**Chapter 1**

**Strategic Leadership: Managing the Strategy-Making Process for Competitive Advantage**

Synopsis of Chapter

This chapter is an introductory chapter. Its purpose is to define critical concepts and introduce the main components of the strategic leadership and management process. This chapter serves to establish the context within which subsequent chapters fit.

Chapter 1 begins with a discussion of the concept of strategy. The strategies an organization pursues have a major impact upon its performance relative to its peers. The firm’s top managers have direct responsibility for choosing strategies that will lead to superior performance and provide competitive advantage.

Next, the chapter equates superior performance with profitability, for profit-seeking enterprises. Sustained competitive advantage occurs when a firm is able to maintain above average profitability over an extended period of time. Strategic management is just as crucial to nonprofits as it is to profit-seeking businesses. Much of this book is about identifying and describing the strategies that managers can pursue to achieve superior performance and provide their company with a competitive advantage. The book will provide a thorough understanding of the business model analytical techniques and skills necessary to identify and implement strategies successfully.

A discussion of strategic managers and the strategy-making process follows. Strategic managers are the linchpin in the strategy-making. Strategy-making is the process by which managers formulate and implement a set of strategies for a company, the aim of which is to attain competitive advantage. It examines the types of strategic managers, their roles and their responsibilities at three main levels within an organization—corporate, business, and functional. This chapter also gives an overview of the formal strategic management process. The process consists of two phases. The first phase, formulation, includes the establishment of corporate mission, values, and goals; analysis of the external environment; analysis of the internal environment; and selection of an appropriate functional-, business-, global, or corporate-level strategy. The second phase, implementation, consists of the actions taken to carry out the chosen strategy such as appropriate governance and ethics, designing an organizational structure, designing an organization culture, and designing organization controls.

The traditional concept of the strategic planning process is one that is rational and deterministic, and orchestrated by senior managers. However, strategies may also emerge through other mechanisms.

The next section of this chapter presents a discussion of strategic planning in practice. Formal planning helps companies make better strategic decisions, and the use of decision aids can help managers make better forecasts. However, formal strategic planning systems do not always produce the desired results.

The next section of the chapter stresses the importance of strategic decision-making by providing an understanding of how cognitive biases impact strategic decision making along with techniques for improving decision making.

The final section of the chapter addresses key characteristics of good strategic leadership that will lead organizations to high performance.

By the end of this chapter, students will understand how strategic leaders can manage the strategy-making process, formulating and implementing strategies that enable a company to achieve a competitive advantage and superior performance. Moreover, they will have an appreciation for how the strategy-making process can go wrong, and what managers can do to make this process more effective.

Learning Objectives

. Explain what is meant by “competitive advantage.”

. Discuss the strategic role of managers at different levels within an organization.

. Identify the primary steps in a strategic planning process.

. Discuss the common pitfalls of planning, and how those pitfalls can be avoided.

. Outline the cognitive biases that might lead to poor strategic decisions, and explain how these biases can be overcome.

. Discuss the role strategic leaders play in the strategy-making process.

Opening Case

**Wal-Mart**

The opening case examines Wal-Mart’s persistently superior profitability, which reflects a competitive advantage that is based upon a number of strategies. Wal-Mart’s competitive advantage was based on a business model of targeting small southern towns as well as the urban and suburban locations. Wal-Mart grew quickly by pricing its products lower than those of local retailers, often putting them out of business. The company was also an innovator in information systems, logistics, and human resource practices. These strategies resulted in higher productivity and lower costs as compared to rivals, which enabled the company to earn a high profit while charging low prices. Wal-Mart led the way among U.S. retailers in developing and implementing sophisticated product tracking systems using bar-code technology and checkout scanners. This information technology enabled Wal-Mart to track what was selling and adjust its inventory accordingly so that the products found in each store matched local demand, thereby avoiding overstocking. With regard to human resources, Sam Walton believed that employees should be respected and rewarded for helping to improve the profitability of the company. By the time the 1990s came along, Wal-Mart was already the largest seller of general merchandise in the United States. But, rivals Target and Costco have continued to improve their performance, and Costco in particular is now snapping at Wal-Mart’s heals.

**Teaching Note:**

This Opening Case provides an excellent opportunity to discuss many of the concepts that will be introduced in Chapter 1. For example, Wal-Mart developed a business model that was unique and revolutionary at the time. The model allowed the firm to keep costs low and capture a greater portion of the profits. Because the model was unique and led to improved effectiveness and efficiency, the firm achieved a sustained competitive advantage. The business model was developed by Sam Walton and provides an example of effective strategic leadership and vision. This case may be used to point out to students that every firm, no matter how successful, is vulnerable to competitive attack.

Figure 1.1: Profitability of Wal-Mart and Competitors, 2003-2012

Lecture Outline

**I. Overview**

This book argues that the strategies that a company’s managers pursue have a major impact on the company’s performance relative to that of its competitors. A **strategy** is a set of related actions that managers take to increase their company performance. This book identifies and describes the strategies that managers can pursue to achieve superior performance and provide their companies with a competitive advantage. One of its aims is to give the students a thorough understanding of the analytical techniques and skills necessary to identify and implement strategies successfully.

**Strategic leadership** is about how to most effectively manage a company’s strategy-making process to create competitive advantage. The strategy-making process is the process by which managers select and then implement a set of strategies that aim to achieve a competitive advantage. **Strategy formulation** is the task of selecting strategies, whereas **strategy implementation** is the task of putting strategies into action, which includes designing, delivering, and supporting products; improving the efficiency and effectiveness of operations; and designing a company’s organization structure, control systems, and culture.

**II. Strategic Leadership, Competitive Advantage, and Superior Performance**

Strategic leadership is concerned with managing the strategy-making process to increase the performance of a company, thereby increasing the value of the enterprise to its owners, its shareholders. To increase shareholder value, managers must pursue strategies that increase the profitability of the company and ensure that profits grow (Figure 1.2). To do this, a company must be able to outperform its rivals; it must have a competitive advantage.

Figure 1.2: Determinants of Shareholder Value

**A. Superior Performance:**

Maximizing shareholder value is the ultimate goal of profit making companies for two reasons:

* Shareholders provide a company with the risk capital that enables managers to buy the resources needed to produce and sell goods and services. **Risk capital** is capital that cannot be recovered if a company fails and goes bankrupt.
* Shareholders are the legal owners of a corporation, and their shares therefore, represent a claim on the profits generated by a company. Thus, mangers have an obligation to invest those profits in ways that maximize shareholder value.

**Shareholder value** means the returns that shareholders earn from purchasing shares in a company. These returns come from two sources:

* Capital appreciation in the value of a company’s shares
* Dividend payments

One way of measuring the **profitability** of a company is by the return that it makes on the capital invested in the enterprise. The return on invested capital (ROIC) that a company earns is defined as its net profit over the capital invested in the firm (profit/capital invested). Net profit means net income after tax. Capital means the sum of money invested in the company—that is, stockholders’ equity plus debt owed to creditors. So defined, *profitability is the result of how efficiently and effectively managers use the capital at their disposal to produce goods and services that satisfy customer needs.*

The **profit growth** of a company can be measured by the increase in net profit over time. A company can grow its profits if it sells products in markets that are growing rapidly, gains market share from rivals, increases the amount it sells to existing customers, expands overseas, or diversifies profitably into new lines of business.

Together, profitability and profit growth are the principal drivers of shareholder value. *To both boost profitability and grow profits over time, managers must formulate and implement strategies that give their company a competitive advantage over rivals*. What shareholders want to see, and what managers must try to deliver through strategic leadership, is profitable growth—that is, high profitability and sustainable profit growth.

**B. Competitive Advantage and a Company’s Business Model**

To maximize shareholder value, managers must formulate and implement strategies that enable their company to outperform rivals—that give it a competitive advantage. A company is said to have a **competitive advantage** over its rivals when its profitability is greater than the average profitability and profit growth of other companies competing for the same set of customers. The higher its profitability relative to rivals, the greater its competitive advantage will be. A company has a sustained competitive advantage when its strategies enable it to maintain above-average profitability for a number of years.

A **business model** is managers’ conception of how the set of strategies their company pursues should work together as a congruent whole, enabling the company to gain a competitive advantage and achieve superior profitability and profit growth. In essence, a business model is a kind of mental model, or gestalt, of how the various strategies and capital investments a company makes should fit together to generate above-average profitability and profit growth.

**III. Industry Differences in Performance**

It is important to recognize that in addition to its business model and associated strategies, a company’s performance is also determined by the characteristics of the industry in which it competes. Different industries are characterized by different competitive conditions. In some industries, demand is growing rapidly, and in others it is contracting. Some industries might be beset by excess capacity and persistent price wars, others by strong demand and rising prices. Figure 1.3 shows the average profitability, measured by ROIC, among companies in several different industries between 2002 and 2011.

Figure 1.3: Return on Invested Capital (ROIC) in Selected Industries, 2002-2011

**A. Performance in Nonprofit Enterprises**

Nonprofit enterprises such as government agencies, universities, and charities are not in “business” to make profits. Nevertheless, they are expected to use their resources efficiently and operate effectively, and their managers set goals to measure their performance. The managers of nonprofits need to map out strategies to attain these goals. They also need to understand that nonprofits compete with each other for scarce resources, just as businesses do.

**IV. Strategic Managers**

In most companies, there are two primary types of managers:

* **General managers**, who bear responsibility for the overall performance of the company or for one of its major self-contained subunits or divisions. The overriding concern of general managers is the success of the whole company or the divisions under their direction; they are responsible for deciding how to create a competitive advantage and achieve high profitability with the resources and capital they have at their disposal.
* **Functional managers**, who are responsible for supervising a particular function, that is, a task, activity, or operation, such as accounting, marketing, etc.

Figure 1.4 shows the organization of a **multidivisional company**, that is, a company that competes in several different businesses and has created a separate self-contained division to manage each. There are three main levels of management—corporate, business, and functional.

Figure 1.4: Levels of Strategic Management

1. **Corporate-Level Managers**

The corporate level of management consists of the chief executive officer (CEO), other senior executives, and corporate staff. The CEO is the principal general manager. In consultation with other senior executives, the role of corporate-level managers is to oversee the development of strategies for the whole organization. This role includes defining the goals of the organization, determining what businesses it should be in, allocating resources among the different businesses, formulating and implementing strategies that span individual businesses, and providing leadership for the entire organization.

Corporate-level managers also provide a link between the people who oversee the strategic development of a firm and those who own it (the shareholders). Corporate-level managers, and particularly the CEO, can be viewed as the agents of shareholders.

1. **Business-Level Managers**

A **business unit** is a self-contained division (with its own functions—e.g., finance, purchasing, etc.) that provides a product or service for a particular market. The principal general manager at the business level, or the business-level manager, is the head of the division. The strategic role of these managers is to translate the general statements of direction and intent that come from the corporate level into concrete strategies for individual businesses.

1. **Functional-Level Managers**

Functional-level managers are responsible for the specific business functions or operations (human resources, purchasing, product development, customer service, etc.) that constitute a company or one of its divisions. Thus, a functional manager’s sphere of responsibility is generally confined to one organizational activity, whereas general managers oversee the operation of an entire company or division.

**V. The Strategy-Making Process**

**A. A Model of the Strategic Planning Process**

The formal strategic planning process has five main steps:

* Select the corporate mission and major corporate goals.
* Analyze the organization’s external competitive environment to identify opportunities and threats.
* Analyze the organization’s internal operating environment to identify the organization’s strengths and weaknesses.
* Select strategies that build on the organization’s strengths and correct its weaknesses in order to take advantage of external opportunities and counter external threats. These strategies should be consistent with the mission and major goals of the organization.
* Implement the strategies.

The task of analyzing the organization’s external and internal environments and then selecting appropriate strategies constitutes strategy formulation. In contrast, strategy implementation involves putting the strategies (or plan) into action. This includes taking actions consistent with the selected strategies of the company at the corporate, business, and functional levels; allocating roles and responsibilities among managers (typically through the design of organization structure); allocating resources (including capital and money); setting short-term objectives; and designing the organization’s control and reward systems. These steps are illustrated in Figure 1.5.

***Figure 1.5: Main Components of the Strategic Planning Process***

Each step in Figure 1.5 constitutes a sequential step in the strategic planning process. At step 1, each round, or cycle, of the planning process begins with a statement of the corporate mission and major corporate goals. The mission statement, then, is followed by the foundation of strategic thinking: external analysis, internal analysis, and strategic choice. The strategy-making process ends with the design of the organizational structure and the culture and control systems necessary to implement the organization’s chosen strategy.

Some organizations go through a new cycle of the strategic planning process every year. This does not necessarily mean that managers choose a new strategy each year. In many instances, the result is simply to modify and reaffirm a strategy and structure already in place. The strategic plans generated by the planning process generally project over a period of 1 to 5 years, and the plan is updated, or rolled forward, every year. In most organizations, the results of the annual strategic planning process are used as input into the budgetary process for the coming year so that strategic planning is used to shape resource allocation within the organization.

**B. Mission Statement**

The first component of the strategic management process is crafting the organization’s mission statement, which provides the framework—or context—within which strategies are formulated. A mission statement has four main components:

* A statement of the raison d’être of a company or organization—its reason for existence—which is normally referred to as the mission
* A statement of some desired future state, usually referred to as the vision
* A statement of the key values that the organization is committed to
* A statement of major goals

1. **Mission**

A company’s **mission** describes what the company does. According to the late Peter Drucker, an important first step in the process of formulating a mission is to come up with a definition of the organization’s business. Essentially, the definition answers these questions—“What is our business? What will it be? What should it be?” The responses to these questions guide the formulation of the mission. To answer the question, “What is our business?” a company should define its business in terms of three dimensions—who is being satisfied (what customer groups), what is being satisfied (what customer needs), and how customers’ needs are being satisfied (by what skills, knowledge, or distinctive competencies)? Figure 1.6 illustrates these dimensions.

***Figure 1.6: Defining the Business***

This approach stresses the need for a *customer-oriented* rather than a *product-oriented* business definition.

1. **Vision**

The **vision** of a company defines a desired future state; it articulates, often in bold terms, what the company would like to achieve.

1. **Values**

The **values** of a company state how managers and employees should conduct themselves, how they should do business, and what kind of organization they should build to help a company achieve its mission. Insofar as they help drive and shape behavior within a company, values are commonly seen as the bedrock of a company’s organizational culture—the set of values, norms, and standards that control how employees work to achieve an organization’s mission and goals.

In one study of organizational values, researchers identified a set of values associated with high-performing organizations that help companies achieve superior financial performance through their impact on employee behavior. These values include respect for the interests of key organizational stakeholders—individuals or groups that have an interest, claim, or stake in the company, in what it does, and in how well it performs. They include stockholders, bondholders, employees, customers, the communities in which the company does business, and the general public.

**VI. Major Goals**

A goal is a precise and measurable desired future state that a company attempts to realize. The purpose of goals is to specify with precision what must be done if the company is to attain its mission or vision. Well-constructed goals have four main characteristics:

* They are precise and measurable.
* They address crucial issues.
* They are challenging but realistic.
* They specify a time period in which the goals should be achieved, when that is appropriate.

Well-constructed goals also provide a means by which the performance of managers can be evaluated. The primary goal of most corporations is to maximize shareholder returns, and doing this requires both high profitability and sustained profit growth. Thus, most companies operate with goals for profitability and profit growth.

**A. External Analysis**

The essential purpose of external analysis is to identify strategic opportunities and threats within the organization’s operating environment that will affect how it pursues its mission. Three interrelated environments should be examined when undertaking an external analysis—the industry environment in which the company operates, the country or national environment, and the wider socioeconomic or macroenvironment.

1.1 Strategy in Action: Strategic Analysis at Time Inc.

In the mid-2000s, Time Inc. recognized that it needed to change its strategy. Its traditional publications were losing readers. External analysis showed that younger readers were turning to the web for information of the type provided by Time’s publications. Internally, Time treated web publication as a separate and less desirable outlet for its content. The Managing Editor of People, Martha Nelson, was the first to see the advantages of a web presence. She merged the two newsrooms and emphasized the need for original content on the web. She stressed the importance of driving traffic to the web and earning advertising revenues. The People model became the template for the other magazines published by Time. Ann Moore, the CEO, neutralized the cultural weakness that hindered online efforts in the past at Time and redirected resources to Web publishing. Web partnerships that merged news channels, magazines, and websites resulted in top online websites. This Web-centric publishing created a focus on energy, resources, and investments toward brands having the ability to obtain digital form audiences.

Teaching Note:

This insert provides an example of how a large, mainstream firm can experience the strategy-making process. An external analysis revealed the need for change, an internal analysis revealed the weaknesses of the firm; the strategic options were identified and implemented. Ultimately, the strategic options were expanded throughout the firm and continued to evolve.

**B. Internal analysis**

Internal analysis focuses on reviewing the resources, capabilities, and competencies of a company. The goal is to identify the strengths and weaknesses of the company.

1. **SWOT Analysis and the Business Model**

The comparison of strengths, weaknesses, opportunities, and threats is normally referred to as a **SWOT analysis**. The central purpose is to identify the strategies to exploit external opportunities, counter threats, build on and protect company strengths, and eradicate weaknesses.

The goal of a SWOT analysis is to create, affirm, or fine-tune a company-specific business model that will best align, fit, or match a company’s resources and capabilities to the demands of the environment in which it operates. Managers compare and contrast the various alternative possible strategies against each other and then identify the set of strategies that will create and sustain competitive advantage. These strategies can be divided into four main categories:

* *Functional-level strategies*, directed at improving the effectiveness of operations within a company, such as manufacturing, marketing, etc.
* *Business-level strategies*, which encompass the business’s overall competitive theme, the way it positions itself in the marketplace to gain a competitive advantage, and the different positioning strategies that can be used in different industry settings—for example, cost leadership, differentiation, etc.
* *Global strategies*, which address how to expand operations outside the home country to grow and prosper in a world where competitive advantage is determined at a global level.
* *Corporate-level strategies*, which answer the primary questions—What business or businesses should we be in to maximize the long-run profitability and profit growth of the organization, and how should we enter and increase our presence in these businesses to gain competitive advantage?

The strategies identified through a SWOT analysis should be congruent with each other. Thus, functional-level strategies should be consistent with, or support, the company’s business-level strategies and global strategies.

1. **Strategy** **Implementation**

Strategy implementation involves taking actions at the functional, business, and corporate levels to execute a strategic plan. Implementation can include, for example, putting quality improvement programs into place, changing the way a product is designed, positioning the product differently in the marketplace, segmenting the marketing and offering different versions of the product to different consumer groups, implementing price increases or decreases, etc. Strategy implementation entails designing the best organization structure and the best culture and control systems to put a chosen strategy into action. In addition, senior managers need to put a governance system in place to make sure that all within the organization act in a manner that is not only consistent with maximizing profitability and profit growth, but also legal and ethical.

1. **The Feedback Loop**

The feedback loop indicates that strategic planning is ongoing—it never ends. Once a strategy has been implemented, its execution must be monitored to determine the extent to which strategic goals and objectives are actually being achieved, and to what degree competitive advantage is being created and sustained. Top managers can then decide whether to reaffirm the existing business model and the existing strategies and goals, or suggest changes for the future.

**VII. Strategy as an Emergent Process**

The planning model suggests that a company’s strategies are the result of a plan, that the strategic planning process is rational and highly structured, and that top management orchestrates the process. Several scholars have criticized the formal planning model for three main reasons:

* The unpredictability of the real world
* The role that lower-level managers can play in the strategic management process
* The fact that many successful strategies are often the result of serendipity, not rational strategizing

**A. Strategy Making in an Unpredictable World**

Critics of formal planning systems argue that we live in a world in which uncertainty, complexity, and ambiguity dominate, and in which small chance events can have a large and unpredictable impact on outcomes. In such circumstances, they claim, even the most carefully thought-out strategic plans are prone to being rendered useless by rapid and unforeseen change. In an unpredictable world, being able to respond quickly to changing circumstances, and to alter the strategies of the organization accordingly, is paramount.

**B. Autonomous Action: Strategy Making by Lower-Level Managers**

Another criticism leveled at the rational planning model of strategy is that too much importance is attached to the role of top management, particularly the CEO. An alternative view is that individual managers deep within an organization can—and often do—exert a profound influence over the strategic direction of the firm. Autonomous action may be particularly important in helping established companies deal with the uncertainty created by the arrival of a radical new technology that changes the dominant paradigm in an industry.

1.2 Strategy in Action: Starbucks’ Music Business

Starbucks sells music in addition to its coffee and food offerings. Music sales came about, not through a formal planning process, but due to an emergent situation. The company’s journey into music started in the late 1980s when Tim Jones, the manager of one Starbucks in Seattle’s University Village, started to bring his own tapes of music compilations into the store to play. Soon Jones was getting requests for copies from customers. Jones told this to Starbucks’ CEO, Howard Schultz, and suggested that Starbucks start to sell music compilations. At first, Schultz was skeptical, but after repeated lobbying efforts by Jones, he eventually took up the suggestion. Today Starbucks’ music business represents a small but healthy part of its overall product portfolio.

Teaching Note:

The key point here is that strategy is not only a rational and deterministic planning process. It can come about by autonomous action on the part of lower-level managers.

**1.3 Strategy in Action: A Strategic Shift at Charles Schwab**

Charles Schwab had been a successful discount stockbroker company for over twenty years. Its business was handled through branches and a telephone system as well as proprietary software. Then E\*Trade came on the scene. E\*Trade used the web of online trading; it had no branches, no brokers, no telephone system, thus having a very low cost structure. A software specialist at Schwab, William Pearson, realized the power of the web but couldn’t get the attention of his superiors. Eventually he approached Anne Hennegar, a former Schwab manager who now worked as a consultant to the company. Hennegar suggested that Pearson meet with Tom Seip, an executive vice president at Schwab who was known for his ability to think outside the box. Hennegar approached Seip on Pearson’s behalf, and Seip responded positively, asking her to set up a meeting. Hennegar and Pearson arrived, expecting to meet only Seip, but to their surprise, in walked Charles Schwab, his chief operating officer, David Pottruck, and the vice presidents in charge of strategic planning and electronic brokerage.

As the group watched Pearson’s demo, which detailed how a Web-based system would look and work, they became increasingly excited. A year later, Schwab launched its own Web-based offering, eSchwab, which enabled Schwab clients to execute stock trades for a low flat-rate commission. eSchwab went on to become the core of the company’s offering, enabling it to stave off competition from deep discount brokers like E\*Trade.

Teaching Note:

An interesting discussion could be generated from this case by asking students to consider what kind of organization culture, policies, structure, leadership, and so on would be necessary to encourage and accept employees’ creativity and autonomy. William Pearson was able to overcome the inertia of the system at Charles Schwab. Others may not be so fortunate. Classroom discussion can also be enlivened and humor introduced if you describe, or ask students to describe, other innovations that were not pursued, to disastrous results. For example, when a Harvard MBA student wrote a paper proposing a profit-making delivery service, he hoped his professor would help him find venture financing, but instead received a D on the assignment. The professor believed that no firm would ever be able to deliver packages more efficiently or cheaply than the government-subsidized U.S. Postal Service. The student went on to become the founder of Federal Express.

**C. Serendipity and Strategy**

Business history is replete with examples of accidental events that help to push companies in new and profitable directions. These examples suggest that many successful strategies are not the result of well-thought-out plans, but of serendipity—stumbling across good things unexpectedly. Serendipitous discoveries and events can open all sorts of profitable avenues for a company. But some companies have missed profitable opportunities because serendipitous discoveries or events were inconsistent with their prior (planned) conception of what their strategy should be.

**D. Intended and Emergent Strategies**

Henry Mintzberg’s model of strategy development provides an encompassing view of what strategy actually is. According to this model, a company’s realized strategy is the product of whatever planned strategies are actually put into action (the company’s deliberate strategies) and any unplanned, or emergent, strategies (Figure 1.7). In Mintzberg’s view, many planned strategies are not implemented because of unpredicted changes in the environment (they are unrealized). Emergent strategies are the unplanned responses to unforeseen circumstances. They arise from autonomous action by individual managers deep within the organization, from serendipitous discoveries or events, or from an unplanned strategic shift by top-level managers in response to changed circumstances.

***Figure 1.7: Emergent and Deliberate Strategies***

Mintzberg maintains that emergent strategies are often successful and may be more appropriate than intended strategies. Successful strategies can often emerge within an organization without prior planning, and in response to unforeseen circumstances. As Mintzberg has noted, strategies can take root wherever people have the capacity to learn and the resources to support that capacity.

In practice, the strategies of most organizations are likely a combination of the intended and the emergent. The message for management is that it needs to recognize the process of emergence and to intervene when appropriate, relinquishing bad emergent strategies and nurturing potentially good ones. To make such decisions, managers must be able to judge the worth of emergent strategies. They must be able to think strategically. Although emergent strategies arise from within the organization without prior planning, top management must still evaluate emergent strategies.

**VIII. Strategic Planning in Practice**

Despite criticism, research suggests that formal planning systems do help managers make better strategic decisions. For strategic planning to work, it is important that top-level managers plan not only within the context of the current competitive environment but also within the context of the future competitive environment.

**A. Scenario Planning**

**Scenario planning** involves formulating plans that are based upon “what-if” scenarios about the future. In the typical scenario-planning exercise, some scenarios are optimistic and some are pessimistic. Teams of managers are asked to develop specific strategies to cope with each scenario. A set of indicators is chosen as signposts to track trends and identify the probability that any particular scenario is coming to pass. The idea is to allow managers to understand the dynamic and complex nature of their environment, to think through problems in a strategic fashion, and to generate a range of strategic options that might be pursued under different circumstances.

The great virtue of the scenario approach to planning is that it can push managers to think outside the box, to anticipate what they might need to do in different situations. It can remind managers that the world is complex and unpredictable, and to place a premium on flexibility, rather than on inflexible plans based on assumptions about the future. As a result of scenario planning, organizations might pursue one dominant strategy related to the scenario that is judged to be most likely, but they make some investments that will pay off if other scenarios come to the fore (Figure 1.8).

***Figure 1.8 Scenario Planning***

**B. Decentralized Planning**

A mistake that some companies have made in constructing their strategic planning process has been to treat planning exclusively as a top-management responsibility. This “ivory tower” approach can result in strategic plans formulated in a vacuum by top managers who have little understanding or appreciation of current operating realities. The ivory tower concept of planning can also lead to tensions between corporate-, business-, and functional-level managers.

Correcting the ivory tower approach to planning requires recognizing that successful strategic planning encompasses managers at all levels of the corporation. Much of the best planning can and should be done by business and functional managers who are closest to the facts; in other words, planning should be decentralized. Corporate-level planners should take on roles as facilitators who help business and functional managers do the planning by setting the broad strategic goals of the organization and providing the resources necessary to identify the strategies that might be required to attain those goals.

**IX. Strategic Decision Making**

Even the best-designed strategic planning systems will fail to produce the desired results if managers do not effectively use the information at their disposal. One important way in which managers can make better use of their knowledge and information is to understand how common cognitive biases can result in poor decision making.

1. **Cognitive Biases and Strategic Decision Making**

Humans are not supercomputers, and it is difficult for us to absorb and process large amounts of information effectively. As a result, when we make decisions, we tend to fall back on certain rules of thumb, or heuristics, that help us to make sense out of a complex and uncertain world. However, sometimes these rules lead to severe and systematic errors in the decision-making process. Systematic errors are those that appear time and time again. They seem to arise from a series of **cognitive biases** in the way that humans process information and reach decisions. The following are some of the cognitive biases that exist and that people are prone to:

* The **prior hypothesis bias** refers to the fact that decision makers who have strong prior beliefs about the relationship between two variables tend to make decisions on the basis of these beliefs, even when presented with evidence that their beliefs are incorrect.
  + Moreover, they tend to seek and use information that is consistent with their prior beliefs while ignoring information that contradicts these beliefs.
* Another well-known cognitive bias, **escalating commitment** occurs when decision makers having already committed significant resources to a project, commit even more resources if they receive feedback that the project is failing.
  + This may be an irrational response; a more logical response would be to abandon the project and move on, rather than escalate commitment.
* A third bias, **reasoning by analogy** involves the use of simple analogies to make sense out of complex problems.
  + The problem with this heuristic is that the analogy may not be valid.
* A fourth bias, **representativeness** is rooted in the tendency to generalize from a small sample or even a single vivid anecdote.
  + This violates the statistical law of large numbers, which says that it is inappropriate to generalize from a small sample, let alone from a single case.
* A fifth cognitive bias is referred to as the **illusion of control**, or the tendency to overestimate one’s ability to control events.
  + General or top-level managers seem to be particularly prone to this bias—having risen to the top of an organization, they tend to be overconfident about their ability to succeed.
* The **availability error** is yet another common bias.
  + The availability error arises from our predisposition to estimate the probability of an outcome based on how easy the outcome is to imagine.

1. **Techniques for Improving Decision Making**

The existence of cognitive biases raises a question—How can critical information affect the decision-making mechanism so that a company’s strategic decisions are realistic and based on thorough evaluations? Two techniques known to enhance strategic thinking and counteract cognitive biases are:

* **Devil’s advocacy**—this requires the generation of a plan, and a critical analysis of that plan. One member of the decision-making group acts as the devil’s advocate, emphasizing all the reasons that might make the proposal unacceptable.
  + In this way, decision makers can become aware of the possible perils of recommended courses of action.
* **Dialectic inquiry**—this is more complex because it requires the generation of a plan (a thesis) and a counter-plan (an antithesis) that reflect plausible but conflicting courses of action. Strategic managers listen to a debate between advocates of the plan and counterplan and then decide which plan will lead to higher performance.
  + The purpose of the debate is to reveal problems with definitions, recommended courses of action, and assumptions of both plans. As a result of this exercise, strategic managers are able form a new and more encompassing conceptualization of the problem, which then becomes the final plan (a synthesis).

Another technique for countering cognitive biases is the **outside view**, which has been championed by Nobel Prize winner Daniel Kahneman and his associates. The **outside view** requires planners to identify a reference class of analogous past strategic initiatives, determine whether those initiatives succeeded or failed, and evaluate the project at hand against those prior initiatives.

**X. Strategic Leadership**

One of the key strategic roles of both general and functional managers is to use all their knowledge, energy, and enthusiasm to provide strategic leadership for their subordinates and develop a high-performing organization. Several authors have identified a few characteristics of good strategic leaders that do lead to high performance:

* Vision, eloquence, and consistency
* Articulation of a business model
* Commitment
* Being well informed
* Willingness to delegate and empower
* Astute use of power
* Emotional intelligence

**A. Vision, Eloquence, and Consistency**

One of the key tasks of leadership is to give an organization a sense of direction. Strong leaders seem to have a clear and compelling vision of where the organization should go, are eloquent enough communicate this vision to others within the organization in terms that energize people, and consistently articulate their vision until it becomes part of the organization’s culture.

**B. Articulation of the Business Model**

Another key characteristic of good strategic leaders is their ability to identify and articulate the business model the company will use to attain its vision. A business model is managers’ conception of how the various strategies that the company pursues fit together into a congruent whole. Although individual strategies can take root in many different places in an organization, and although their identification is not the exclusive preserve of top management, only strategic leaders have the perspective required to make sure that the various strategies fit together into a congruent whole and form a valid and compelling business model.

**C. Commitment**

Strong leaders demonstrate their commitment to the visions and business models by actions and words, and they often lead by example.

**D. Being Well Informed**

Effective strategic leaders develop a network of formal and informal sources who keep them well informed about what is going on within the company. Using informal and unconventional ways to gather information is wise because formal channels can be captured by special interests within the organization or by gatekeepers—managers who may misrepresent the true state of affairs to the leader.

**E. Willingness to Delegate and Empower**

High-performance leaders are skilled at delegation. They recognize that unless they learn how to delegate effectively, they can quickly become overloaded with responsibilities. They also recognize that empowering subordinates to make decisions is a good motivational tool and often results in decisions being made by those who must implement them.

**F. The Astute Use of Power**

In a now-classic article on leadership, Edward Wrapp noted that effective leaders tend to be very astute in their use of power. He argued that strategic leaders must often play the power game with skill and attempt to build consensus for their ideas rather than use their authority to force ideas through; they must act as members of a coalition or its democratic leaders rather than as dictators.

**G. Emotional Intelligence**

*Emotional intelligence* is a term that Daniel Goleman coined to describe a bundle of psychological attributes that many strong and effective leaders exhibit:

* Self-awareness—the ability to understand one’s own moods, emotions, and drives, as well as their effect on others.
* Self-regulation—the ability to control or redirect disruptive impulses or moods, that is, to think before acting.
* Motivation—a passion for work that goes beyond money or status and a propensity to pursue goals with energy and persistence.
* Empathy—the ability to understand the feelings and viewpoints of subordinates and to take those into account when making decisions.
* Social skills—friendliness with a purpose.

According to Goleman, leaders who possess these attributes—who exhibit a high degree of emotional intelligence—tend to be more effective than those who lack these attributes. Their self-awareness and self-regulation help to elicit the trust and confidence of subordinates. In Goleman’s view, people respect leaders who, because they are self-aware, recognize their own limitations and, because they are self-regulating, consider decisions carefully. Goleman also argues that self-aware and self-regulating individuals tend to be more self-confident and therefore better able to cope with ambiguity and more open to change. A strong motivation exhibited in a passion for work can also be infectious, helping to persuade others to join together in pursuit of a common goal or organizational mission.

Teaching Note: Ethical Dilemma

This question should solicit an interesting discussion of various viewpoints regarding whether to aim toward accomplishing a large bonus and promotion or keep with the mission statement and maintain the importance of acting with integrity at all times. The instructor should explain, in such a dilemma that while satisfying the goals is important, employees should not lower lending standards and should not lend money to people whose ability to meet their mortgage payments is questionable.

Answers to Discussion Questions

1. What do we mean by strategy? How is a business model different from a strategy?

Strategy is an action a company takes to attain superior performance. Strategy also involves both thinking and doing. From Mintzberg’s definition of strategy as a pattern in a stream of decisions or actions, strategy is more than what a company intends to do; it is also what it actually does. That is to say, a company’s strategy is the product of (a) that part of its intended strategy that is actually realized and (b) its emergent strategy. A business model is managers’ conception of how the various strategies that the company pursues fit together into a congruent whole.

. What do you think are the sources of sustained superior profitability?

Sustained superior profitability results when a company is able to increase profits, either by increasing revenues or decreasing expenses or both, and when that ability is difficult or impossible for competitors to imitate. Sustained superior profitability is most likely to occur when the advantages are intangible, such as management insight, disciplined cost cutting by employees, or a culture that nourishes creativity. Intangible resources are much more difficult to imitate than tangible ones, and thus provide a sustainable advantage. However, no firm can sustain an advantage forever. The advantage itself will tend to weaken over time and competitors will learn to imitate that advantage or develop other advantages of their own that will counteract the power of the original advantage.

3. What are the strengths of formal strategic planning? What are its weaknesses?

A formal strategic planning process results in a systematic review of all the external and internal factors that might have a bearing on the ability of the company to meet its strategic objectives. Formally identifying strengths, weaknesses, opportunities, and threats is a good way of alerting strategic managers to what needs to be done if the firm is to fulfill its strategic mission.

However, like any rational process, strategic planning is limited by the fallibility of human decision makers. In particular, strategic managers may fall victim to the phenomenon of groupthink and to their own cognitive biases. Thus, supposedly rational decisions can turn out to be anything but rational. This hazard can be minimized, however, if the organization uses decision-making techniques such as devil’s advocacy or dialectic inquiry.

In addition, in a complex and uncertain world characterized by rapid change, strategic plans can become outdated as soon as they are made. In such circumstances, the company’s plan can become a policy straitjacket, committing it to a course of action that is no longer appropriate. Change is something that cannot be insured against. Consequently, flexible, open-ended plans are perhaps the best way of giving the company room to maneuver in response to change. Moreover, consistent vision and strategic intent are probably more important than detailed strategic plans. The strategies that a company adopts might need to change with the times, but the vision can be more enduring.

4. To what extent do you think that cognitive biases may have contributed to the global financial crisis that gripped financial markets in 2008–2009? Explain your answer.

Cognitive biases prevent rational action and prevent leaders from being mentally prepared for trouble. Behavioral economists such as the Nobel prize-winner, Daniel Kahneman, have documented cognitive biases in markets, such as over-optimism, over-pessimism, deal frenzy, failure to ignore sunk costs, and so on. Hence, the CEOs end up making poor acquisition decisions, often paying far too much for the companies they acquire. Subsequently, servicing the debt taken on to finance such an acquisition makes it all but impossible to make money from the acquisition.

. Discuss the accuracy of the following statement: Formal strategic planning systems are irrelevant for firms competing in high-technology industries where the pace of change is so rapid that plans are routinely made obsolete by unforeseen events.

Formal strategic planning systems are not at their best in situations with rapid and unpredictable change. Formal systems are time-consuming, and may not be able to provide answers quickly enough when time is very short. Also, formal systems depend upon detailed estimates and forecasts, which are very difficult to do well when conditions are chaotic.

Nevertheless, formal systems may still be useful in some ways, even in these challenging environments. For example, formal systems are often associated with detailed and directive plans, but they may also be used to prepare flexible, open-ended plans that are more appropriate for rapidly changing environments. Also, the activities of formal planning—gathering data, preparing forecasts, generating and considering multiple alternatives, and so on—are themselves good preparation for making strategic choices, and thus could be useful in any type of environment.

. Pick the current or a past president of the United States and evaluate his performance against the leadership characteristics discussed in the text. On the basis of this comparison, do you think that the president was/is a good strategic leader? Why?

Students’ answers will vary. Answering this question calls for students to rate the president according to the six main characteristics of good strategic leaders discussed in the text. There is no right answer to this question. Students’ political biases will undoubtedly color the answers they give. It is the exercise itself that is important. Only with the passage of time will a more objective judgment of a president’s leadership skills be possible.

# Practicing Strategic Management

# Small-Group Exercise: Designing A Planning System

The students are asked to break up into groups of three to five students and discuss the following scenario. They are asked to appoint one group member as a spokesperson who will communicate the group’s findings to the class when called on to do so by the instructor.

You are a group of senior managers working for a fast-growing computer software company. Your product allows users to play interactive role-playing games over the Internet. In the past 3 years, your company has gone from being a start-up enterprise with 10 employees and no revenues to a company with 250 employees and revenues of $60 million. It has been growing so rapidly that you have not had time to create a strategic plan, but now members of the board of directors are telling you that they want to see a plan, and they want the plan to drive decision making and resource allocation at the company. They want you to design a planning process that will have the following attributes:

1. It will be democratic, involving as many key employees as possible in the process.
2. It will help to build a sense of shared vision within the company about how to continue to grow rapidly.
3. It will lead to the generation of three to five key strategies for the company.
4. It will drive the formulation of detailed action plans, and these plans will be subsequently linked to the company’s annual operating budget.

Design a planning process to present to your board of directors. Think carefully about who should be included in this process. Be sure to outline the strengths and weaknesses of the approach you choose, and be prepared to justify why your approach might be superior to alternative approaches.

Teaching Note:

This is an excellent exercise to get students involved. In addition, it is an excellent exercise to break the ice and to make the students feel comfortable with one another and with the instructor. This is an interactive exercise, and students should be asked to present their findings to the rest of the class. The students should think carefully about who should be included in this process and to outline the strengths and weaknesses of their proposed approach. Several groups will be asked to present. Each group will then be asked to justify the advantages of their approach relative to that of other groups. If time permits, an open discussion involving all groups at the end of the class can be used to come up with some kind of synthesis. From this classroom discussion, students should emerge with two important conclusions. First, there is no single “best” way to plan. Different companies and different situations require different processes. Second, every approach to planning involves some tradeoffs. The key to choosing an appropriate process is understanding the tradeoffs and choosing the process that is best for the firm’s specific needs.

# Strategy Sign-On

# Article File 1

This exercise asks students to find an example of a company that has recently changed its strategy. They should identify whether this change was the outcome of a formal planning process or whether it was an emergent response to unforeseen events occurring in the company’s environment.

Teaching Note:

Students will come away from this task with an appreciation for the ways in which formal planning and emergent strategies interact and influence each other. For example, a firm without any formal planning may be reacting to events as they occur, but this is unlikely to occur in ways that achieve a focused strategy. On the other hand, firms that engage in some formal planning are better prepared to react to unforeseen events with a coherent and realistic strategy. However, if formal planning is carried to an extreme and adherence to plans is strictly enforced, emergent responses may be discouraged and inflexibility may present problems.

# Strategic Management Project Module 1

To give students practical insight into the strategic management process, this book provides a series of strategic modules; one is at the end of every chapter. Each module asks students to collect and analyze information relating to the material discussed in that chapter. By completing these strategic modules, students will gain a clearer idea of the overall strategic management process.

The first step in this project is to pick a company to study. The book recommends that students focus on the same company throughout the book. Remember also that the book will be asking students for information about the corporate and international strategies of their company as well as its structure. The book strongly recommends that students pick a company for which such information is likely to be available.

There are two approaches that can be used to select a company to study, and the students’ instructor will tell them which one to follow. The first approach is to pick a well-known company that has a lot of information written about it. For example, large publicly held companies such as IBM, Microsoft, and Southwest Airlines are routinely covered in the business and financial press. By going to the library at their university, students should be able to track down a great deal of information on such companies. Many libraries now have comprehensive Web-based electronic data search facilities such as ABI/Inform, the Wall Street Journal Index, Predicasts F&S Index, and the LexisNexis databases. These enable students to identify any article that has been written in the business press on the company of their choice within the past few years. A number of non-electronic data sources are also available and useful. For example, Predicasts F&S publishes an annual list of articles relating to major companies that appeared in the national and international business press. S&P Industry Surveys is also a great source for basic industry data, and Value Line Ratings and Reports contain good summaries of a firm’s financial position and future prospects. Students should collect full financial information on the company that they pick. This information can be accessed from Web-based electronic databases such as the EDGAR database, which archives all forms that publicly quoted companies have to file with the Securities and Exchange Commission (SEC); for example, 10-K filings can be accessed from the SEC’s EDGAR database. Most SEC forms for public companies can now be accessed from Internet-based financial sites, such as Yahoo!’s finance site ([www.finance.yahoo.com](http://www.finance.yahoo.com)).

A second approach is to choose a smaller company in the city or town to study. Although small companies are not routinely covered in the national business press, they may be covered in the local press. More important, this approach can work well if the management of the company will agree to talk to the students at length about the strategy and structure of the company. If students happen to know somebody in such a company or if they have worked there at some point, this approach can be very worthwhile. However, the book does not recommend this approach unless students can get a substantial amount of guaranteed access to the company of their choice. If in doubt, students should ask their instructor before making a decision. The primary goal is to make sure that students have access to enough interesting information to complete a detailed and comprehensive analysis.

Students assignment for Module 1 is to choose a company to study and to obtain enough information about it to carry out the following instructions and answer the questions:

1. Give a short account of the history of the company, and trace the evolution of its strategy. Try to determine whether the strategic evolution of your company is the product of intended strategies, emergent strategies, or some combination of the two.
2. Identify the mission and major goals of the company.
3. Do a preliminary analysis of the internal strengths and weaknesses of the company and the opportunities and threats that it faces in its environment. On the basis of this analysis, identify the strategies that you think the company should pursue. (You will need to perform a much more detailed analysis later in the book.)
4. Who is the CEO of the company? Evaluate the CEO’s leadership capabilities.

Whichever approach the students use, the instructor should point out to students that some sources are biased, and that they should think carefully about the source of the information as they interpret it. For example, company founders may be overly optimistic about their firm’s performance. Corporate web sites should be treated as advertisements because few will report any negative information. Some respected publications have biases towards liberal or conservative reporting—consider the difference between the *New York Times* and the *Wall Street Journal*. Other publications tend to present a more balanced view. In order to reduce biases in their data, students should consult several different sources.

Once students have chosen a company for this project, they should obtain information about its history, trace the evolution of its strategy, and try to determine whether the strategic evolution of the company is the product of intended strategies, emergent strategies, or some combination of the two. They should identify its mission and major goals, perform a preliminary analysis of its internal strengths and weaknesses, and the opportunities and threats that it faces in its environment for the purpose of identifying the strategies they think the company should pursue. They should also obtain information about the firm’s CEO and evaluate their leadership capabilities. The information they obtain in this first chapter is of an introductory nature. They will perform a full-blown SWOT analysis in later chapters. For this chapter, the purpose of this assignment is to acquaint themselves with several data sources, and to develop an understanding of the firm that can be used as a foundation for further exploration in future assignments.

Closing Case

**General Electric’s Ecomagination Strategy**

Back in 2004, GE’s top-management team was going through its annual strategic planning review when the management team came to a sudden realization: six of the company’s core businesses were deeply involved in environmental and energy-related projects. What was particularly striking was that GE had initiated almost all of these projects in response to requests from its customers. They initiated a data-gathering effort. They made an effort to educate themselves on the science behind energy and environmental issues, including greenhouse gas emissions. At the same time, GE talked to government officials and regulators to try and get a sense for where public policy might be going.

This external review led to the conclusion that energy prices would likely increase going forward, driven by rising energy consumption in developing nations and creating demand for energy-efficient products. The team also saw tighter environmental controls, including caps on greenhouse gas emissions, as all but inevitable. What emerged from these efforts was a realization that GE could build strong businesses by helping its customers to improve their energy efficiency and environmental performance. Thus was born GE’s ecomagination strategy. First rolled out in 2005, the ecomagination strategy cut across businesses. The corporate goals were broken into subgoals and handed down to the relevant businesses. Performance against goals was reviewed on a regular basis, and the compensation of executives was tied to their ability to meet the goals.

The effort soon started to bear fruit. These included a new generation of energy-efficient appliances, more-efficient fluorescent and LED lights, a new jet engine that burned 10% less fuel, a hybrid locomotive that burned 3% less fuel and put out 40% lower emissions than its immediate predecessor, lightweight plastics to replace the steel in cars, and technologies for turning coal into gas in order to drive electric turbines, while stripping most of the carbon dioxide (CO2) from the turbine exhaust. By the end of its first 5-year plan, GE had met or exceeded most of its original goals, despite the global financial crisis that hit in 2008. Not only did GE sell more than $20 billion worth of eco-products in 2010, according to management, these products were also among the most profitable in GE’s portfolio.

Teaching Note:

This case illustrates a number of concepts from the chapter, including many successful strategic ideas, the evolution of strategy over time, and the impact of environmental and internal forces on strategic decision-making and strategic success. It also emphasizes the importance of strategic leadership and a thorough analysis when formulating strategies.

Answers to Case Discussion Questions

1. Where did the original impetus for GE’s ecomagination strategy come from? What does this tell you about strategy making?

GE’s ecomagination strategy originally came up when the top-management team realized that six of the company’s core businesses were deeply involved in environmental and energy-related projects, all in response to requests from its customers. So, an effort was made to educate themselves about the science behind environmental issues. This shows that strategy making should value the company’s customers’ response and should believe in building strong businesses by meeting the customers changing needs.

2. To what extent did GE follow a classic SWOT model when formulating its ecomagination strategy?

While formulating its ecomagination strategy GE followed the classic SWOT analysis to a great extent. GE realized that it had strength and opportunities because customers knew the brand and were loyal to it. Moreover, it realized that there was not much of a threat because there was no other company to give it strong competition.

3. GE’s CEO Jeff Immelt often states that “green is green.” What does he mean by this? Is the ecomagination strategy in the best interests of GE’s stockholders?

Immelt’s statement emphasizes the fact that the company can make money and improve the environment at the same time by developing new technology. The strategy also considers the best interests of its stockholders.

4. By most reports, GE’s ecomagination strategy has been successfully implemented. Why do you think this is the case? What did GE do correctly? What are the key lessons here?

The strategy has been successful as the company had set some goals that were successfully handled by the company’s promising young leaders who headed the program. These corporate goals were broken into subgoals and handed down to the relevant businesses. Performance against goals was reviewed on a regular basis, and the compensation of executives was tied to their ability to meet these goals.

5. If GE had not pursued an ecomagination strategy, where do you think it would be today? Where might it be 10 years from now?

Students’ answers may vary. Some of them may say that with the growing concern that customers these days have about environment and energy efficiency, GE would have lost its customers if it had not pursued an ecomagination strategy.