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Can strategic planning pay off?

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In an article from the *McKinsey Quarterly* archives, Louis V. Gerstner, Jr., proposes four guidelines to help strategic planners make the crucial leap from plans to decisions.

One of the most intriguing management phenomena of the late 60s and the early 70s has been the rapid spread of the strategic-planning concept. Except for the so-called computer revolution, few management techniques have swept through corporate and government enterprises more rapidly or completely. Writer after writer has hailed this new discipline as the fountainhead of all corporate progress. In 1962, one published report extolled strategic planning as "a systematic means by which a company can become what it wants to be" (Stanford Research Institute). Five years later, it was called "a means to help management gain increasing control over the destiny of a corporation" (R. H. Schaffer). By 1971, praise of strategic planning verged on the poetic; it had become "the manifestation of a company's determination to be the master of its own fate . . . to penetrate the darkness of uncertainty and provide the illumination of probability" (S. R. Goodman).

It is not surprising, therefore, that one company after another raced to embrace this new source of managerial salvation. As a result, most major companies today can boast a corporate-planning officer, often with full attendant staff. It seemed appropriate to ask some chief executives whether strategic planning has lived up to its advance billings. Three anonymous reactions were as follows:

> "Strategic planning is basically just a plaything of staff . . ."
>
> "It's like a Chinese dinner: I feel full when I get it, but after a little while I wonder whether I've eaten at all!"
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> "Strategic planning? A staggering waste of time and money."

Some CEOs, of course, would disagree with these comments, and certainly few if any would agree publicly. But the fact remains that in the large majority of companies corporate planning tends to be an academic, ill-defined activity with little or no bottom-line impact. Observations of many companies wrestling with the strategic-planning concept strongly suggest that this lack of real payoff is almost always the result of one fundamental weakness, namely, the failure to bring strategic planning down to current decisions. Before describing this problem and some possible ways to overcome it, I shall briefly define what I mean by the term strategic planning.

Many strategic-planning programs begin with the extension of the annual operating budget into a five-year projection. This can be a valuable exercise, particularly for institutions that have operated on a yearly or even monthly planning cycle. Most companies, however, soon discover that five-year operational and financial forecasts, in and of themselves, are ineffective as strategic-planning tools for a fundamental reason: they are predicated on the implicit assumption of no significant change in environmental, economic, and competitive conditions.

In other words, they are purely extrapolative projections and, by practically everyone's standards, fall far short of real strategic planning. They offer no overview, no analyses of external trends, and no perceptive insights into company strengths and weaknesses—elements that both theorists and practitioners would agree are central to real corporate planning.

Forecast planning of the sort I have described can usually be identified by leafing through a company's planning documents. Pages and pages of accounting information, detailing five years of financial forecasts with little or no explanatory material, are one earmark. Graphs of projected future performance also tend to follow a predictable pattern; ie, if recent performance has been good, the forecast calls for more and more of the same—on into eternity. On the other hand, if performance has been poor, the forecast will allow for a year or two to effect the inevitable turnaround, and then—off to eternity. (The manager doing the forecasting hopes, of course, that he will get promoted before the two-year period is up.)

Working with forecasts like this, executives tend to dismiss the second, third, fourth, and fifth years as irrelevant and continue to concentrate solely on the current year, that is, the annual budget. Most companies seem to have passed beyond forecast planning, and its weaknesses are fairly manifest—namely, a preoccupation with accounting data as the principal output of a planning program and the assumption that the future, at least in relation to general economic indexes, will closely resemble the past.

Recognizing these weaknesses, many institutions have introduced a more rigorous planning program aimed at defining or redefining the basic objectives, economics, competitive profile, and outlook of the company. These formal strategic-planning processes show a distinct family resemblance. They usually begin with an assessment of environmental trends and an analysis of the company's strengths and weaknesses. A statement of corporate goals is then developed. From these three elements, a juxtaposition between the organization's present position and its desired position is derived; comparison of the two positions defines the well-known strategic gap. Finally, plans are developed to close the gap and bring the two positions together.

Of course, the steps required to arrive at the statements of present and desired position are quite detailed. Such an effort is inevitably painful and time consuming, but it may be necessary in the first planning cycle. Barring major changes inside or outside the company, subsequent plans can be considerably shorter. Since the specific elements of a good strategic plan have been described in many texts, I shall not dwell on them here. Instead, I shall move on to the central question of why strategic planning so often fails to pay off and what can be done about it.

Make decisions—Not plans

As mentioned earlier, the most fundamental weakness of most corporate plans today is that they do not lead to the major decisions that must be made currently to ensure the success of the enterprise in the future. All too often, the end product of present-day strategic-planning activities is a strategic plan period. Nothing really new happens as a result of the plan, except that everyone gets a warm glow of security and satisfaction now that the uncertainty of the future has been contained. Unfortunately, warm feelings do not produce earnings or capture market share. Neither do graphs of five-year earnings projections, gap charts, or complex strategy statements.

What does produce earnings are strategic decisions, and strategic decisions should be the ultimate output of a strategic-planning program. That is, the strategic plan should clearly set forth the critical issues currently facing a company or division in terms of alternative courses of current action. If there are more than five or six issues, they are probably the wrong ones. If the decisions do not involve major risks or investments and/or changes in competitive posture, or if the decisions do not have to be made now, they are the wrong decisions. This is the creative leap that too many managements fail to make in strategic planning. They fail to ask, "What do we do now as a result of this plan?" They fail to recognize that the end product of strategic analysis should not be plans but current decisions. Some of the reasons why the leap to decisions is not made are important to understand.

It is risky. Probably the most significant reason is that stating plans in terms of decisions frequently requires an executive to take a personal stand on an important and controversial issue. In other words, it can often make or break a career. All of us can call to mind people who have staked their careers and reputations on major strategic recommendations—for example, T. Vincent Learson leading IBM into digital computers, and William Donaldson opening DLJ to public capital.

But most of us can also call to mind a few corporate casualties of such decisions—those who took a strong position as an adversary on a major strategic move and found themselves on the losing side. So the leap to decisions takes courage—and most executives prefer to play it safe. We can look at the top-management teams of too many companies and find no risk-taking, success-story managers.

It is difficult. Strategic planning, almost by definition, deals with the most complex questions facing a company. Just assembling the data to measure the variables is a considerable task. Moreover, once the data are in hand, the real job begins—the job of synthesizing critical issues and strategic options to resolve those issues. This is fundamentally a creative process. It cannot be programmed or systematized. To structure meaningful, practical action programs requires insight, wisdom, and perspective. Many executives find it an elusive, uncomfortable task.

It requires leadership. Most strategic decisions are controversial. The underlying issue being addressed is rarely new to the corporate executive team; typically, it has been debated within the company for some time. I use the word "debate" advisedly; these discussions tend to be problem-defining, opinion-swapping sessions. Because the issues they address have vital implications for individual careers, they soon become less than objective, and they almost never lead to action. In some companies propositions such as "We ought to liquidate that business" can bounce about in the executive committee for months or even years without any decisions being made. The missing ingredient is the leadership needed to push through tough-minded analysis and action on controversial matters.

I know a company that is face to face with a strategic problem of critical importance—in fact, its survival is at stake. The underlying strategic issues were correctly identified and thoroughly analyzed over three years ago. A detailed action program was outlined. It is still valid, still ready for implementation, yet the company is headed for bankruptcy. The reason is simple: the CEO simply cannot bring himself to make some tough decisions. He is waiting and hoping that his key lieutenants will reach a consensus. Given the nature of the decisions, this is impossible. In a situation of this kind, only the CEO can exert the needed leadership, and this CEO is not the one to do it.

The value system works against it. Too often a company's executive motivation system flies in the face of strategic decision making. This occurs for two reasons. First, good managers tend to be promoted so fast that they never have to live with the medium- to long-run outcome of their plans. Second, incentive compensation is often tied either to short-term earnings performance or to stock-price movements, neither of which has anything to do with strategic success.

As we have seen, the leap from plans to decisions is an entrepreneurial step that cannot be reduced to a routine. Making it happen is an educational, attitudinal task, but some concrete steps can be taken to facilitate the process.

Meeting external risks

To begin with, the formal strategic-planning program should be thoroughly reviewed to ensure that it requires a decision-oriented approach. Many planning systems simply are not designed to demand decisions as the end product. Instead, they produce forecasts of financial results, or statements of objectives, or future action steps. This type of planning, which is basically "momentum" planning as opposed to dynamic planning that is attuned to the realities of external change, often results from excessive internal focus in the planning process. To overcome this problem, heavy emphasis should be given to three critical aspects of strategic analysis that are particularly important in identifying key issues and decisions: evaluating competitive strategies, developing contingency plans, and assessing environmental forces.

Evaluating competitive strategies. Too many corporate plans fail to give even minimal attention to the present and future action of competitive firms. They set out elaborate strategies without any real consideration of competitive reaction. A simple analysis of each major competitor's existing strategy can be extremely helpful in overcoming this weakness. In most cases, analysis of this kind leads to the identification of opportunities or threats that call for current management decisions.

Contingency plans. Most companies with active planning programs recognize the value of asking "what if" questions, taking important contingencies into account. Yet few really address this issue in a substantive way. A frequent excuse is that there are so many potential contingencies that it would take years to analyze them all.

The obvious answer to this objection is that one can and should be very selective, and deal only with the one or two possible contingencies that could upset the entire strategy.

Here are two examples:

An American packaging company selling a commodity product regularly reviews potential price changes by one of its smaller competitors. This competitor dropped prices sharply several years ago, catching the market leaders by surprise and increasing its own market share significantly.

Last year, in speculating on the major contingencies they might face, the management of the packaging company asked, in effect, "What if they should do it again?" In view of the capacity situation in the industry, it was not an unrealistic question. Accordingly, the company meticulously planned a contingency program to be put into effect if and when its small competitor should move again. Early this year he did. The packaging company was ready and responded immediately and effectively.

An electronic-components company depended on a single large customer for 30 percent of its sales. Management simply asked, "What if they should integrate backward?" There was no visible reason to believe that such a move was in the offing, and the question would probably not have surfaced as a serious issue without the forcing device of required contingency planning. But development of the contingency plan led to two real benefits. First, it brought out the need for some preventive medicine, and this became a continuing part of the company's relationship with its big customer. Second, it led to a detailed economic analysis of the risks and disadvantages to the customer of backward integration. One year later, that analysis was instrumental in convincing the customer that a tentative step he had been about to take toward integration would be unwise.

Assessing environmental forces. We can all think of companies that have failed to anticipate important changes in their external environments. The US automobile industry, with all its vast managerial and financial resources, was simply unprepared for the explosive issues of automotive safety and air pollutants. And during the late 1960s, stock brokers on Wall Street almost drowned in their own success because they had failed to anticipate the volume growth of the industry and its attendant "back-office" requirements.

Despite the difficulties of forecasting sociopolitical or even marketplace trends, the most aggressive companies are energetically taking steps to raise their present level of competence in this arena. These are some of the approaches they have found productive:

- Drawing on the work of the so-called “futurologists,” who seek to identify major developments emerging in the world. Their work is rarely directly applicable to a given industrial situation, but it can serve as a starting point for rigorous internal assessment of issues highly relevant to the corporation’s future.

- Building on broad economic forecasts. Here again it will be necessary to translate general trends into specific issues, but this simply requires thoughtful attention by corporate management and their advisors. A number of large companies annually prepare a general economic forecast to be used by all their operating units. These forecasts cover such subjects as government-spending programs, expected major shifts in international trade and monetary policies, and potential new regulatory programs in ecology, safety, hiring, and so on.

- Simply requiring a written assessment of critical environmental trends in every strategic-planning document. The assessment of environmental forces is not easy; nevertheless, the major issues (and therefore the strategic decisions) facing many institutions today are arising more and more in the external sociopolitical milieu. Merely being able to anticipate the issues (even if the “right” response is not clear) is a lot better than being caught unawares.

“Top-down” leadership

Since the purpose of strategic planning is to make basic decisions on the future course of the company, it is ultimately a responsibility of the CEO and his or her key lieutenants. In other words, top management cannot confine itself to perusing written plans and giving a perfunctory once-a-year approval. That would be abdication, not responsible delegation. To ensure that the right set of critical issues and decisions is in fact identified, top management must actively involve itself in the planning process. Even before the process of issue identification begins, the CEO should satisfy himself that the company’s financial targets are properly integrated.

Most companies today include some statement of financial objectives in their corporate plans. Surprisingly often, however, these objectives fail to take into account the inherent interrelationships among most financial targets. Sales, earnings, and return-on-investment targets, which are of course inextricably interlinked, often are set apart from each other in the manner of a diner ordering a meal at a Chinese restaurant: one from Group A, two from Group B. Since the objectives chosen are often inherently inconsistent and thus worthless if not actually debilitating, the result is frequently a case of strategic indigestion.

More important, too many companies fail to recognize the potential advantages of making trade-offs among various financial objectives. A company can choose widely different sets of financial and operating objectives and still achieve an identical overall earnings-per-share target. Each set of objectives implies a fundamentally different way of operating the company, and each set is internally consistent.

Again, top management can vitally enhance the effectiveness of the whole strategic-planning process by instituting a regular and rigorous process of *strategic review*. Most companies today accept without question the fact that operational planning is inseparable from operating control, that one without the other is meaningless. But too often they ignore the logical corollary in the strategic-planning area and omit the vital follow-up linkage between planning and control. To be sure, top management conscientiously reads the strategic plans and sits through strategic-planning presentations, but it rarely challenges the validity of the plans or their relevance to current decisions. This situation is dangerous, because a division manager cannot be both advocate and challenger of his strategic plan.

Strategic review should not be a mechanistic process. One of the most successful approaches I have seen is to get a few key members of the top-management team out of the office for two or three days of informal but intensive review of the strategic options as set forth in the plan. Superb leadership by the CEO is required to keep the discussion centered on the critical problems and opportunities, keep it on an objective plane so that no one feels threatened, and come out with a set of actionable decisions as the end product. Given such leadership and adequate advance preparation by the participants, valuable results can be achieved.

Strategy review, of course, is not entirely a free-form creative process; it can be supported by an analytical framework. For example, one CEO has his staff subject the plans submitted by division managers to a set of validity tests designed to identify and evaluate the key assumptions underlying performance forecasts in the plan. This top-down testing process ensures that issues and decisions that the division managers have failed to identify will be brought to the surface for top-management consideration.

Guidelines for capital deployment

As a company diversifies its activities, the task of capital allocation tends to emerge as the central function of the corporate CEO—the heart of strategic decision making in a multibusiness enterprise. Resource allocation or portfolio decisions arise because of the need to maximize overall results by managing a collection of relatively independent operating units or product lines as a single portfolio. This means setting earnings targets and making investment decisions for any one division (or product line) within a framework that encompasses the whole enterprise. Of course, it can be argued that portfolio management is not a required function in a multibusiness company, since the pieces can simply be allowed to operate independently. But by that reasoning, a corporate-management team is equally unnecessary, since if all the parts operate independently, there is no "value added" at the corporate or holding-company level.

Too often, companies actually undermine their strategic-planning programs by approaching major capital-deployment decisions purely on a traditional capital-budgeting basis. That is, in principle all requests for capital funds are filled no matter what division or product line they come from, provided only that they clear a single financial hurdle such as a payback or discounted cash-flow rate of return. Of course, when the requests exceed the available resources, some ranking system is employed, but, in effect, the hurdle is simply raised and a new single-number decision rule is applied uniformly to all requests.

This approach fails to provide any portfolio assessment of the various parts of the enterprise considered as a group. Therefore, capital can flow to a mediocre division or product line as fast as it flows to a high-potential division, or even faster. This simply perpetuates the status quo, frequently negating the value of the strategic planning at the corporate level. In other words, the CEO's all-important decision of allocating capital is blurred and in fact abdicated.

One simple but powerful approach some multibusiness managers are using today is to sort their individual businesses into three broad portfolio categories: sources of growth (future earnings); sources of current and intermediate earnings; and sources of immediate cash flow. One of my colleagues has suggested that these categories relate directly to the so-called product lifecycle curve which can also, for these purposes, be termed a business-lifecycle curve. When a company views its operations in this manner, some interesting implications for the capital-allocation process may emerge.

Of course, change in capital-allocation decisions is only one of the many management implications of multibusiness strategic planning. The impact of this broad perspective can and should carry over to every facet of management responsibility.

The need for such top-down guidelines is perhaps most vividly apparent in the “pruning” or divesting activities of a multibusiness company, aimed at milking declining divisions or products for cash, which will then be redeployed in more attractive opportunities. (Hopefully, opportunities exist for redeployment, but this kind of analysis can bring to light imbalances at either end of this spectrum.)

While such a disinvestment program often makes eminent sense from a corporate point of view, it is a rare division or product manager who willingly plans himself out of business. Most managers will argue that the new growth is just around the corner; all they need to get the payoff is a little more investment “up front.” For this reason, strategic-planning efforts rarely bring disinvestment-redeployment decisions to the surface, unless the CEO has provided explicit guidelines. He must find ways to create an environment in which different planning criteria and different performance criteria are not only acceptable but demanded.

This brings us to the human-relations dimension of strategic planning, and the final action step needed to make it effective.

Responsibility and reward

No strategic-planning program will produce bottom-line results without careful attention to human motivations. This is a highly subjective matter, tied inextricably to the leadership style of the CEO, but two general recommendations apply in almost every case.

First, involve the decision makers. In a decision-oriented planning environment, developing and implementing strategies can only be the responsibility of line managers. This does not mean that the CEO should do away with his planning staff and planning processes. Rather, it means that the output of such staffs and processes should only be an input to top management. It is top management’s responsibility to weigh strategic issues, apply judgment, and make the decisions. Strategic planning may be a staff function, but strategic decision making is the responsibility of the CEO and the top-management team. Several companies have underscored this point by requiring division managers to present and defend their strategies and plans in the absence of their staff planners.

Second, reward good strategic decision makers. If all promotions, bonuses, and other rewards go to the executives who meet or exceed short-term budget goals, without regard to the way they position their organizations for future success, then strategies and strategic plans will be no more than a charade. I am not suggesting that short-term performance measures should be eliminated; rather, I am saying that long-term performance milestones must be added and built into the annual performance review, particularly in companies where the best line managers get promoted every 18 to 24 months.

Following the widespread introduction of data processing in the 1950s, many companies sooner or later were obliged to recognize that the promise of this great management tool was stubbornly refusing to materialize. Real, tangible return on investment was low or nonexistent. Today, a great many companies have largely overcome this problem. Not without a struggle, they have substantially brought their computer systems under control, and most of these managements are a good deal wiser for the experience. The most successful among these companies would, I believe, include at least the following among the lessons they have learned:

- The effort must be integrated directly into the important decision-making activities of the company. Each potential new project must pass the "so what?" test.

- The chief executive holds the key to success; commitment and leadership is absolutely necessary.

- The payoff when it works is substantial and it can be measured in dollars and cents. All of these lessons apply to strategic planning. When it is focused on current decisions, under the leadership of a committed CEO, it works. And when it works, we may be sure that the payoff will show on the bottom line.

Lou Gerstner, former CEO of IBM, is an alumnus of McKinsey's New York office. This is an adapted version of an article reprinted from the December 1972 issue of *Business Horizons* by permission of the copyright holder, the Kelley School of Business, Indiana University.