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The Real Value of Strategic Planning

The goal of a strategic planning process should not be to make strategy but to build prepared minds that are capable of making sound strategic decisions.

Sarah Kaplan and Eric D. Beinhocker

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

Management thinker Henry Mintzberg has gone so far as to label the phrase "strategic planning" an oxymoron.[1] He notes that real strategy is made informally — in hallway conversations, in working groups, and in quiet moments of reflection on long plane flights — and rarely in the paneled conference rooms where formal planning meetings are held. Our own research on strategic planning supports Mintzberg's observation: We found that few truly strategic decisions are made in the context of a formal process. But we also found that, when approached with the right goal in mind, formal planning need not be a waste of time and can, in fact, be a real source of competitive advantage. (See "About the Research.") Companies that achieved such success used strategic planning not to generate strategic plans but as a learning tool to create "prepared minds" within their management teams (to paraphrase Louis Pasteur).[2]

A former senior executive at GE Capital explained the logic of such thinking to us: Business is often unpredictable — two competitors merge, another develops a new technology, the government issues new regulations, market demand swings in a different direction. It is often during these real-time developments that a company's most important strategic decisions are made. Too often, however, companies react poorly under the pressure. Because they

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About the Research

We began our research by looking in depth at the strategic planning processes of 30 companies, including some that have highly regarded records of long-term strategic success and others that have made serious strategic blunders in recent years. The companies represented a variety of industries and had approaches to strategic planning that ranged from seat-of-the-pants to very analytical and buttoned-up. Our sources of information for the case studies included public information, interviews with top managers, interviews with former executives, prior McKinsey research and academic research. We then developed hypotheses about what constituted the most effective approach to strategic planning, tested them in workshops and discussions with approximately 50 additional companies around the world, and worked with many of those companies to transform their strategic planning processes.

Companies drawn on for case studies include ABB, Allied Signal, American Express, Boeing, BP, Capital One, Coca-Cola, Compaq, Emerson Electric, Frito-Lay, General Electric, General Mills, Hewlett-Packard, IBM, Intel, J.P. Morgan, Johnson & Johnson, Lucent Technologies, Merrill Lynch, Microsoft, Monsanto, Motorola, PepsiCo, Philip Morris, Rubbermaid, Sara Lee, SmithKline Beecham, Textron and Unilever.

are not well prepared, discussions among top managers are often based more on opinion than fact, and the subsequent decisions end up being based on gut instinct rather than thoughtful analysis. GE Capital, however, believes it gains a competitive advantage by following a disciplined strategy process that focuses on preparing it for the uncertainties ahead.

As this analysis makes clear, real strategy is made in real time. It follows, then, that the goal of a formal strategic planning process is to make sure that key decision makers have a solid understanding of the business, share a common fact base, and agree on important assumptions. These elements of the prepared mind serve as the foundation upon which good strategic decisions can be made throughout the year.[3] And one of the most important ways of building that foundation is by getting the central elements of the process right.

How To Create Prepared Minds

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

We found that the key to transforming these review meetings from dog and pony shows into effective vehicles for learning was to view them not as "reviews by the CEO" but as conversations. The difference is that a conversation is a two-way street in which participants learn from and challenge one another — the goal is for everyone to leave the room much better informed than when they went in. Achieving that outcome requires a lot of preparation by all the participants. The devil, it turns out, is in a host of seemingly mundane, but actually critical, details:

Who should attend the reviews? Real conversations take place in groups of three to 10 people; they simply do not happen in large groups for both logistical and political reasons. Once the group grows in size, it is difficult to ensure that everyone can participate meaningfully, so hierarchical forces are more likely to come into play. Rather than frank discussion, in larger groups one is more likely to see posturing and politicking. Some companies in our study, tempted by the values of inclusion, brought in groups as large as 30 or 40 people to their strategy reviews. These discussions were inhibited, and people came away feeling that the exercise had been more of a slide show than a real dialogue about critical business issues.

In reality, there are only two essential participants in a business-unit strategy review: the CEO and the business-unit head. Everyone else is discretionary and should be included only if he or she is truly a decision maker. The number of decision makers varies from company to company but typically includes the corporate CFO, the group executive (if there is one) that the business unit reports to, the head of corporate HR, one or two senior corporate executives and two to three senior members of the business-unit team. The corporate head of strategy also usually attends as the person responsible for making sure the conversation is effective. Thus the total number of participants can be kept to between five and 10, with 12 as the maximum. People will fight to be included in these meetings, but other forums can be set up to keep them informed and get their buy-in.

How long should the reviews be? It's not possible to have an in-depth strategy discussion about a significant business in less than a day. There are simply too many topics to cover: customers, competitors, technology, regulation, risks, investments and more. Spending less time prevents the careful poking and prodding of issues required to get the full benefit from the effort. It may sound like a lot to commit a full day to each major business unit, but most CEOs we interviewed said they wanted to spend about a third of their time on strategy. Given 240 working days, that leaves 80 days to devote to strategy. In that context, it seems reasonable to expect the CEO to spend 10 to 30 days in intensive, well-prepared strategy discussions. As one Emerson Electric executive told us, "At first I resented the Emerson process because it was such a large commitment of time, but then after a few

cycles I realized it was making me and my team better managers. The process of preparing for it and the meetings themselves made us realize things about our business we wouldn't have found out in any other way." Former CEO Charles F. Knight said that "more than half my time each year is blocked out strictly for planning," a commitment to strategy that has been carried on by his successor David Farr.

Where should they be held? It is best to hold planning meetings at the business-unit site; they will then feel less like a "summons from corporate." Holding the meeting at the business unit also minimizes the distractions of day-to-day business at corporate headquarters, and the CEO's presence at the site signals the importance of strategy to the entire organization. The CEO can often use additional time at the site to take the temperature of the business by attending formal and informal events with employees, taking a plant tour and visiting important local customers.

What should be discussed? Many companies combine their strategy reviews with a discussion of budgets and financial targets. That is a big mistake. When the two are combined, the discussion is dominated by a focus on the numbers and short-term issues; long-term strategy questions receive only cursory attention. Likewise, if there is no other forum in which to discuss the financials, they will inevitably come up in the strategy meetings. Ideally, companies should have two clearly demarcated meetings: one full day on business-unit strategy and another meeting at a different time of the year to set financial targets. The two should then be linked with a common, rolling five- to seven-year financial plan that ties together strategic initiatives with budgets. Such linking is crucial: We have seen some companies use the strategy review to advocate a major change in direction but, in a separate process, build a budget that looks like an update of last year's financials. The lack of connection is sure to stymie the change effort.

Rather than near-term financial targets, the conversation should focus on long-term trends, opportunities, challenges and decisions. In businesses where decisions have a long lifetime and are difficult to reverse, such as aerospace or telecommunications, "long term" might mean five to 10 years. In those where commitments have a shorter life, such as software or consumer goods, it might mean two to five years. The discussion should focus on questions over the appropriate time horizon such as: What are our aspirations? What are the critical trends regarding customers, competitors, technology and regulation? How is our business model performing, and how will it likely evolve? What are the key challenges and opportunities we face? What capabilities do we need to build for the future? What are the key risks and uncertainties we face, and what can we do to ensure our adaptability?

Challenging the Strategy

The strategic planning review is most effective when it instigates productive challenge regarding the scope of the strategy, the choices that lie behind it and the process used to develop it. Some examples of challenge questions include:

QUESTIONS ABOUT SCOPE

- What assumptions about market trends, competitor behavior, new entrants, changes in technology and customer needs have you made? If those assumptions are wrong, how would the strategy be affected?
- Are there trends that could force you to change the way you do business now?
- If you had to triple your growth, what new businesses would you enter?
- What is the definition of the market you are in, and what is the logic behind that definition?
- What new uses for your products and technologies have you explored?

QUESTIONS ABOUT CHOICES

- What strategic choices are you making, and what are you rejecting? What is the rationale? Are there circumstances or situations that would cause you to choose differently?
- Are you pursuing growth aggressively enough? Are you compromising growth by failing to provide adequate resources?
- Can you reverse a basic assumption held in the industry? How, and what would be the benefit?
- How are your plans the same as or different from those of your competitors? How will you ensure that you have a distinctive value proposition?
- What actions have your competitors taken in the last three years to upset global market dynamics? What are the most dangerous things they could do in the next three years?
- What have you done to affect global dynamics over that period, and what are the most effective things you could do in the next three years?

QUESTIONS ABOUT PROCESS

- How many customers did you interview? How many noncustomers?
- How did you involve different markets from around the world?
- What approaches did you use to develop creative or breakthrough strategies?
- Have you committed sufficient resources to your strategic initiatives? Are they linked to your financial and HR plans?

How should the conversation be conducted? The main purpose of the discussions is to challenge the strategy by testing assumptions about the market, checking that a full range of strategic choices is considered, exploring potential opportunities and risks and forcing an honest assessment of the business's strengths and weaknesses. (See "Challenging the Strategy" for examples of questions that should be raised.)

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

The conversations can be hard-nosed, but it's important to create an environment that doesn't become "us versus them." In a company like Emerson, where people are able to challenge one another, that is done by exploring the boundaries of the strategy: pushing the business team to explore worst-case scenarios and understand what might make them come true, testing to see if aspirations could be ratcheted upward, or investigating the competitive implications of a radical cost reduction or product performance improvement. It's also fine to have a collegial atmosphere, as long as it doesn't devolve to the point where uncomfortable issues are glossed over or buried. One company we studied never made an effective strategic plan because it was so consensus-oriented. Tough issues simply were postponed until another meeting because the members of the management team were not able to confront one another.

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

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

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Each unit, however, should be given a lot of latitude. For one thing, every business unit is different, and one-size-fits-all templates are likely to obscure more than they reveal. For another, strategy reviews are a great way for a CEO to check out the quality of the company's managers. If there is too much corporate guidance, it becomes harder to tell the real strategists from those who are merely good at filling out templates.

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

Prepared Minds in Action

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

Consider how rigorous planning processes helped a multibusiness industrial goods company expand internationally. Quite unexpectedly, its automotive parts division was faced with the opportunity to acquire two large businesses in Germany, where it had not been a significant player. Because the

company would be new to the market and would need to commit significant resources in order to succeed in it, the decision was risky. Fortunately, the CEO, top corporate team and top business-unit team had engaged in extensive strategy discussions and therefore already had a point of view on the German market and the strategic fit presented by the opportunity, as well as a thorough understanding of the economics of the product area in question. The company was able to make a

Changing the Process

Companies that are muddling along with a process that doesn't function well need to work through four tasks to bring about the cultural and organizational change required for truly effective strategy making.

First, they should diagnose the current process: What's working, and what isn't? Members of the strategic planning group should interview key participants in the process — the CEO, other corporate-level senior managers, business-unit heads and others on the planning staff itself — to get their candid answers to those questions. It is also revealing to look back at the last five or so big strategic decisions made at the company and business-unit level. What process was used for making those decisions? What was the quality of the information the participants had? Was there a good process for debating issues, raising challenging questions and gaining consensus? How quickly was everyone able to act? Was the thinking fairly conventional or were more creative options considered as well? Answering these questions can help people looking at the process get a sense of its effectiveness.

Once a baseline has been established, the second task is to design the new process. The strategic planning group is often the logical group to take the lead on the redesign, but it is imperative that the project have the mandate and full backing of the CEO. In our experience, a successful redesign must be viewed in the organization as "the CEO's project with help from the strategic planning group," rather than the strategic planning group's project. Also needed for success is full input from business-unit leaders and their staff as well as other functions involved in planning, such as finance and human resources. An attempt to reinvigorate strategic planning will fail if the business units view it as "just another corporate initiative" or "another way for corporate to get their hands into our business."

Once a new process has been designed, the third task is to roll it out with as much "learning by doing" as possible. Most companies that have gone through this transformation find it takes one or two cycles to iron out the kinks and get it to work. We recommend beginning with a pilot phase in which select business units volunteer to be guinea pigs in return for extra resources and help in developing their strategies for formal review. Providing that extra help to the early adopters can lead to the creation of a companywide "gold standard" for the strategic plans that eventually are presented in the formal process. After the pilot phase, the process can be rolled out to the rest of the organization with the explicit understanding that year one of the new system is a trial year, after which the process will be modified on the basis of the lessons learned.

The fourth task, to be done in parallel with the rollout, is a skill-building effort in which training in strategy development is offered to the business-unit leadership, staff, senior team and even the CEO. Many executives rise through the ranks with operational, finance, or marketing and sales backgrounds and have relatively little training in strategy under their belts, even if they are fairly senior. Some training can help reset everyone's expectations about what a good strategy should look like and how to develop one, and introduce them to tools they might not be familiar with.

Having watched various companies go through this process, we've seen common pitfalls that should be avoided. It is critical not to underestimate the challenge involved in changing the strategy process. Many companies consider the revamping of their strategic planning as a dry, somewhat technical change that can be delegated to relatively junior people in the strategic planning group. But changing the process involves broadly changing mind-sets and culture throughout the company — not a trivial matter. Companies also tend to underestimate the degree of resistance they will get from business units, which often see the drive to implement a new process as a threat, another demand on their time, and an excuse for more interference from the corporate center. A concerted effort must be made to win over business-unit leaders and help them see the ultimate benefits of the new process to their unit and to the corporation as a whole.

The tendency to underestimate the challenge also produces common mistakes in execution. Companies sometimes try to roll out the new process without any piloting or training. As a result, the new process gets off to a bad start, leading to a backlash and "I told you so" from the business units, which in turn can seriously derail the change effort. Another common mistake is the failure to provide adequate staff or consulting support to the change effort, which quickly grows too large to be handled by the group assigned to manage it. Finally, as with any other kind of major change program, constant communication is essential throughout execution of the redesign, in particular between the CEO and the business-unit heads.

decision quite quickly and outnegotiate a slower-moving rival that was not as well prepared. The acquisitions were critical to the success of the company's growth strategy.

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

Companies whose processes look more like tribal rituals may leave corporate leaders unprepared when inevitable moments of truth arise.

Prepared minds can also help companies reject moves that don't make sense. A company with a large aerospace and defense division, for example, invested a lot of time in its strategy reviews to ensure that top managers understood the economic implications of consolidation in its industry. Instead of accepting the standard line from the industry press and pundits, the participants looked in detail at what it meant for their specific subsectors of the industry and their own future economics. They weren't gullible, then, when their investment bankers came to town, arguing that the company needed greater economies of scale to survive and proposing a specific acquisition target that would soon be for sale. Armed with an appreciation of the business and aware of the strengths and weaknesses of competitors, top management chose not to do the deal — which in hindsight proved to be the right decision. Their preparation enabled them to sort out sensible deals from foolish ones and avoid a potentially costly and distracting mistake.

Contrast that outcome with events at an agrochemical company whose processes did not do an adequate job of preparing its leaders to respond to challenges posed by the market. Growth in the company's industry had come primarily from the development and sale of genetically modified (GM) seeds. At one point, the company's seed division held a brainstorming session to talk about new growth opportunities. European colleagues raised the possibility of a backlash in their home countries against food grown from GM seeds, but a corporate senior executive who had joined the discussion, unhappy with this negative view of the business, struck the topic off the table. Later, European consumers did indeed object to GM foods, and the company was blindsided by the rapid decline of its European seed business. That outcome might have been avoided if the company had had a formal process (and forum) for fact-based, open-minded discussions of business-unit risks among senior corporate and business-unit executives. In the absence of such a process, the whim of one senior executive overrode the concerns of the local business unit.

AS THESE EXAMPLES SUGGEST, there's no reason strategic planning should be the butt of cynical jokes — it's one of the most important tasks for senior corporate and business-unit executives. Companies whose processes look more like tribal rituals waste valuable executive time at a minimum; more seriously, they may leave corporate leaders unprepared to respond properly when the inevitable moments of truth arise. When repositioned as a learning process, formal strategic planning can help managers make solidly grounded strategic decisions in a world of turbulence and uncertainty.

REFERENCES

1. H. Mintzberg and J. Lampel, "Reflecting on the Strategy Process," Sloan Management Review 40 (spring 1999): 21-30.

2. Pasteur famously said that "chance favors the prepared mind" in describing his own breakthrough research.

3. Prepared minds, however, are a necessary but not sufficient condition for good strategy making in today's intensely competitive markets. Long-term success also depends on a company's ability to develop truly creative and innovative strategies, which is why formal processes must be balanced by informal ones that allow for creative experimentation. See E. Beinhocker, "Robust Adaptive Strategies," Sloan Management Review 40 (Spring 1999): 83-94; S.L. Brown and K.M. Eisenhardt, "Competing on the Edge: Strategy as Structured Chaos" (Boston: Harvard Business School Press, 1998); R. Foster and S. Kaplan, "Creative Destruction: Why Companies That Are Built To Last Underperform the Market — and How To Successfully Transform Them" (New York: Currency/Doubleday, 2001); and G. Hamel, "Leading the Revolution" (Boston: Harvard Business School Press, 2000).

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