominal and real price changes, be able to identify where there have been significant changes in relative prices, and then be able to analyse the factors which have caused relative prices to change. For this it is necessary to have a theory of supply, demand and price determination.

An aspect of business which makes the application of structured approaches difficult is that the manager's average day is characterised by a continuous sequence of seemingly unrelated activities; many researchers have attempted to record and classify managers' daily routines with the objective of identifying what comprises efficient managerial behaviour. A general finding is that the effective manager needs to do more than provide fast, efficient reaction to events as they occur; it is also necessary for managers to have a structure within which priorities can be established and objectives identified.

The notion of a conceptual structure can be generalised from the individual specialities to the company as a whole. The lack of a structured approach to planning activities can lead to a reactive management style and arbitrary decision-making criteria. It is a common observation in business that individual managers become frustrated by apparently arbitrary decisions which do not relate to any overall purpose; decisions which may be unpleasant for the individual can be made acceptable if they are seen to occur within a recognisable framework. When it comes to making choices between competing alternatives, the absence of a structure within which to allocate resources can lead to the company developing a random portfolio of products; it is possible for the company to exist and grow indefinitely in such a manner, but it is continually faced with the prospect of being confronted by problems which might have been avoidable or predictable within an understood structure.

In the Mythical Company, the CEO imposed a general structure on the information presented to him by thinking in terms of the company's strengths and weaknesses, together with the threats posed by changes in market conditions and the opportunities existing in related markets. By balancing up these categories he arrived at his vision, or the strategic thrust which the company would follow.

Analysis

The information provided by the functional managers was in the form of **analyses** based on their individual areas of expertise. A structure is of little use in business unless it can be applied to real world problems. Many advanced economic theories comprise a powerful structure of thought, but they have no relevance to business because they cannot be used to analyse issues which arise in companies. In this case each functional manager analysed the information relevant to his or her part of the company's operation and came up with a variety of conclusions.

The structure of thought requires to be supplemented with tools and techniques of analysis in order to make sense of relationships and data. Information available in real life often appears to be conflicting, and at times downright useless: this can lead to the 'don't confuse me with the facts' syndrome. The ability to make sense of data and interpret statistics requires an understanding of basic concepts – in finance, accounting, economics and marketing – which enable data to be manipulated and events better understood; for example, why is it that when the price of gin rises the quantity of tonic sold falls and the quantity of whisky sold increases? The reason is that gin and tonic are complements, while gin and whisky are substitutes; when the price of gin increases relative to the price of whisky, some drinkers will substitute whisky for gin. Since gin and tonic are complements, the quantity of tonic purchased will fall with the quantity of gin purchased. The extent to which the quantities of gin, tonic and whisky purchased will change depends on the responsiveness of demand to price changes, otherwise known as elasticity.

Analytical techniques also help to identify what information is important and what is irrelevant; in modern life the problem is typically not the lack of information, but the lack of relevant information. For example, there is plenty of information available on the sales of gin, tonic and whisky over time, by geographical area, across different social groups, by brand and so on. But the really important information is difficult to obtain: the price elasticity of gin and the degree of substitution between gin and whisky.

Many managers take the view that management is an art rather than a science, and that concentration on data is counter-productive. It is, of course, naive to suggest that management problems can always be solved by recourse to numbers, and by statistical and financial calculations. However, rigour and analysis should not be confused with manipulation of numbers. Sometimes all that is available is qualitative rather than quantitative information, but this does not imply that analysis is irrelevant. For example, at the very least it is useful to know whether we are dealing with positive or negative quantities, such as whether cash flow is likely to be positive or negative; the rough order of magnitude may be all that can be concluded from available information, but even this can be useful in determining whether a project is likely to be within a company's resources. The non-quantitative analytical approach can help identify whether the balance of influences is favourable or not to a potential course of action. Always bear in mind that your competitors will also be trying to make as much sense as possible from available data so adopting a non-analytical approach could put the company at a serious disadvantage.

To summarise, the following issues have an important bearing on the analytical approach.

1. Do not confuse rigour with numbers.
2. Precision is not essential.
3. Data can be expressed as:
   - relative orders of magnitude
   - positive or negative
   - quantitative or qualitative

A rigorous approach to issues does not necessarily mean that numbers are involved; the use of theories and concepts to clarify problems and evaluate potential solutions can be independent of the precise numerical quantities. Conversely, the fact that numbers are presented as part of an argument is no guarantee of the rigour with which the argument itself has been developed.

All information about markets, finance and the economy is subject to a degree of error. This means that there is nothing to be gained by attempting to be highly accurate; while the appearance of several figures after the decimal point may impress the unwary, such precision is spurious. Rather than concentrating on the accuracy of calculations, there are some general issues to which attention should be paid when dealing with numbers.

- Whether the orders of magnitude suggested by the numbers are large or small in relation to the operations involved. If the relative magnitude of the numbers is small, the issue is of minor importance; for example, a marketing analyst may predict that the cost of introducing a new brand to maintain market share is around $5 million, but if the total value of sales is $385 million there is not much to be gained by attempting to be more exact about the figure of $5 million. It is sensible to avoid spending time refining relatively unimportant items of information.
- Whether the numbers are positive or negative; for example, is a market expected to increase or decrease in the future, or are cash flows likely to be positive or negative?
- Impressionistic or qualitative information has a role as opposed to numerical information. For example, a feeling that fashions were likely to change in the late 1980s as a result of the change in attitudes towards wearing animal fur could not be quantified, but it had important strategic implications for manufacturers of fur coats. A fur company which realised early on what was happening could have investigated the likely effect of, say, a 10 per cent reduction in demand for fur coats and decide whether production should be reduced immediately and inventories run down to a new level; it could also attempt to predict the effect on prices using its knowledge of demand and supply conditions in the fur market, and produce a forecast of the implications for cash flows. The company could also investigate the implications of a continuing fall in demand, or stabilisation of demand at the new low level, or an eventual return to original levels as manufacturers took action to counter the 'endangered species' argument. Compare the likely competitive position of such a company with one which made no preparation for the change in market conditions and suddenly found itself in a situation of unsold stocks, falling prices and cash flow difficulties.

This perspective on the effective use of information can help to throw light on the seeming contradiction between what theory says managers should do, and what they are actually observed to do. The theory suggests that managers should make careful use of information in analysing situations and arriving at conclusions. But the research reveals that managers have a tendency to rely on abbreviated and verbal accounts. The argument above suggests that in the first instance it is important for managers to determine the direction of change and the rough order of magnitude; in many instances the course of action which these suggest may be virtually unaltered by more detailed information which, because of the errors associated with information, may itself be suspect. As a result, there are likely to be significantly diminishing returns at the margin to the effort devoted to analytical detail. This leads to the paradoxical situation that the educated manager is able to identify what information is really required to deal with a particular issue, and the level of detail to arrive at an informed conclusion in an economical manner, but that this behaviour may appear to be shallow and impressionistic when observed by a researcher who concentrates only on identifying the use of detail.

Integration

In the example discussed above, the CEO was faced with a variety of analyses based on different structures. His task was then to **integrate** them; no single functional manager provided the perspective to decide which of the strategy options to pursue. The CEO added a vision of where the company was going and an overview of the information provided by the functional managers in arriving at a strategic thrust.

Each of the business disciplines has a part to play in developing the overall strategy; an important management skill is to recognise when specific disciplines can be applied, and to identify the tools and concepts relevant to different situations. It is not necessary for the manager himself to be able to carry out a financial appraisal or a marketing study, but it is necessary to be able to see when such studies are required, to understand them well enough to make constructive criticism, to visualise the relative importance of the various results, and to be able to fit the results into the formulation of strategy. The role of the individual business disciplines in successfully achieving a new product launch was outlined in Section 1.1. It is the manager's job to ensure that the appropriate techniques are applied at the right time, and the manager needs to be able to grasp the meaning of the diverse types of information which different techniques generate.

Integration is an essential component of strategy because specific recommendations in one area can have implications for other aspects of company operations. For example, a proposal to abandon a product may be based on a financial appraisal which suggests that the value of the company would be increased because the product is currently losing money; the financial argument needs to be weighed up against potential negative effects. The personnel department might argue that the effect on employee motivation and commitment could be serious because everyone feels that it is a 'worthwhile' product to make; the production department might claim that while the product has a poor accounting contribution it has helped to eliminate excess capacity in the past, and this is not reflected in the accounts; the marketing department might argue that the product is still at an early stage in the evolution of its life cycle and has a substantial longer term potential. The strategy problem is to incorporate and reconcile the implications of the specialist disciplines, which in this case suggest different courses of action.

Control

It was recognised by several functional managers that it was necessary to **control** performance. In the light of the many crises which the company would be facing, it was clear that it would be essential to attempt to determine how well resources were being allocated in the pursuit of the strategy goals.

In order to monitor the performance of the company it is necessary to devise measures which generate information on how well objectives are being attained. A variety of measurements can be used to evaluate company performance such as Return on Investment and Profit Margin, and the efficiency with which resources have been allocated can be judged by measures such as Asset Turnover, Contribution on Assets and Sales per Employee. While difficulties are often encountered in interpreting and reconciling aggregate measures of performance and efficiency, such measures serve the functions of providing an early warning of potential problems, and of identifying areas of potential concern. A further problem is that it is not possible to express all targets in quantitative terms; for example standards of service, corporate image and degree of product differentiation cannot be measured in ways which provide a clear indication of performance.

In a competitive environment absolute measures of performance are less important than measures relative to the competition. Studies have found that companies rarely set even their financial goals relative to competitors. A very good reason for the lack of competitively set benchmarks is the difficulty of obtaining information about competitors; but even if it is difficult to obtain relevant information, it is well worth the trouble. This is because industry-wide changes affect all firms, and by focusing on performance relative to competitors this distorting influence is minimised. For example, the absolute target of increasing return on assets by 2 per cent may be rendered impossible by an unexpected 10 per cent increase in raw material costs; if the target had been defined as achieving a return on assets 2 per cent higher than a major competitor the firm would be able to judge its reaction against the indication of best practice as achieved by the competitor.

Aggregate measurements of company performance cannot be used to provide guidelines at all levels in the organisation, and it is necessary to devise measures which relate properly to the objectives which have been set for individuals and groups. This is difficult to achieve in practice, and it is possible to end up with a set of performance measures which do not adequately reflect the efficiency with which resources are allocated at different levels in the company. There can be few more pointless activities than to censure departmental managers for not performing well on the basis of performance measures which are almost totally meaningless. In fact, the use of irrelevant performance measures can be counter-productive and have serious long term consequences for the company as a whole. In the short term, it is only to be expected that employees will become dispirited and lose their motivation if their efforts and successes are not reflected in measured outcomes; this has implications for productivity and innovative behaviour. In the longer term, the company is liable to misallocate its resources in striving to maximise misleading measurements of objectives. For example, evaluation of the sales force on the basis of growth in sales value may lead to a level of sales where the full cost of additional sales is greater than the additional revenue generated: capacity may be overstretched to meet the demand, service teams may be unable to support sales outside large cities, and resources may be diverted from product development. Thus while the sales manager is performing well in terms of his measure, managers in other areas such as production and support will find their performance measures declining.

Feedback

If a company does not monitor, react to and learn from feedback its strategies will quickly cease to be aligned with actual events. In the case of the Mythical Company, the CEO was immediately confronted with feedback on both internal and external factors, all of which had implications for carrying out the agreed strategy; he now has to make decisions on how to adapt to these changes. In the longer term the CEO would require feedback on the implementation of the strategy and measures of company performance.

An effective process which enables a company to react to changes in the environment is crucial for long-term success in a dynamic market setting. One of the fallacies of the planning approach to strategy identified in Section 1.2.3 was: *After careful analysis, strategy decisions can be clearly specified, summarised and presented; they do not need to be altered because circumstances outside the company have changed.*

1.4 Business and Corporate Strategy

It is useful at an early stage to draw a distinction between business and corporate strategy because the concerns of decision makers differ at the two levels. The firm upon which much economic theory is based is a single product entity operating in a well-defined market. But it is obvious that a large proportion of economic activity takes place in firms of various forms: some produce a range of outputs (horizontal integration), some produce not only the final output but several or all of the intermediate products (vertical integration), some market a given product in different ways in separate markets (Pepsi-Cola), some market the product in much the same way in separate markets (McDonald's). The diversity of forms can be simplified by looking at a firm as a 'corporation' of different activities, and focusing on the running of the corporation as opposed to the individual firms that comprise it.

In order to make the analysis manageable the corporate firm can be visualised as a group of strategic business units (SBUs) which are directed by a corporate headquarters. An SBU is an operating division of a company which serves a distinct product-market segment or a well-defined set of customers or a geographic area. The SBU is given the authority to make its own decisions within corporate guidelines.

The strategic questions addressed by SBUs include:

- What is the market?
- Which segments are products aimed at?
- What is the competition?
- Can a sustainable competitive advantage be achieved?

The strategic goals pursued by an SBU may be independent of other SBUs within the corporation. Indeed, those working in an SBU may be unaware that another company is part of their own corporation. Corporate strategy is therefore concerned with issues including

- determining the portfolio of SBUs;
- allocating resources among SBUs;
- developing new business ventures;
- appointing SBU CEOs.

While the concerns of corporate and SBU strategy differ there are many common themes, such as interpreting diverse information, allocating resources effectively, and reconciling the short and long term. A recurrent theme is the extent to which corporate structure adds value to the SBUs and whether the corporate entity is worth more or less than the sum of its SBUs independently. The rationale for having a corporate structure in the first place is that the costs of the corporate structure are less than the benefits which it bestows on SBUs, otherwise the break-up value of the corporation would be greater than its current value.

1.5 The Development of Strategic Ideas

Given the plethora of books about business and the apparent influence of business gurus it is natural to assume that companies are driven by modern ideas and theories about strategic planning. But it can be argued that strategic ideas have been the outcome of the evolution of companies in their economic environments.

The history of the corporation in Table 1.2 shows how the pursuit of value creation has led to changes in corporate strategies over time, and how ideas relating to corporate strategy have been greatly influenced by the outcome of previous strategic approaches. (This outline owes a great deal to Goold, Campbell and Alexander.[11]) The division of history into decades is an approximation to the time periods involved.

Table 1.2 Corporate history and strategic ideas

Decade	Strategic issues	Strategic concepts	Corporate strategies
1950s	Centralised control	Devolve responsibility	Divisionalisation
1960s	Maintain growth	General management skills plus Synergy	Diversification
1970s	Manage diversity	Portfolio planning	Balanced portfolio
1980s	Poor performance of diversification	Shareholder value	Restructuring
	Value destruction	Stick to the knitting	
	Hostile takeovers		
Early 1990s	Core business	Core competences Dominant logic	Linked portfolios Downsizing
		Parenting advantage	
Late 1990s	Globalisation	Economies of scale Global reach	Mega mergers
2000s	Knowledge	Identify and maintain tacit knowledge	Knowledge management

The following brief discussion touches on many issues that will be dealt with in detail later in the course.

Divisionalisation

After about the mid-1930s companies such as GM, Du Pont and Standard Oil had grown too large and complex to be managed with their previous functional organisation. The decentralisation of activities into divisions heralded the start of the distinction between business and corporate strategy. But the optimal level of decentralisation has never been established. For example, divisions (or SBUs) typically have the power to hire and fire, but this does not extend to the appointment of divisional CEOs and other senior divisional executives; divisions often do not have freedom of action over investment and major projects are usually referred back to corporate headquarters; sometimes marketing strategy is set centrally and sometimes it is left to the discretion of divisional CEOs. Thus while the concept of decentralisation apparently made large corporations more manageable it raised fundamental issues of control.

Diversification

It was during the 1960s that the notion of general management skills which could be used effectively in any business setting began to be developed, and was associated with the growth and development of the first business schools whose objective was to identify and teach the common core of business skills. By the 1960s the established markets of many large companies had entered the mature stage, and opportunities for growth were now perceived to lie in diversification of activities. This built on divisionalisation, and new companies were brought under the corporate umbrella as additional divisions (or SBUs). A compelling argument during this period was that the assimilation of different, but related, businesses under the corporate umbrella would lead to synergy. The quest for synergy provided a powerful rationale for diversification through acquisition, because it offered the promise of creating value beyond that which the business would have done were it left on its own. Synergy in fact turned out to be elusive; this ought not to have been surprising, because the benefits were based more on hope than on evidence (this is dealt with in detail in Section 6.12.2). The quest for synergy often led to value destruction rather than value creation, and this corporate weakness sowed the seeds for later corporate strategies. Another reason advanced for diversification was risk spreading (dealt with in Section 6.12.1); this was a questionable basis for corporate strategy because it spread management risk rather than shareholder risk.

As the number of takeovers increased, the forces of competition led to increased prices for acquisitions, and this reduced the scope for value creation. In fact, as takeover prices began to reflect not only the current but the potential value of companies, diversification often led to the destruction of value because companies were caught up in takeover battles, and ended up literally paying too much for their acquisitions. At the same time the notion of the generalist manager started to come under criticism: it started to become clear that 'management' could ***not*** be viewed as independent of the particular business, and the emphasis turned to the importance of focused skills.

Portfolio Planning

Economic conditions changed in the 1970s with slower national growth rates, recession, and historically high inflation: at the same time it was generally felt that competitive pressures had increased with advances in technology, reduction of trade barriers and the growth of the Pacific rim economies with the result that the market environment was much more complex and unpredictable than in the 1960s. The management of diversity was increasingly recognised to be a problem, and the search for a balanced portfolio of products led to the development of the portfolio approach to product management (dealt with in detail in Section 5.7).

It was now widely recognised that unless the corporate centre could identify value creating potential that had not already been realised and which had not been recognised by another bidder, the company would pay the full price of a takeover, including potential value increases. At the same time capital markets had developed to a level of sophistication far greater than in the 1960s, and the argument that a portfolio must include high profit products (Cash Cows) to pay for products which had still to generate profits (Stars and Question Marks) no longer applied with the same force; this is because in many ways internal financing is not more efficient than external financing. It is questionable whether an investment project which cannot satisfy external financiers should be funded by retained earnings; it is reasonable to ask whether shareholders would be willing to invest their funds in an internal project rather than in some other company which offers a potentially higher return.

Restructuring

The inability of many companies to manage and add value to diverse portfolios led to takeovers by corporate raiders who saw opportunities for releasing value from failed corporate strategies. This development was largely confined to the US and the UK partly because of their more developed capital markets and the independence of corporations from banks. The scale of the takeover strategy was staggering: in the US in 1988 over 2000 companies were acquired with a total market value of over $850 billion. The takeover battles made the specialists into household names: Goldsmith, Milken, Kravis and Boesky (who went to jail) in the US, Hanson and White in the UK (both of whom were rewarded with the title of Lord). The excitement of these times was captured in the film *Wall Street* in 1987 starring Michael Douglas as Gordon Gekko, to whom 'greed is good'. The search for value creation focused on cash flows and led to the development of techniques known as value-based planning, which include discounted cash flows and net present values. These financial ideas are central to understanding company valuations and value creation but they had been largely ignored in the preceding decades.

The approaches adopted to release value in diversified companies included delayering, which involved reducing management structures, and divestment, which involved selling off parts of the corporation. The Peters and Waterman study mentioned above concluded that successful firms had a focus (they called it 'stick to the knitting'); they concluded that diversified companies had performed less well than those which concentrated on a core activity. There was now a great deal of concern about pseudo-professional managers who knew nothing about the businesses they were running. The inevitable conclusion was that many corporations were destroying value by the 1980s; it was no wonder their break-up value was often found to be greater than their corporate value.

Core Businesses

Available evidence suggests that the performance of conglomerates has not been improved by takeovers. Clearly some radical thinking was required if conglomerates were to remain viable in the long run. The process of restructuring implies the selection of appropriate core businesses which remain once the process of breaking up is complete. But it is not necessarily obvious where a company's core advantages lie. One possible answer was to focus on related diversifications; but this would not necessarily solve the problem of value destruction because related activities do not necessarily reduce complexity, and there are no guarantees that the simple fact of running two apparently related businesses under the same corporate umbrella will lead to overall cost reductions. An alternative approach was to utilise the company's dominant general management logic by selecting companies in strategically similar industries.

> A dominant general management logic is defined as the way in which managers conceptualise the business and make critical resource allocation decisions – be it in technologies, product development, distribution, advertising or in human resource management.[12]

A rather different view is that the only valid justification for a diversified company is sharing resources and particular competitive advantages – which came to be called core competences[13] – across businesses; otherwise diversification is nothing more than mutual fund portfolio management. One view is that businesses comprising the diversified company should be viewed as a collection of competences. Even a poorly performing business, in terms of financial indicators, may make a significant contribution to overall company performance in terms of competence. But it is difficult to transform this idea into practice, because it means suspending the normal investment criteria which had been so useful in the era of value-based planning. It is difficult in practice to predict how companies will achieve benefits from corporate strategies based on supply chain linkages, core competences and synergy.

> Benefits of synergy are now truly legendary. Diversification and synergy have become virtually inseparable in texts and business language. Yet … those particular benefits show an almost unshakeable resolve not to appear when it becomes time for their release.[14]

While there is no doubt that the concept is important, it is not unreasonable to conclude that linking businesses by core competences is neither a necessary nor sufficient condition for success.

Parenting Advantage

A different approach is to identify the real benefits that might accrue from being part of a corporate conglomerate. Goold *et al.* identify four potential ways by which the corporate parent might add value together with reservations attached to each.

1. Stand-alone influence: the parenting activities include agreeing and monitoring performance targets, approving major capital expenditures and selecting business unit managing directors; the parenting influence may extend to product-market strategies, pricing and human resource management. But it can be argued that the more the parent extends its influence into the affairs of the individual businesses, the more likely it is that it will destroy value; this is the 10 per cent versus 100 per cent paradox: why should a parent manager working part time do better than a business manager working full time?
2. Linkage influence: the parent can encourage relationships to capitalise on synergy. But in the absence of a parent, business managers are free to establish linkages without parental involvement; so why should the parent do any better? This is the 'enlightened self-interest' paradox.
3. Functional and services influence: the parent can provide functional leadership and cost effective services. But this creates a supplier insulated from outside competition, and it is difficult to guarantee that internal suppliers will be as efficient as the market. This is the 'beating the specialists' paradox.
4. Corporate development activities: the main role of the parent is usually seen as buying and selling businesses, creating new businesses, and redefining businesses. This amounts to changing the businesses in the corporate portfolio. But since the weight of research indicates that the majority of corporately sponsored acquisitions, new ventures and business redefinitions fail to create value, the odds against success are long; this is the 'beating the odds' paradox.

While there is a potential role for the parent in the areas outlined above, it has to be recognised that success is not guaranteed and that there are formidable obstacles in the path of value creation. Given these obstacles, it is not surprising to find that value has often been destroyed rather than created, and when the parent organisation is responsible for poor executive appointments, invalid objectives, inappropriate strategies, and unsuitable review processes the potential for value destruction is multiplied.

Globalisation

As trade barriers continued to fall, through the work of the World Trade Organisation and the formation of trading blocs such as the European Union, and capital markets transcended national frontiers, companies increasingly found themselves competing in an international market place. Companies in many industries began to fear that nationally based operations would stand little chance against powerful multinationals. Thus the late 1990s witnessed huge international mergers in industries such as financial institutions, telecommunications, energy supply, car production and pharmaceuticals. While the arguments in favour of mega mergers are clearly persuasive enough to provide companies with the incentive to embark on these ventures, it is an open question whether the outcome in the longer term will be viable, value generating operations. There is no guarantee that scale economies will be realised, nor is there any guarantee that size will confer a real competitive advantage in servicing distinctive local markets for goods and services.

Knowledge

It has always been difficult to build sustainable competitive advantage because eventually anything can be imitated. In an environment of fast technological change companies started to realise that part of their advantage lay in the knowledge and unique skills of their experienced employees. It became a priority to identify and classify knowledge so that it could be maintained and disseminated as required. But it soon became apparent that the really important bits of knowledge were extremely difficult to identify because they resided within specific individuals and were largely learned on the job; this became known as 'tacit' knowledge. This presented organisations with a real problem: competitive advantage and innovation depend on a resource that cannot readily be identified or controlled. Techniques of knowledge management began to be developed to tackle these imponderables.

1.6 Is Strategic Planning Only for Top Management?

Since strategic planning is typically visualised as the grand strategy of a company, it could be argued that this is the domain of top management and that middle and lower management need not be concerned with such issues. However, there are potential returns to both the company and the individual from comprehension of strategic planning at all levels of management.

Company Benefits of Strategic Planning

Some organisational behaviour experts maintain that it is not so much the existence of a plan which benefits the company, but the process by which a plan is developed; this process leads to relationships among employees, and approaches to the job, which would otherwise be missing. Apart from this general potential benefit, the company stands to benefit in several ways from managers' comprehension of strategic planning.

- The individual manager is enabled to see where his or her sub-unit fits into the overall system of objectives, and is able to interpret corporate objectives in that light. The manager competing for scarce resources has a better understanding of the true opportunity cost of his or her demands. Similarly, the manager is in a better position to understand instances where cooperation is required; the reason for such cooperation might not be obvious in the context of a limited set of objectives. In many circumstances, managers can be excused for feeling that decisions are simply made at the whim of their superiors since they do not appreciate the overall resource allocation picture and have no understanding of the direction in which the company is headed. This reasoning applies to all aspects of management education, i.e. that a better appreciation of company functions provides individuals with a more balanced view of the actions of others; comprehension of strategic planning has a particularly powerful role to play in the elimination of unnecessary conflicts, and the associated effects on morale and productivity.

- The manager will better understand which of his or her potential proposals are likely to contribute to the overall plan; the manager will also be in a position to produce arguments for a proposal which will be consistent with the objectives of higher level managers.
- Because strategies are developed in a dynamic fashion, managers who are actually involved in the process of making the company's strategy work may not be aware of the strategy within which they are operating. For example, economic circumstances may lead to a change in general objectives and the criteria used to judge company performance; it cannot be taken for granted that managers will have an up-to-date appreciation of the company's current strategy.

Thus, company-wide knowledge of the approach to strategic planning, and the process by which it is arrived at, can have a positive impact on resource allocation within the company by helping to minimise unnecessary conflict and to provide an overall sense of direction. It is difficult for managers to feel part of a team working towards a common goal when that goal is not clear to them and they do not see how their individual actions contribute to achieving it.

Individual Benefits of Understanding Strategic Planning

If comprehension of strategic planning generates returns to the company, it is clearly worthwhile for the company to persuade managers to spend time learning about it. However, individual managers must have incentives to spend time on this activity. The payoff to the individual manager comes in two ways. First, since the manager will achieve a better understanding of where the company is going, and what it is attempting to achieve, he or she should be able to take advantage of this to predict changes likely to occur in the organisation which will be personally advantageous, or disadvantageous. Second, proposals and arguments submitted to higher level managers will be consistent with and relevant to the aspirations of the manager's superiors, and this can enhance prestige and career prospects.

But not everyone wishes to be educated in strategic planning; many employees are content to operate within their locus of control, or comfort zone. The complexity of decision making and the realisation that competitive forces can lead to job losses at any time can lead to feelings of insecurity and unease. A seemingly enlightened policy of management education can have adverse effects. There are therefore both benefits and costs associated with the communication of strategic planning.

Understanding Strategic Planning: Who Should Pay?

The fact that there are benefits both to the company and to the individual raises an interesting issue concerning who should pay for the education. Since individuals benefit from understanding strategic planning they have an incentive to pay something towards their education; the same goes for the company. However, since both parties will obtain some benefit the issue of who should pay is a negotiating point. There is a maximum amount which the company is willing to pay for any individual's strategic planning education, and there is a maximum amount which any individual is willing to pay for his or her own education. In principle, the compromise will fall in between these two extremes. In practice, it is often not possible for such a negotiation to take place, and this accounts for the fact that some individuals are willing to pay for their own education, and some companies are willing to pay for some employees' education.

Review Questions

1.1 The following is a hypothetical statement by the chief executive officer of a medium sized company producing packaged breakfast cereals.

> The people who sell strategic planning are certainly on to a good thing. They don't define their product, they have no measure of success or failure when applying their methods, many of them seem to provide contradictory solutions, and they can provide no proof whatsoever that they have done any good. As an ex-army man I know a lot about strategy, and in my business I simply keep an eye on who is doing what in the market, try to make sure my costs are under control and keep my customers and my employees as happy as I reasonably can. I have given up trying to look more than a year ahead, because every time I have done so in the past, events have turned out to be completely unpredictable. In the past 10 years we have managed a 12 per cent return on capital and have kept our market share. I don't think I have much to learn from studying strategic planning.

This CEO gives the impression of being complacent, and perhaps he has good reason for feeling this way. Think up a series of questions which might unsettle him.

1.2 Analyse the strategic planning experiences of the Mythical company in terms of the three approaches to strategy: planning, emergent and resource based.

1.3 Assess the Mythical company's five point plan in terms of business unit and corporate strategy.

1.4 Assess the experience of the Mythical company's CEO in terms of Rittel's properties.

1.5 Sometime in the future the Mythical company ran into another problem. About halfway through the financial year the company finance director informed the CEO that half year profits were much reduced and that there was little prospect of maintaining the performance of the past three years. The CEO gathered his senior management team to discuss the reasons for this setback and hired a strategy consultant to contribute. This is an extract from the discussion.

CEO: I don't think our profit problem is simply due to external events such as the recent problems with the economy. It seems to me that it is more to do with the way we do things – I am not certain that we are acting as efficiently as we could be.

Operations manager: we have actually invested heavily in more productive assets and in training programmes in the last two years. I am not sure there is much more we can do in that respect.

Marketing manager: I don't think we exploited the market opportunities for our new range of products as well as we could have done. We invested a great deal in attempting to capture an increased share of the market early on last year; when that didn't work we should have channelled a lot more resources into the marketing effort. We should have allowed for changing market conditions.

Finance director: but we had no spare resources.

CEO: we put a lot of effort into the plan and it was a great disappointment when it didn't work out. Maybe we need to spend even more time planning in the future.

Marketing manager: what is the point of planning in ever more detail when we can't seem to react to the unexpected?

Operations manager: that is a defeatist attitude. We just don't spend enough time collecting and analysing information.

Strategy consultant: you are approaching the strategy problem from two different perspectives; once you have recognised this you might be able to work out where to go from here.

What did the strategy consultant mean?