2.3: Role of Strategy in Operations Management

Wikibooks: “Business Strategy/Approaches to Strategic Management”

Read this article, making sure to pay particular attention to the section on the strategy hierarchy.

Exploring Business, v. 2.0: “Chapter 2, Section 5: Corporate Social Responsibility”

Read section 2.5. This provides insight into the nature of Corporate Social Responsibility (CSR) and the necessity of stakeholders to the success of the organization. CSR crucial to the establishment of goodwill amongst the employees and within the local and/or greater business community. Integrating a CSR plan when developing the strategy requires that managers consider all of the stakeholders’ (internal and external) needs. Complete Exercise 1 located at the end of the reading. This is a self-graded activity.

Boundless: *Management*: “Chapter 12, Section 4, Part 1: Strategic Management”

Read this section. The strategy pursued by an organization has a distinct impact on the way that the organization chooses to operate. The five steps of strategy are crucial in the design of the operations.

Corporate Governance, v.1.0: “Chapter 7, Section 1”

Read section 7.1. There are many discussions surrounding the importance of the Board of Directors taking a guiding role in the development of strategy. Consider the challenges that boards face in carving out a significant role in the strategy process.

Building Strategy and Performance, v. 1.0: “Chapter 5: Building and Managing the Strategic Architecture“

Read chapter 5. This chapter explains the connection between operations and strategy. There is a direct connection (or should be) between this functional area and organizational plan. The strategy provides the foundation for the operational decisions made on a daily basis. In other words as an operations manager, you choose tactics based on the developed organizations corporate, business, and functional level strategy. Take time to complete the Action Checklist activity at the end of the chapter. This is a self-graded activity.

Developing New Products and Services, v. 1.0: “Chapter 8: Strategic Planning and Ten–Ten Planning”

Read chapter 8. This chapter explains the nature of planning and the importance of analysis to the creation of differentiated product or services or higher levels of efficiency. Understanding the nature of strategic planning and the types of analysis used during the strategic planning process are important for operation managers

Home2.5 Corporate Social Responsibility

Learning Objective

1. Define *corporate social responsibility* and explain how organizations are responsible to their stakeholders.

Corporate social responsibility refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economic, ethical, and social decisions. What motivates companies to be “socially responsible” to their various stakeholders? We hope it’s because they want to do the right thing, and for many companies, “doing the right thing” is a key motivator. The fact is, it’s often hard to figure out what the “right thing” is: What’s “right” for one group of stakeholders isn’t necessarily just as “right” for another. One thing, however, is certain: Companies today are held to higher standards than ever before. Consumers and other groups consider not only the quality and price of a company’s products but also its character. If too many groups see a company as a poor corporate citizen, it will have a harder time attracting qualified employees, finding investors, and selling its products. Good corporate citizens, by contrast, are more successful in all these areas.

Figure 2.6 “The Corporate Citizen” presents a model of corporate responsibility based on a company’s relationships with its *stakeholders*. In this model, the focus is on managers—not owners—as the principals involved in all these relationships. Here, owners are the stakeholders who invest risk capital in the firm in expectation of a financial return. Other stakeholders include employees, suppliers, and the communities in which the firm does business. Proponents of this model hold that customers, who provide the firm with revenue, have a special claim on managers’ attention. The arrows indicate the two-way nature of corporation-stakeholder relationships: All stakeholders have some claim on the firm’s resources and returns, and it’s management’s job to make decisions that balance these claims.See David P. Baron, *Business and Its Environment*, 4th ed. (Upper Saddle River, NJ: Prentice Hall, 2003), 650–52.

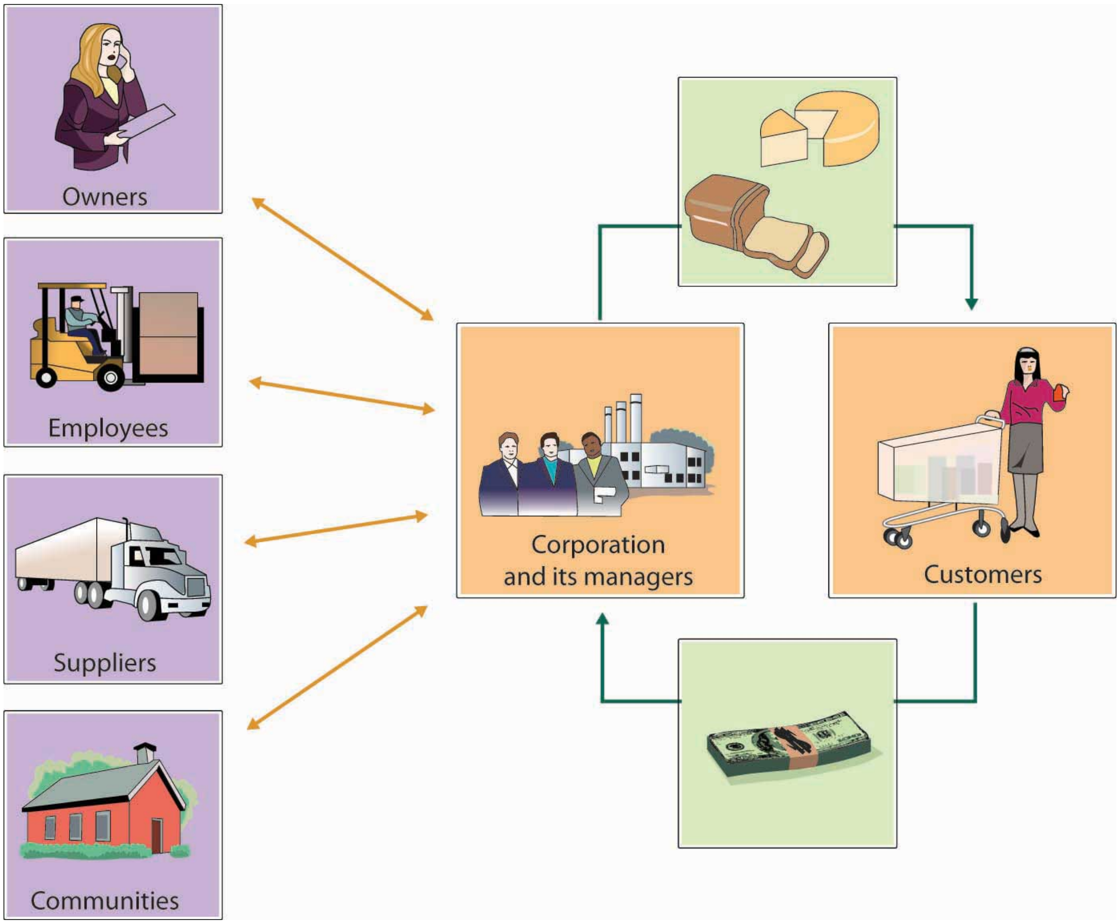


Figure 2.6 The Corporate Citizen Let's look at some of the ways in which companies can be "socially responsible" in considering the claims of various stakeholders.

Owners

Owners invest money in companies. In return, the people who run a company have a responsibility to increase the value of owners' investments through profitable operations. Managers also have a responsibility to provide owners (as well as other stakeholders having financial interests, such as creditors and suppliers) with accurate, reliable information about the performance of the business. Clearly, this is one of the areas in which WorldCom managers fell down on the job. Upper-level management purposely deceived shareholders by presenting them with fraudulent financial statements.

Fiduciary Responsibilities

Finally, managers have a fiduciary responsibility to owners: They're responsible for safeguarding the company's assets and handling its funds in a trustworthy manner. This is a responsibility that was ignored by top executives at both Adelphia and Tyco, whose associates and families virtually looted company assets. To enforce managers' fiduciary responsibilities for a firm's financial statements and accounting records, the Sarbanes-Oxley Act of 2002 requires CEOs and CFOs to attest to their accuracy. The law also imposes penalties on corporate officers, auditors, board members, and any others who commit fraud.

Employees

Companies are responsible for providing employees with safe, healthy places to work—as well as environments that are free from sexual harassment and all types of discrimination. They should also offer appropriate wages and benefits. In the following sections, we'll take a closer look at each of these areas of responsibility.

Safety and Health

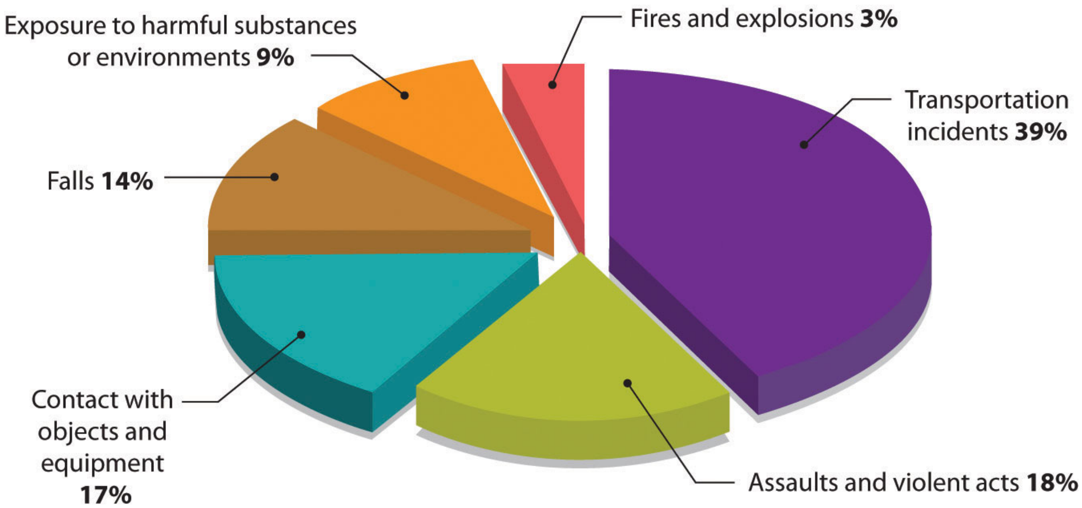


Figure 2.7 Workplace Deaths by Event or Exposure, 2010

Though it seems obvious that companies should guard workers' safety and health, a lot of them simply don't. For over four decades, for example, executives at Johns Manville suppressed evidence that one of its products, asbestos, was responsible for the deadly lung disease developed by many of its workers.Saul W. Gellerman, "Why 'Good' Managers Make Bad Ethical Choices," *Harvard Business Review on Corporate Ethics* (Boston: Harvard Business School Press, 2003), 49–66. The company concealed chest X-rays from stricken workers, and executives decided that it was simply cheaper to pay workers' compensation claims (or let workers die) than to create a safer work environment. A New Jersey court was quite blunt in its judgment: Johns Manville, it held, had made a deliberate, cold-blooded decision to do nothing to protect at-risk workers, in blatant disregard of their rights.Saul W. Gellerman, "Why 'Good' Managers Make Bad Ethical Choices," *Harvard Business Review on Corporate Ethics* (Boston: Harvard Business School Press, 2003), 53.

About four in one hundred thousand U.S. workers die in workplace "incidents" each year. The Department of Labor categorizes deaths caused by conditions like those at Johns Manville as "exposure to harmful substances or environments." How prevalent is this condition as a cause of workplace deaths? See Figure 2.7 "Workplace Deaths by Event or Exposure, 2010", which breaks down workplace fatalities by cause. Some jobs are more dangerous than others. For a comparative overview based on workplace deaths by occupation, see Figure 2.8 "Workplace Deaths by Industry, 2010".

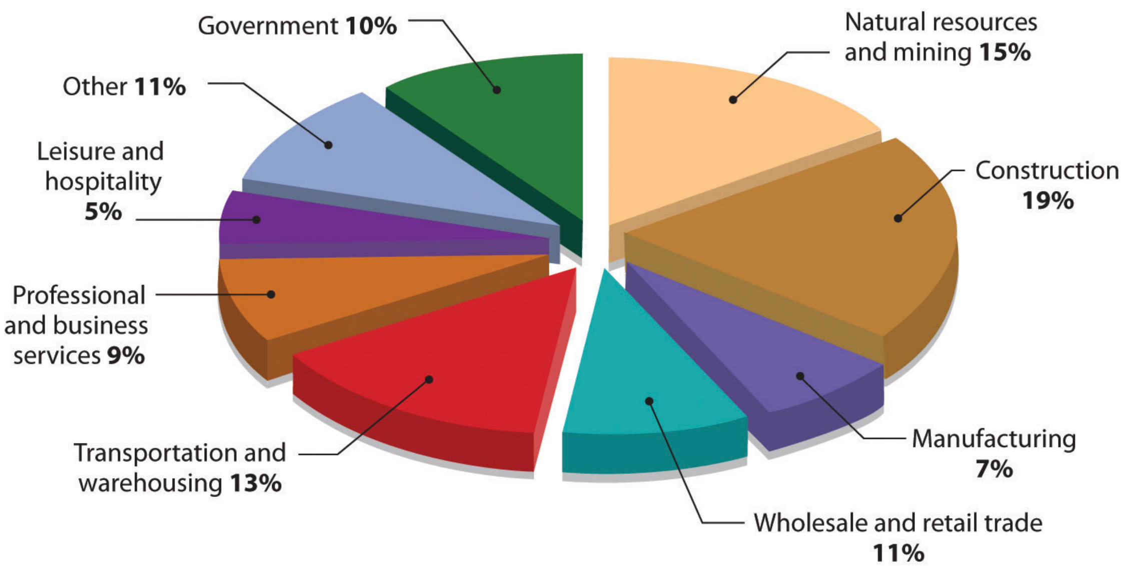


Figure 2.8 Workplace Deaths by Industry, 2010

For most people, fortunately, things are better than they were at Johns Manville. Procter & Gamble (P&G), for example, considers the safety and health of its employees paramount and promotes the attitude that "Nothing we do is worth getting hurt for." With nearly one hundred thousand employees worldwide, P&G uses a measure of worker safety called "total incident rate per employee," which records injuries resulting in loss of consciousness, time lost from work, medical transfer to another job, motion restriction, or medical treatment beyond first aid. The company attributes the low rate of such incidents—less than one incident per hundred employees—to a variety of programs to promote workplace safety.Procter & Gamble, *2003 Sustainability Report*, http://www.pg.com/content/pdf/01_about_pg/corporate_citizenship/sustainability/reports/sustainability_report_2003.pdf (accessed April 24, 2006).

Freedom from Sexual Harassment

What is *sexual harassment*? The law is quite precise:

- Sexual harassment occurs when an employee makes "unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature" to another employee who doesn't welcome the advances.
- It's also sexual harassment when "submission to or rejection of this conduct explicitly or implicitly affects an individual's employment, unreasonably interferes with an individual's work performance or creates an intimidating, hostile or offensive work environment."U.S. Equal Employment Opportunity Commission, "Facts about Sexual Harassment," http://www.eeoc.gov/facts/fs-sex.html (accessed January 22, 2012).

To prevent sexual harassment—or at least minimize its likelihood—a company should adopt a formal anti-harassment policy describing prohibited conduct, asserting its objections to the behavior, and detailing penalties for violating the policy.Joanna Grossman, "Sexual Harassment in the Workplace: Do Employers' Efforts Truly Prevent Harassment, or Just Prevent Liability," *Find Laws Legal Commentary, Writ*, http://writ.news.findlaw.com/grossman/20020507.html (accessed January 22, 2012). Employers also have an obligation to investigate harassment complaints. Failure to enforce anti-harassment policies can be very costly. In 1998, for example, Mitsubishi paid $34 million to more than three hundred fifty female employees of its Normal, Illinois, plant to settle a sexual harassment case supported by the Equal Employment Opportunity Commission. The EEOC reprimanded the company for permitting an atmosphere of verbal and physical abuse against women, charging that female workers had been subjected to various forms of harassment, ranging from exposure to obscene graffiti and vulgar jokes to fondling and groping.Joanna Grossman, "Sexual Harassment in the Workplace: Do Employers' Efforts Truly Prevent Harassment, or Just Prevent Liability," *Find Laws Legal Commentary, Writ*, http://writ.news.findlaw.com/grossman/20020507.html (accessed January 22, 2012).

Equal Opportunity and Diversity

People must be hired, evaluated, promoted, and rewarded on the basis of merit, not personal characteristics. This, too, is the law—namely, Title VII of the 1964 Civil Rights Act. Like most companies, P&G has a formal policy on hiring and promotion that forbids discrimination based on race, color, religion, gender, age, national origin, citizenship, sexual orientation, or disability. P&G expects all employees to support its commitment to equal employment opportunity and warns that those who violate company policies will face strict disciplinary action, including termination of employment.Procter & Gamble, "Respect in the Workplace," *Our Values and Policies*, http://www.pg.com/content/pdf/01_about_pg/01_about_pg_homepage/about_pg_toolbar/download_report/values_and_policies.pdf (accessed January 22, 2012).

Equal Pay and the Wage Gap

The Equal Pay Act of 1963 requires equal pay for both men and women in jobs that entail equal skill, equal effort, equal responsibility, or similar working conditions. What has been the effect of the law after forty years? In 1963, women earned, on average, $0.589 for every $1 earned by men. By 2010, that difference—which we call the *wage gap*—has been closed to $0.812 to $1, or approximately 81 percent.Mike Aamodt, "Human Resource Statistics," Radford University, http://maamodt.asp.radford.edu/HR%20Statistics/Salary%20by%20Sex%20and%20Race.htm (accessed August 15, 2011).Figure 2.10 "Median Annual Earnings by Gender and Race" provides some interesting numbers on the differences in annual earnings based not only on gender but on race, as well. Figure 2.11 "Median Annual Earnings by Level of Education" throws further light on the wage and unemployment gap when education is taken into consideration.

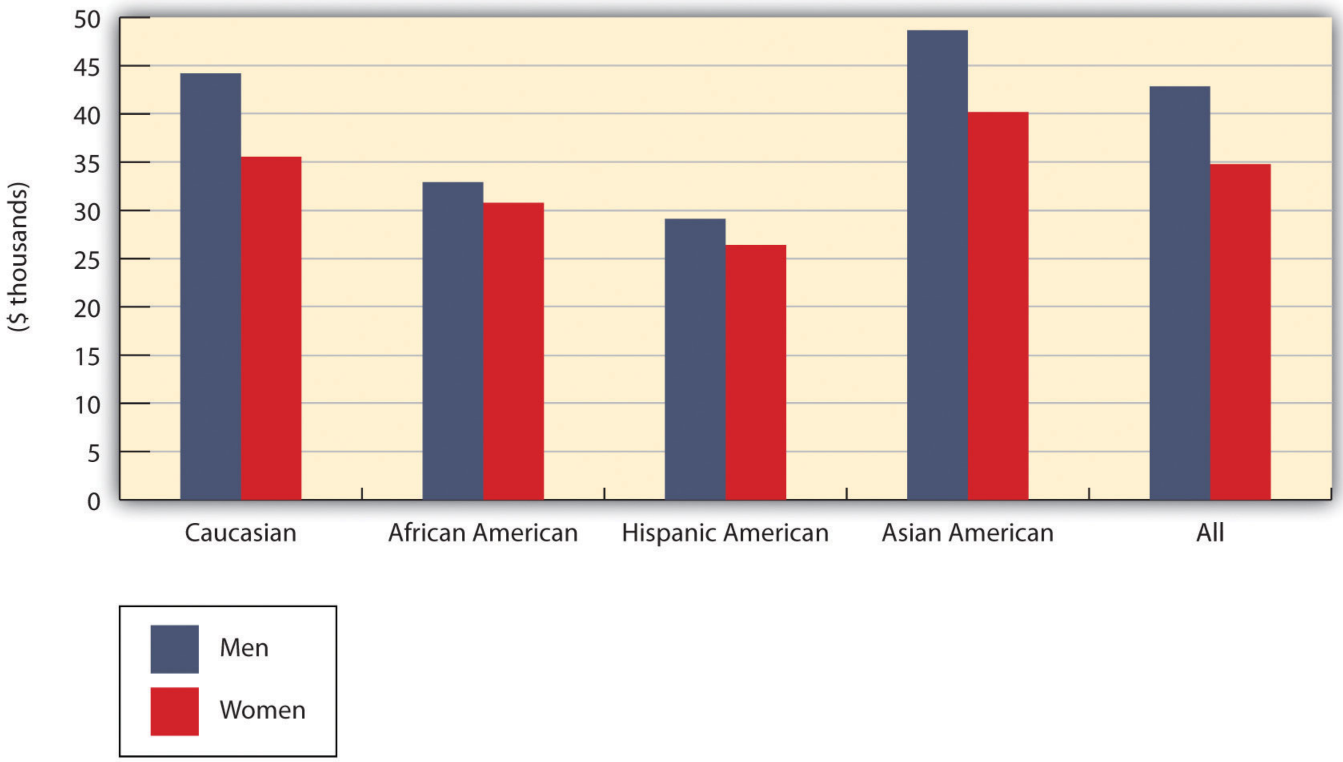


Figure 2.10 Median Annual Earnings by Gender and Race

What accounts for the difference, despite the mandate of federal law? For one thing, the jobs typically held by women tend to pay less than those typically held by men. In addition, men often have better job opportunities. For example, a man newly hired at the same time as a woman will often get a higher-paying assignment at the entry level. Coupled with the fact that the same sort of discrimination applies when it comes to training and promotions, women are usually relegated to a lifetime of lower earnings.

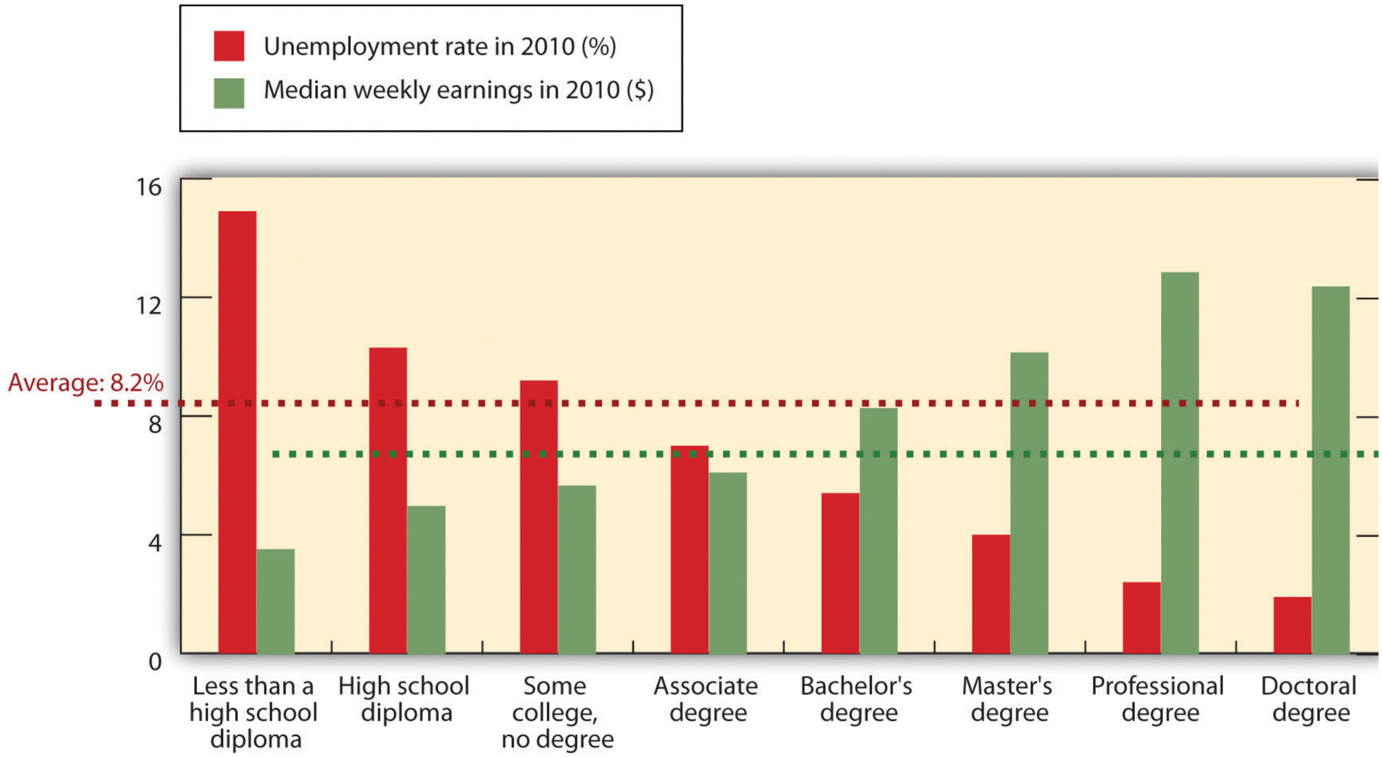


Figure 2.11 Median Annual Earnings by Level of Education Education pays in higher earnings and lower unemployment rates. Note: Data are 2010 annual averages for persons age 25 and over. Earnir Source: Bureau of Labor Statistics, Current Population Survey.

Building Diverse Workforces

In addition to complying with equal employment opportunity laws, many companies make special efforts to recruit employees who are underrepresented in the workforce according to sex, race, or some other characteristic. In helping to build more diverse workforces, such initiatives contribute to competitive advantage for two reasons: (1) People from diverse backgrounds bring new talents and fresh perspectives to an organization, typically enhancing creativity in the development of new products. (2) By reflecting more accurately the changing demographics of the marketplace, a diverse workforce improves a company's ability to serve an ethnically diverse population.

Wages and Benefits

At the very least, employers must obey laws governing minimum wage and overtime pay. A minimum wage is set by the federal government, though states can set their own rates. The current federal rate, for example, is $7.25, while the rate in the state of Washington is $8.67. When there's a difference, the higher rate applies.U.S. Department of Labor, "Minimum Wage Laws in the States," http://www.dol.gov/esa/minwage/america.htm (accessed January 22, 2012). By law, employers must also provide certain benefits—social security (which provides retirement benefits), unemployment insurance (which protects against loss of income in case of job loss), and workers' compensation (which covers lost wages and medical costs in case of on-the-job injury). Most large companies pay most of their workers more than minimum wage and offer considerably broader benefits, including medical, dental, and vision care, as well as pension benefits.

Customers

The purpose of any business is to satisfy customers, who reward businesses by buying their products. Sellers are also responsible—both ethically and legally—for treating customers fairly. The rights of consumers were first articulated by President John F. Kennedy in 1962 when he submitted to Congress a presidential message devoted to consumer issues.Henry A. Waxman, House of Representatives, "Remarks on Proposed Consumer Bill of Rights Day, Extension of Remarks," March 15, 1993, http://thomas.loc.gov/cgi-bin/query/z?r103:E15MR30-90 (accessed April 24, 2006), 1–2. Kennedy identified four consumer rights:

1. *The right to safe products*. A company should sell no product that it suspects of being unsafe for buyers. Thus, producers have an obligation to safety-test products before releasing them for public consumption. The automobile industry, for example, conducts extensive safety testing before introducing new models (though recalls remain common).
2. *The right to be informed about a product*. Sellers should furnish consumers with the product information that they need to make an informed purchase decision. That's why pillows have labels identifying the materials used to make them, for instance.
3. *The right to choose what to buy*. Consumers have a right to decide which products to purchase, and sellers should let them know what their options are. Pharmacists, for example, should tell patients when a prescription can be filled with a cheaper brand-name or generic drug. Telephone companies should explain alternative calling plans.
4. *The right to be heard*. Companies must tell customers how to contact them with complaints or concerns. They should also listen and respond.

Companies share the responsibility for the legal and ethical treatment of consumers with several government agencies: the Federal Trade Commission (FTC), which enforces consumer-protection laws; the Food and Drug Administration (FDA), which oversees the labeling of food products; and the Consumer Product Safety Commission, which enforces laws protecting consumers from the risk of product-related injury.

Communities

For obvious reasons, most communities see getting a new business as an asset and view losing one—especially a large employer—as a detriment. After all, the economic impact of business activities on local communities is substantial: They provide jobs, pay taxes, and support local education, health, and recreation programs. Both big and small businesses donate funds to community projects, encourage employees to volunteer their time, and donate equipment and products for a variety of activities. Larger companies can make greater financial contributions. Let's start by taking a quick look at the philanthropic activities of a few U.S. corporations.

Financial Contributions

Many large corporations donate a percentage of sales or profits to worthwhile causes. Retailer Target, for example, donates 5 percent of its profits—about $2 million per week—to schools, neighborhoods, and local projects across the country; its store-based grants underwrite programs in early childhood education, the arts, and family-violence prevention.Target Brands Inc., "Target Gives Back over $2 Million a Week to Education, the Arts and Social Services," http://target.com/target_group/community_giving/index.jhtml (accessed August 15, 2011). The late actor Paul Newman donated 100 percent of the profits from "Newman's Own" foods (salad dressing, pasta sauce, popcorn, and other products sold in eight countries). His company continues his legacy of donating all profits and distributing them to thousands of organizations, including the Hole in the Wall Gang camps for seriously ill children.Jennifer Barrett, "A Secret Recipe for Success: Paul

Newman and A. E. Hotchner Dish Up Management Tips from Newman's Own," *Newsweek*, November 3, 2003, http://www.highbeam.com/doc/1G1-109357986.html (accessed January 22, 2012); Paul Newman, "Our Story," Newman's Own Web site, http://www.newmansown.com/ourstory.aspx (accessed August 15, 2011).

Volunteerism

Many companies support employee efforts to help local communities. Patagonia, for example, a maker of outdoor gear and clothing, lets employees leave their jobs and work full-time for any environmental group for two months—with full salary and benefits; so far, more than 850 employees have taken advantage of the program."Environmental Internships," Patagonia Web site, http://www.patagonia.com/us/patagonia.go?assetid=1963 (accessed August 15, 2011).

Supporting Social Causes

Companies and executives often take active roles in initiatives to improve health and social welfare in the United States and elsewhere. Microsoft's former CEO Bill Gates intends to distribute more than $3 billion through the Bill and Melinda Gates Foundation, which funds global health initiatives, particularly vaccine research aimed at preventing infectious diseases, such as polio,"2011 Annual Letter from Bill Gates," Bill and Melinda Gates Foundation, http://www.gatesfoundation.org/annual-letter/2011/Pages/home.aspx (accessed August 15, 2011). in undeveloped countries.Dan Ackman, "Bill Gates Is a Genius and You're Not," *Forbes.com*, July 21, 2004, http://www.forbes.com/2004/07/21/cx_da_0721topnews.html (accessed January 22, 2012). Noting that children from low-income families have twice as many cavities and often miss school because of dental-related diseases, P&G invested $1 million a year to set up "cavity-free zones" for 3.3 million economically disadvantaged children at Boys and Girls Clubs nationwide. In addition to giving away toothbrushes and toothpaste, P&G provided educational programs on dental hygiene. At some locations, the company even maintained clinics providing affordable oral care to poor children and their families.Philip Kotler and Nancy Lee, "Best of Breed," *Stanford Social Innovation Review*, Spring 2004, 21. Proctor & Gamble recently commited to provide more than two billion liters of clean drinking water to adults and children living in poverty in developing countries. The company believes that this initiative will save an estimated ten thousand lives."Social Responsibility, P&G Children's Safe Drinking Water Program," Proctor & Gamble Web site, http://www.pg.com/en_US/sustainability/social_responsibility/childrens_safe_water.shtml (accessed August 15, 2011).

Key Takeaways

- **Corporate social responsibility** refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economic, ethical, and social decisions.
- Companies are socially responsible to their various stakeholders—owners, employees, customers, and the communities in which they conduct business.
- Owners invest money in companies. In return, the people who manage companies have a responsibility to increase the value of owners' investments through profitable operations.
- Managers have a responsibility to provide owners and other stakeholders with accurate, reliable financial information.
- They also have a **fiduciary responsibility** to safeguard the company's assets and handle its funds in a trustworthy manner.
- Companies have a responsibility to guard workers' safety and health and to provide them with a work environment that's free from sexual harassment.
- Businesses should pay appropriate wages and benefits, treat all workers fairly, and provide equal opportunities for all employees.
- Many companies have discovered the benefits of valuing diversity. People with diverse backgrounds bring new talents and fresh perspectives, and improve a company's ability to serve an ethically diverse population.
- Sellers are responsible—both ethically and legally—for treating customers fairly. Consumers have certain rights: to use safe products, to be informed about products, to choose what to buy, and to be heard.
- Companies also have a responsibility to the communities in which they produce and sell their products. The economic impact of businesses on local communities is substantial. Companies have the following functions:
  1. Provide jobs
  2. Pay taxes
  3. Support local education, health, and recreation activities
  4. Donate funds to community projects
  5. Encourage employees to volunteer their time
  6. Donate equipment and products for a variety of activities

Exercises

1. Nonprofit organizations (such as your college or university) have social responsibilities to their stakeholders. Identify your school's stakeholders. For each category of stakeholder, indicate the ways in which your school is socially responsible to that group.
2. **(AACSB) Communication**

   Pfizer is one of the largest pharmaceutical companies in the United States. It's in the business of discovering, developing, manufacturing, and marketing prescription drugs. While it's headquartered in New York, it sells products worldwide, and its corporate responsibility initiatives also are global. Go to the Pfizer Web site (http://www.pfizer.com/responsibility/global_health/global_health.jsp) and read about the firm's global corporate-citizenship initiatives (listed on the left sidebar). Write a brief report describing the focus of Pfizer's efforts and identifying a few key programs. In your opinion, why should U.S. companies direct corporate-responsibility efforts at people in countries outside the United States?

HomeBoundless: *Management*: "Chapter 12, Section 4, Part 1: Strategic Management"

Read this section. The strategy pursued by an organization has a distinct impact on the way that the organization chooses to operate. The five steps of strategy are crucial in the design of the operations.

Strategic Management

Strategic management entails five steps: analysis, formation, goal setting, structure, and feedback.

LEARNING OBJECTIVE

- Identify the five general steps that allow businesses to develop a strategic process

KEY POINTS

- Strategic management analyzes the major initiatives, involving resources and performance in external environments, that a company's top management takes on behalf of owners.
- The first three steps in the strategic management process are part of the strategy formulation phase. These include analysis, strategy formulation, and goal setting.
- The final two steps in strategic management constitute implementation. These steps include creating the structure (internal environment) and obtaining feedback from the process.
- By integrating these steps into the strategic management process, upper management can ensure resource allocation and processes align with broader organizational purpose and values.

TERMS

- **implementation**: The process of moving an idea from concept to reality. In business, engineering, and other fields, implementation refers to the building process rather than the design process.
- **objectives**: The goals of an organization.

FULL TEXT

Strategic management analyzes the major initiatives, involving resources and performance in external environments, that a company's top management takes on behalf of owners. It entails specifying the organization's mission, vision, and objectives, as well as developing policies and plans which allocate resources to drive growth and profitability. Strategy, in short, is the overarching methodology behind the business operations.

Five Steps of Strategic Management

As strategic management is a large, complex, and ever-evolving endeavor, it is useful to divide it into a series of concrete steps to illustrate the process of strategic management. While many management models pertaining to strategy derivation are in use, most general frameworks include five steps embedded in two general stages:

Formulation

1. *Analysis* – Strategic analysis is a time-consuming process, involving comprehensive market research on the external and competitive environments as well as extensive internal assessments. The process involves conducting Porter's Five Forces, SWOT, PESTEL, and value chain analyses and gathering experts in each industry relating to the strategy.
2. *Strategy Formation* – Following the analysis phase, the organization selects a generic strategy (for example, low-cost, differentiation, etc.) based upon the value-chain implications for core competence and potential competitive advantage. Risk assessments and contingency plans are also developed based upon external forecasting. Brand positioning and image should be solidified.
3. *Goal Setting* – With the defined strategy in mind, management identifies and communicates goals and objectives that correlate to the predicted outcomes, strengths, and opportunities. These objectives include quantitative ways to measure the success or failure of the goals, along with corresponding organizational policy. Goal setting is the final phase before implementation begins.

Implementation

1. *Structure* – The implementation phase begins with the strategy in place, and the business solidifies its organizational structure and leadership (making changes if necessary). Leaders allocate resources to specific projects and enact any necessary strategic partnerships.
2. *Feedback* – During the final stage of strategy, all budgetary figures are submitted for evaluation. Financial ratios should be calculated and performance reviews delivered to relevant personnel and departments. This information will be used to restart the planning process, or reinforce the success of the previous strategy.

Home7.1 Who Is Responsible for Strategy Development?

Boards are being urged to play a more active role in strategy formulation. If evaluating the quality of management's strategic and business plans, including the likelihood of realizing the intended results, is a key board responsibility, so the argument goes, should it not determine for itself whether the company has the capacity to implement and deliver? It is a good but tricky question. How might a board do this? What, for example, should a board do if management presents a bold plan for spinning off or acquiring strategic assets worldwide? Assume that the logic is consistent, that the plan makes sense, that the numbers look good, and that management has a convincing answer for every tough question asked by the board. Has the board met its fiduciary responsibility or should it seek an independent opinion to "audit" the strategic assumptions made by management and its consultants? After all, directors do not have the equivalent time and resources to review the details of strategies presented to them.

A strong argument can be made that if the board feels compelled to retain outside experts to review corporate strategy, it probably has lost confidence in the CEO and should simply fire him or her. Conversely, one can argue that hiring outside consultants is the most cost-effective way for the board to prove its independence and positively challenge top management. Which is it?

In attempts to provide guidance on this issue, numerous "codes of best practice" have been proposed in recent years urging boards to define their responsibilities with respect to strategy development as

- setting the ultimate direction for the corporation;
- reviewing, understanding, assessing, and approving specific strategic directions and initiatives;
- assessing and understanding the issues, forces, and risks that define and drive the company's long-term performance.Bart (2004), pp. 111–125.

As the simple example above demonstrates, however, reality is considerably more complex. Traditionally, boards have become involved in strategy mainly when there were specific reasons for them to do so. The most common are the retirement of an incumbent CEO, a major investment decision or acquisition proposal, a sudden decline in sales or profits, or an unsolicited takeover bid. In recent years, however, as regulatory and other pressures increased, many boards have sought to become more deeply involved and create an ongoing strategic role, for example, by participating in annual strategy retreats or through the CEO performance evaluation process. Still, in most companies even today boards limit their involvement to approving strategy proposals and to monitoring progress toward strategic goals; very few participate in shaping and developing the company's strategic direction.

There are a number of reasons for this. First, there is a longstanding concern on the part of both executives and directors regarding where to draw the line between having directors involved through contributing ideas about the company's strategic direction and having directors who try to manage the company.Lorsch (1995, January–February). Specifically, there is a widely shared belief that strategy formulation is fundamentally a management responsibility and that the role of the board should be confined to making sure that an appropriate strategic planning process is in place and the actual development—and approval—of strategy is left to the CEO. Even those who do favor greater director involvement in strategy say that the degree of involvement should depend on the specific circumstances at hand. A significant acquisition proposal or a new CEO, for example, may indicate the needs for greater board involvement.

Second, in the aftermath of the Enron and other governance scandals, many boards had to focus on internal issues and on digesting the new accounting compliance rules of the landmark Sarbanes-Oxley Act. In a number of companies, this turning inward has had the undesirable side effect that the board's decision making has become so focused on compliance issues that strategic considerations have taken a backseat.

Third, some CEOs simply do not want their boards involved in strategy discussions; they view the board's engagement in developing strategy as interference into their managerial responsibilities and a threat to their sense of personal power. Of course, the downside of this posture is that the board may not fully understand or buy into the organization's strategy and that board talent is underutilized. Taking this approach sometimes backfires on CEOs when formerly disengaged boards become overengaged and then make their CEOs "walk through fire" on tactics.

Fourth, there is the delicate question of how knowledgeable even the most capable directors are to assist with strategy development. Most are quite effective in dealing with short-term financial data. Strategy development, however, also demands a detailed understanding of more future- and long-term oriented issues, such as changing customer preferences, competitive trends, technological developments, and the firm's core competencies. A typical board of directors is poorly designed and ill-equipped for this task. According to a recent McKinsey survey, more than a quarter of directors have, at best, a limited understanding of the current strategy of their companies. Only 11% claim to have a complete understanding. More than half say that they have a limited or no clear sense of their companies' prospects 5 to 10 years down the road. Only 4% say that they fully understand their companies' long-term position. More than half indicate that they have little or no understanding of the 5 to 10 key initiatives that their companies need in order to secure the long-term future.Felton and Fritz (2005).

Finally, while board meetings are conducive to questioning specific strategic assumptions and monitoring progress toward strategic goals, they are not a good forum for the more creative, elaborate, and nonlinear process of crafting strategy. Board discussions tend to focus on the implementation and tactics of an ongoing strategic direction. Revealing serious reservations about the underlying strategic assumptions sometimes not only is seen as distracting and inappropriate but also may be interpreted as a vote of no confidence in the current management.

The bottom line is that carving out a significant role for the board in strategy formulation is extremely difficult. First, as we have seen, there is the nature of the strategy development process itself. Characterizing a board's involvement in strategy on a continuum from "passive" to "active" is a dangerous oversimplification. A passive posture assumes that strategic decisions are both separate and sequential, that managers generate options that boards choose from, and that managers then implement the chosen option and boards evaluate the outcomes. An active conception assumes that boards and management formulate strategy in a partnership approach, that management then implements and both groups evaluate. In reality, strategic decisions often evolve through complex, nonlinear, and fragmented processes. What is more, a board can be actively involved in strategy without being involved in its formulation. For example, a board can "shape" strategy through a process of influence over management in which it guides strategic thinking but never actually participates in the development of the strategies themselves.de Kluyver and Pearce (2009), chap. 1.

Second, as noted, certain situations dictate a more influential strategy role for the board than others. For example, at times of crisis, such as a sudden decline in performance, a new CEO, or some other major organizational change, boards tend to become more actively involved in strategy. Other determinants of the degree of board engagement in strategy issues include firm size; the nature of the core business; directors' skills and experience; board size; occupational diversity; board tenure and board member age; board attention to strategic issues; and board processes, such as the use of strategy retreats, prior firm performance, and the relative power between the board and the chief executive officer, particularly in terms of board involvement in monitoring and evaluating this position. External factors include the concentration and level of engagement of the firm's ownership and the degree of environmental uncertainty.Bart (2004).

Third, as a consequence of recent governance reforms that focused on making boards more independent, many now lack directors with relevant industry expertise to participate effectively in shaping strategy—much less to reshape it in an increasingly fast-paced business climate. In the current post-scandal governance climate, even as the business landscape is becoming more complex, many boards continue to give priority to compliance-oriented appointments rather than visionary ones.Carey and Patsalos-Fox (2006).

Finally, there are the ever-present constraints on time and knowledge. To become meaningfully engaged in strategy formulation, boards must become much more efficient, particularly since their time has already been stretched in recent years: The average commitment of a director of a U.S.-listed company increased from 13 hours a month in 2001 to more than twice that today, according to Korn/Ferry.Korn/Ferry (2007). Directors also need to become far more knowledgeable and proactive about grasping the company's current strategic position and challenges more clearly. To understand the long-term health of a company, directors must pay attention not only to its current financials but also to a broader range of indicators: market performance, network positioning, organizational performance, and operational performance. Similarly, a broader appreciation of risk—including credit, market, regulatory, organizational, and operational risk—is vital. Without this knowledge, directors will have only a partial understanding of a company. While boards receive and discuss all sorts of "strategic information," financial measures—probably the least valuable component of a board member's strategic information requirements—still dominate. Even with better information, time constraints may prevent a broader role for the board. Boards typically perform their strategic governance role in the course of a couple of hours at every third board meeting—annually supplemented by a 2-day strategy retreat. A more active role in strategy development requires much more time.

Despite these difficulties, Nadler (2004) argues that companies should try hard to create a meaningful role for their boards in the strategy development process. The key is to create a process in which directors participate in strategic thinking and strategic decision making but do not infringe on the CEO's and senior executive team's fundamental responsibilities. In such a process, the CEO and management should lead and develop strategic plans with directors' input, while the board approves the strategy and the metrics to assess progress. The direct benefits of such an engagement are many, including a *deeper understanding* by directors of the company and its strategic environment, a *sense of ownership* of the process and the resulting strategy, *better decisions* reflecting the broader array of perspectives, *greater collaboration* between the board and management on other initiatives and decisions, *increased board satisfaction*, and *more effective external advocacy*.Nadler (2004).

But, as Nadler notes, while the benefits can be significant, broader board participation in strategy development also has costs. First, directors must have a thorough understanding of the company—its capital allocation, debt levels, risks, business unit strategies, and growth opportunities, among many issues—and that takes time and commitment. Importantly, they must engage management on the major challenges facing the company and have a firm grasp on the trade-offs that must be made. A second potential cost is that increased board participation can result in less management control over outcomes. Real participation means influence, and influence means the ability to change outcomes. A well-designed process yields the benefits of participation while limiting the amount of time and potential loss of control.Nadler (2004).

HomeChapter 5 Building and Managing the Strategic Architecture

Overview

We now have everything we need to develop and use a complete picture of your organization's performance. This chapter will show you the following:

- **how to assemble a complete strategic architecture of your business** involving performance, resources, flows, and interdependences
- **how to use this architecture** to manage the system, understanding past performance, likely developments, and alternative possibilities
- **how to control performance into the future**

Remember the strategy challenges that we highlighted in Chapter 1 "Performance Through Time"? These were

- *Why* has performance followed the path that it has?
- *Where* is it going if we carry on as we are?
- *How* can we change it for the better?

Now that you understand the way a system of resources works, you are in a position to answer these questions in detail.

5.1 Building the Strategic Architecture

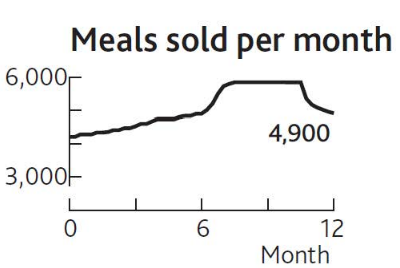
Why Has Performance Followed a Particular Path?

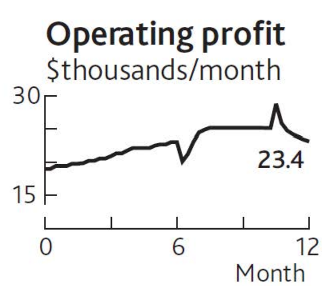
Earlier chapters have given us all the elements we need to develop a complete picture of our business, together with the information that explains why it has performed as it has up to now. These pieces are as follows:

- **the time chart of one or more performance measures** (e.g., profits, sales, service levels), with scale and timing
- **the list of likely resources involved** (e.g., customers, clients, staff, products, services, cash, capacity)
- **the chain of immediate causes for that performance**, often with simple arithmetical relationships (e.g., gross margin, revenue, labor costs, customer demand)
- at the head of those causal chains, **the resources driving demand, supply, and performance** (e.g., customers, staff, products, services, cash)
- **the flows of resource** (e.g., customers won and lost per month; staff hired, promoted, or leaving per month; products added or discontinued per year) into, through, and out of the organization's system
- **the immediate causes of these rates of flow**, whether your own decisions or other factors
- **the dependence of each resource flow on existing resources**, either for the same resource or others

To illustrate these stages, let us go back to the performance of your restaurant that you wanted to understand before deciding what to do next. Start by pulling the pieces together.

1. The time chart of one or more performance measures, with scale and timing (Figure 1.4 "Restaurant Performance Example").

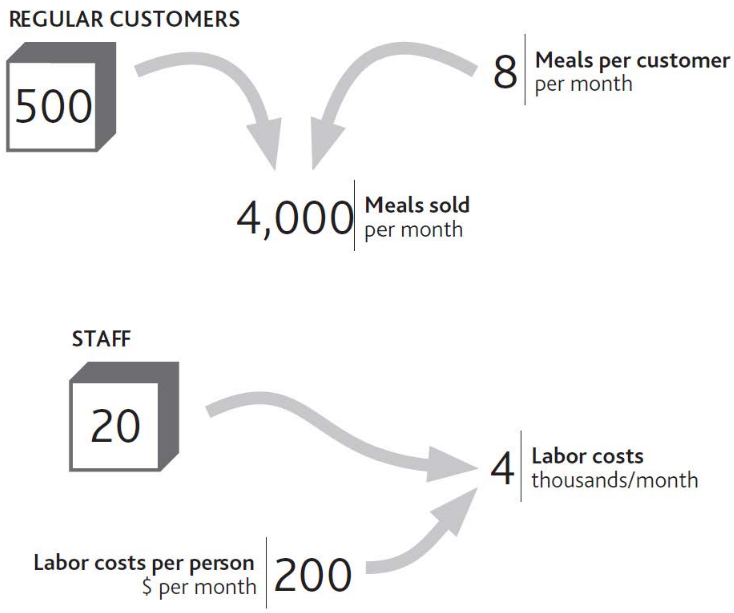




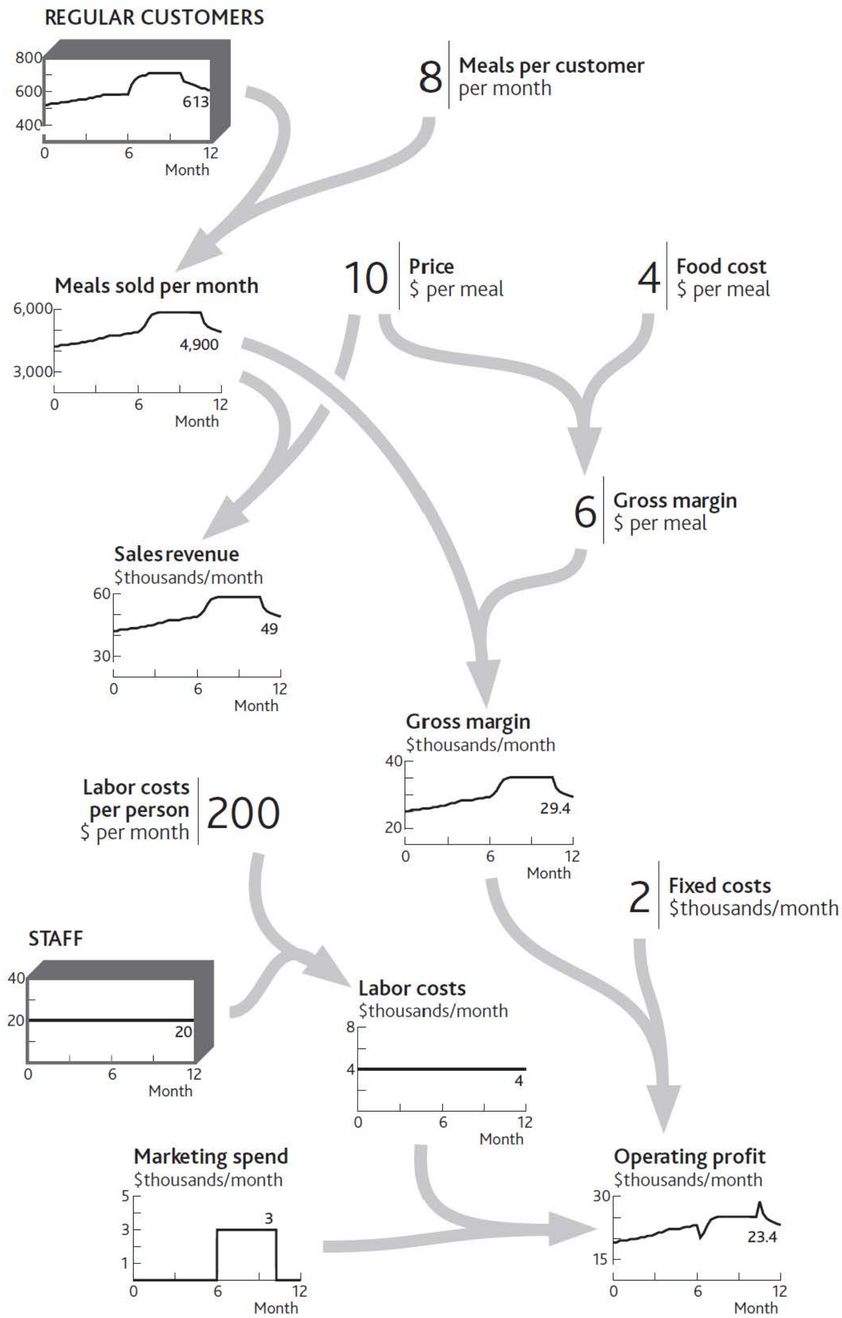
2. The list of likely resources involved. (Note: Not all of these may be needed to tackle a specific challenge. Subsequent stages will identify those that *are* involved.)

Resource	Measure
Regular customers	People
Staff	People
Menu	Items
Capacity	Seats
Cash	$

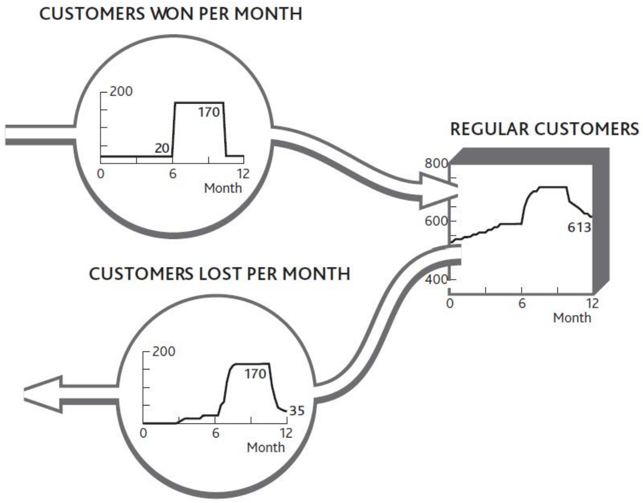
3. The immediate causes of that performance (Figure 2.1 “The Explanation for Restaurant Sales and Labor Costs”).



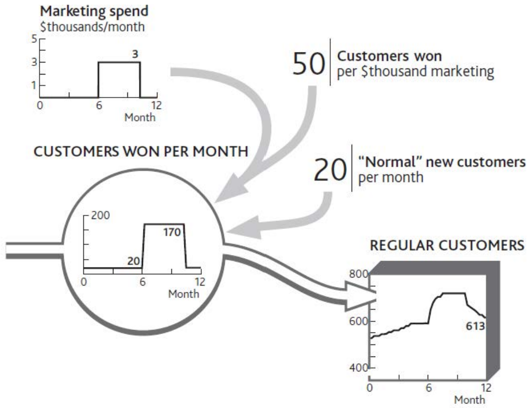
4. The resources driving demand, supply, and performance (Figure 2.2 “Your Restaurant’s Resources and Operating Profits”).

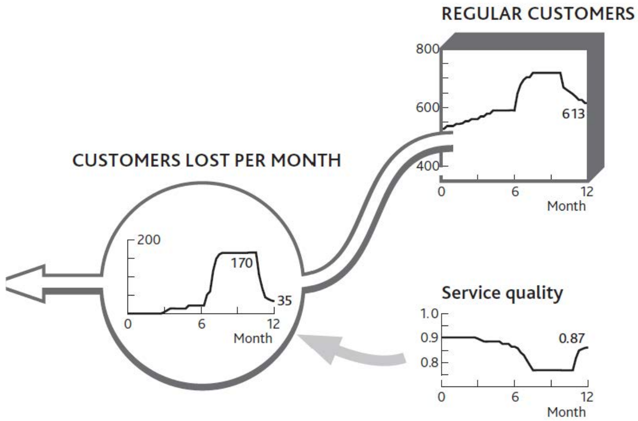


5. The flows of resources into, through, and out of the organization's system (Figure 3.6 "The Separate Flows of Customers Into and Out of Your Regular Customer Group").

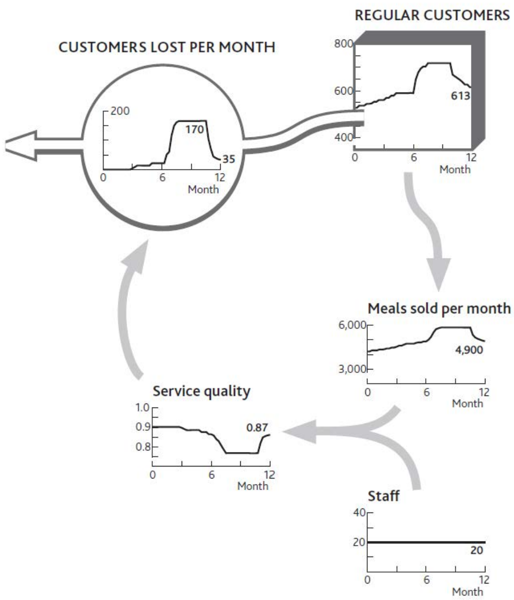


6. The immediate causes for these flows to be running at the rate they are (a) why customers are being won (Figure 4.1 “Marketing Decisions Change the Inflow of Customers” shows the “normal” rate at which new customers arrive, plus those won from your marketing spending). (b) why customers are being lost (extended version of Figure 4.8 “The History of Service Quality and Customer Losses”).





7. The dependence of each flow on *existing* resource levels (Figure 4.9 “Why Service Quality Suffered Then Recovered”).



Doing It Right: Do Not Try to Do Everything

Figure 5.1 “The Strategic Architecture of Your Restaurant, With Data Explaining Recent Performance” is far from a *complete* architecture of your restaurant. It does not, for example, include certain resources, such as the menu or the seating capacity. Nor does it include potentially important factors that could drive changes in performance, such as price or competitors’ actions. The best approach is to include as much of the architecture as is necessary to create a plausible explanation of performance over time.

This needs great care!

- First, do not do unnecessary work, such as collecting data on things that are not relevant. Keep the pictures to a minimum, so you can show people what is happening and why.
- Conversely, check you do not leave out factors that are (or could be) important. This is especially tricky when looking forward rather than just trying to explain the past.
- Finally, when you have an architecture that explains performance, ask whether you have missed anything that may be important to the question you set out to answer.

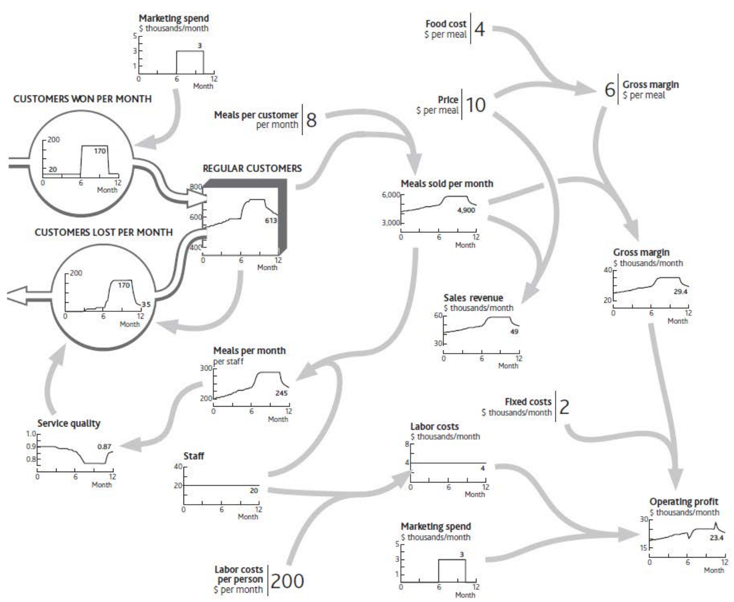


Figure 5.1 The Strategic Architecture of Your Restaurant, With Data Explaining Recent Performance

These elements connect together to provide a complete explanation of recent performance and future challenges (Figure 5.1 “The Strategic Architecture of Your Restaurant, With Data Explaining Recent Performance”).

5.2 Using the Architecture

How Have We Come to This Position?

A strategic architectureA tool used to resolve specific issues and guide the performance of an entire strategy. The strategic architecture should be focused on flow rates. provides a living reference for a firm’s structure and behavior. A critical part of top management’s job is to understand that structure, ensure that it is well designed, and steer its performance (Keough & Doman, 1992). Diagrams such as Figure 5.1 “The Strategic Architecture of Your Restaurant, With Data Explaining Recent Performance” are a common way of understanding and controlling complex systems. Even if you have never visited a chemicals plant or power station, flown an aircraft, or managed a rail network, you will have seen pictures of “control panels” that give management continuous information on the states of key variables. Their control panels *look like* the system they are managing.

We are trying to achieve the same analog-style diagram for your organization. To make best use of such a picture, you need to have it available and accessible to your whole team, perhaps on a large wallboard in the main meeting room. It may be helpful to have other diagrams in other meeting rooms to show more detail about the architecture of key parts of the system: a diagram of customer segment details in the marketing area, a diagram of people flows in the human resource (HR) department, and so on.

You may not get it right the first time. However, any inaccuracies will become apparent as you learn whether the relationships you have sketched between the connected data provide a good explanation of what is happening. If not, you can readily identify what may be missing or inaccurate and revise the architecture diagram accordingly.

A well-developed strategic architecture is a powerful tool, both to resolve specific issues and to guide the performance of the entire enterprise strategy. To understand this, consider a rather more extensive example than your restaurant: the architecture of a low-fare airline (similar to Ryanair, which is featured in Chapter 2 "Resources: Vital Drivers of Performance"). Figure 5.2 "Growth Slowdown for a Low-Fare Airline" shows the first 2 years of operation, followed by a possible 3-year future, denoted by the dotted portion of the lines.

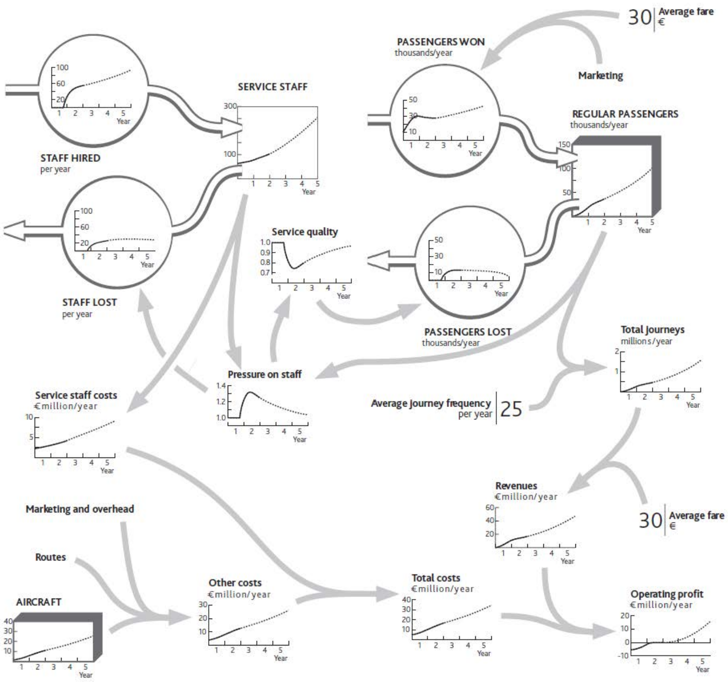


Figure 5.2 Growth Slowdown for a Low-Fare Airline

Doing It Right: Whole Numbers

The chart for aircraft in this example shows a smooth line, even though this resource comes in batches; operating 7.5 planes, as it seems you did at one point in year 2, does not make sense. Strictly, we should have a stepped chart over time for aircraft, with a jump to a new number each time a batch of ordered aircraft is received. But for a strategic view of what is happening you do not need to worry about this picky detail.

It looks complicated, but if you take it in sections, you can see how the stages come together:

- Issues of concern by the end of year 2 are operating profit (bottom right), which seems to have stalled, and total journeys (middle right), where growth has slowed.
- The core resources are aircraft, passengers, and staff (routes, too, but we can add these later).
- The immediate factors driving operating profits can be traced back through revenues to total journeys, and through total costs to staff and other cost drivers (in practice, these would be split further).
- The flows of resources into, through, and out of the organization's system are the gains and losses of passengers, the hiring and loss of staff, and the acquisition of planes. Since buying and selling planes is a simple decision, directly under management control, we do not need to show that on the diagram.
- The problematic flows are the loss of passengers, which appears to be due to a sharp drop in service quality, and the loss of staff, which arose from a steep increase in work pressure.
- The pressure on staff appears to be due to the imbalance between passenger volumes and staff numbers.
- The entire picture explains recent history. Growth in passengers and journeys exceeded the staff's ability to cope, causing them to leave and thus damaging service quality, which in turn increased the loss of passengers.

Valuable insights can arise simply from the team activity involved in developing this picture, as it will typically prompt substantial debate and analysis. Two elements will ensure that insights are accurate and address the correct issues:

- The time charts for core resources, flow drivers, and performance keep discussion focused on the best-known facts of the situation. Do not give up if you do not know precise data; instead, estimate what the facts *might* have been, then use judgment to fill in unknowns. For example, you may not have records of staff attrition rates, but if you know hiring rates and total staff numbers, the history of attrition is easy to calculate.
- You will have quantified how each resource flow depends on the factors driving it. Again, if you do not know for sure what is happening, think through your best explanation and check that it fits with the facts. Do not tolerate unsubstantiated assertions like "Everyone knows staff are leaving because our competitor offers better pay" unless there is factual evidence to back it up.

Where Is Performance Heading if We Go on Like This?

Figure 5.2 "Growth Slowdown for a Low-Fare Airline" goes further than explaining recent history. It sketches out the team's best estimate of where performance is heading into the future. The dashed lines show the estimate that you and your team came up with about the way things are likely to develop if you continue with present policies.

You will continue running a tight operation. This means continuing to hire staff at a steady rate. They may be under pressure, and service quality may not be great, but the business is satisfactory, passengers and journeys are growing, and your company is profitable. You expect that by increasing staff numbers ahead of growth in passengers and journeys, you will gradually bring down the pressure on your staff. In time, service quality will recover enough to slow the loss of passengers and overall growth will pick up.

How Can We Act to Improve Future Performance?

The strategic architecture you develop will enable your team to evaluate a range of possible future strategies—the final stage of the process. You again need an organized approach:

- Start with the points in the business architecture where step 6 showed the challenge to lie: where flows are not running as you would like.
- Focus on the links into that part of the architecture that management can influence. For the airline in Figure 5.2 "Growth Slowdown for a Low-Fare Airline", these would be price changes, marketing, and hiring.
- Estimate the scale of policy revision and the likely scale and timing of its results. For example, if you cut fares by 10%, how much would the passenger win rate change? If you double the hiring rate, how quickly will staff numbers rise to your target level?

- Follow the consequences of these policy changes. If you cut fares and bring in more passengers, how much will this change total journeys and pressure on staff? How much impact will *this* have on passenger losses and staff turnover? If you boost hiring, how much will *that* change pressure on staff, and what impact will *that* have on passenger losses and staff turnover?
- Anticipate any issues that might arise from altering the part of the system where the current problem is focused. Cutting your fares will clearly cut revenue per journey, and increasing staff will increase costs, both resulting in a short-term *drop* in profits. How long will it take before the improved resource flows you stimulated work through to generate revenues and profit improvements that overcome this short-term penalty?
- Finally, work through how any performance outcomes might evolve over time because of the proposed changes. The cut in fares might very quickly bring in more passengers and boost revenues and profits, although the *further* consequence would be increased workloads for staff, faster passenger losses, and hence a later decrease in passengers, journeys, revenues, and profits. Alternatively, increasing hiring should reduce the pressure staff are under, reduce turnover, improve service quality, and cut passenger losses, thus increasing total passengers even if there is no change in passenger win rates. More passengers means more journeys and revenues, which will more than pay for the higher staff costs.

Let us work through an example. One of your colleagues believes that poor service quality is unacceptable: It risks building up a poor reputation among potential passengers, which could hurt future growth. This colleague feels you should immediately hire enough staff to remove the overload.

Together, your team works through what might happen (Figure 5.3 "Relieving Staff Pressure to Improve Service", heavy dotted lines). One risk in the proposed solution is that these newcomers will not know what they are doing at first, so they will be deployed on simple tasks, and hiring rates can be reduced for a while so they can acquire more skill. Your colleague feels that this simple step will immediately relieve some of the pressure and give your people the ability to improve service quality quickly—especially if you tell them that this is your plan!

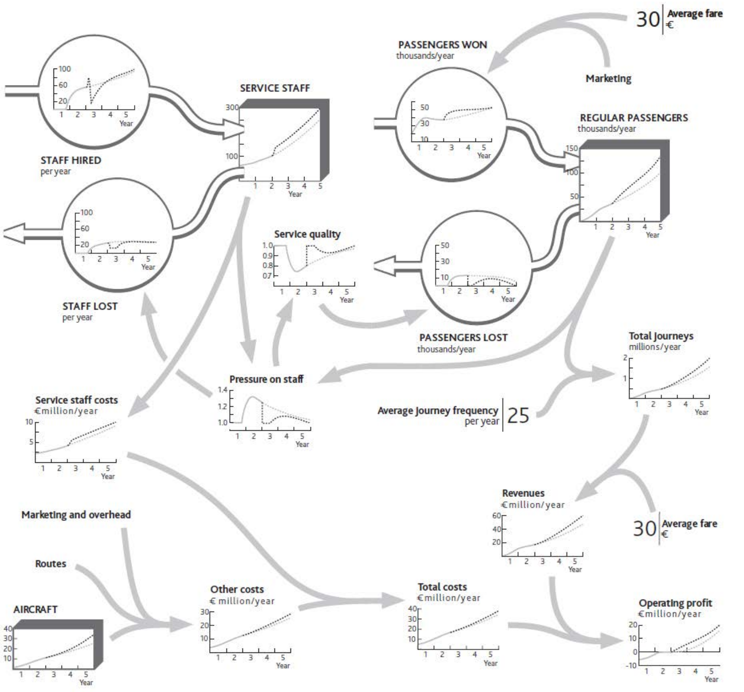


Figure 5.3 Relieving Staff Pressure to Improve Service

You are reasonably confident that the improvements to workload and quality will materialize, so you estimate that passenger growth will accelerate once more, provided you continue adding routes and aircraft. You feel there is a small risk that this will again put staff under pressure some time during year 3. You resolve to keep track of this issue and revisit the hiring policy if it looks as though the problem is recurring.

5.3 Take Control: Looking for Fixes

The airline's one-off hiring effort is just one example of a management response to improve performance. There are other common types of response, and it is important to look for and evaluate these in the right order, otherwise you risk undermining one fix by missing unintended consequences:

Minimize Leakages in the Resource System

Many organizations focus on cost-effectively acquiring resources and building them but pay much less attention to keeping them. However, there is little advantage in trying to increase the stock of resources in the system if the organization simply loses them again. Too often, customers are won, only to be lost again by poor products or service; staff are hired and trained, only to leave again for any of a host of reasons; new brands are established, only to become uncompetitive as the excitement of the launch fades; distribution agreements are set up, but stall when the company proves unable to sustain the relationship. Of course, there may be situations where the organization has good reason to reduce resources deliberately: for example, cutting back on sales efforts as you progress toward fully exploiting a market opportunity.

Improve Resource Acquisition and Development

Once you have ensured there are no leaks in your bath, you can think about filling it!

- Examine each resource inflow, ensuring that other necessary resources, mechanisms, and policies are in place to enable growth. Is the marketing budget sufficient to reach potential customers to make the desired win rate feasible? Is the product's functionality adequate to win customers and are the production, delivery, and installation resources in place to turn orders into completed sales? Is the hiring and training capacity in place to bring in staff at the rate required and make them productive quickly?
- Apply the same principle to ensure that existing resources, mechanisms, and policies are in place to allow resource *development* to occur: turning prototype products into marketable goods, developing sufficient numbers of experienced people, and so on.

Eliminate Self-Imposed Limits

The development of one resource can be hampered by inadequacies in other resources. The team should therefore examine the strategic architecture, focusing on each resource in turn and ascertaining whether its own growth may cause imbalances that restrict its further progress. A valuable question to trigger insight is, "If we are successful in winning these customers (or finding these staff, or launching these products), what are all the things that could go wrong or get in the way?"

Look for Reinforcing Mechanisms to Drive Growth

Only after steps 1 through 3 have been completed should you turn to the tempting task of finding reinforcing mechanisms to drive growth. By this point it should be safe to look for ways in which existing resources can be leveraged to drive their own growth or that of others. Can you, for example, leverage existing customers and your resulting reputation to drive faster acquisition of *further* new customers or to increase your ability to hire the best people?

Evaluate Step Solutions to Shift the System to a New State

In cases where resource limits and imbalances are serious, it may be impractical or take too long to grow, develop, or reduce the necessary resources. Instead, step changes may be appropriate. These may be limited to actions in a single part of the business or affect many resources simultaneously:

- **Action** may be needed to bring a **single resource into line** with the rest of the system, either as it is or as it is planned to become. Signing up a large new dealership can provide rapid access to a new customer base; licensing products from other firms can quickly fill out a weak product range; and taking on contractors can rapidly relieve staff pressure. Beware, though: Such actions may themselves place new demands on the organization, so make sure they can be absorbed.
- **Larger actions** may be required to take the business to a whole new level, with better balance and stronger growth potential. Acquisition is one of the clearest examples of such a shift for the whole organization and featured strongly, for example, in the growth of Blockbuster Inc. in its drive to become the dominant movie rental business in the United States and other countries. Each acquisition brought a bucket full of new stores, new customers, and new staff, which were assimilated into the established Blockbuster system. On the other hand, rationalization of several parts of a system may be necessary to bring an ineffective organization back to a core of activity that can be sustained into the future. This may entail rationalizing the product range, removing poor-quality customers, reducing capacity, and cutting staff, all in a coherent move over a short period.

Although step solutions are hardly a new approach to improving an organization's performance, a sound architecture of the situation will provide important safeguards for their implementation. Above all, the rest of the system needs to able to absorb the new or increased resource. It may be necessary to develop complementary resources, or at least start them on an increasing trajectory so that they quickly become able to cope with the influx. Without such precautions, the very solution itself may trigger some new resource losses that undermine your hoped-for improvement.

It is common, for example, for staff to resign after new people arrive. Losses may also arise among other resource categories: For example, inward licensing of new products may cause product development staff to become disillusioned and resign, and the opening of new direct customer relationships may cause dealers to defect to rivals.

5.4 Maintain Control: Managing the System

A clear picture of the organization's overall performance and underlying strategic architecture provides valuable insights into how decisions should be guided. The first observation is that using financial outcomes to guide decisions is likely to be hopeless. Clearly, the *immediate* consequences must make sense: You do not want to spend what you cannot afford, or price your product so high as to kill current sales or so low as to destroy margin. But this is not *strategic* control.

A simple principle guides how strategic decisions should be viewed: Strategic management **is all about flow rates!**

To appreciate the implications of this view, think about how our airline team might set a rule of thumb for its marketing spending. Some of the possibilities from which to choose include:

- Marketing spending should not exceed a set fraction of revenue.
- If profits dip too low, cut marketing by a fraction.
- Check that marketing does not exceed a specified cost per passenger journey sold.
- Spend more on marketing if planes are not full.
- Spend more on marketing if regular customers are being lost.

However, marketing *directly* affects just two main items: the frequency with which existing passengers travel with your airline and the rate at which new passengers are won. Marketing is not the *only* factor driving these values, but these values are the only significant things being driven by marketing! These, then, should be the focus of the decision rule for marketing *because they are closely coupled to the decision variable*.

The further you move away from this principle, the more likely it becomes that your decision rule will cause serious problems. It is astonishing, for example, how many organizations stick to "percent of sales" ratios to decide their spending on everything from research and development (R&D) to marketing, training, and maintenance. Just think how this would work for your restaurant:

- Labor cost must not exceed 15% of sales.
- So, if sales fall for some reason, you cut staff.
- So service quality drops, and sales decline.
- So you cut staff again to keep within your 15%!

You become trapped in a cycle of decline. This makes no sense, and in practice, managers usually avoid such foolish consequences. But why *start* with a decision guide that makes no sense in the first place? Pressure from investors who may not understand the structure of the strategic architecture often does not help.

So which performance metrics guide decisions best? Many organizations now use some form of balanced scorecard: an integrated approach to performance measurement and management (Kaplan & Norton, 1996). This recognizes that financial factors alone provide inadequate targets and incentives and so adds measures relating to

- **customers**: satisfaction, retention, market share, and share of business;
- **internal performance**: quality, response times, cost, and new product introductions;
- **learning and growth**: employee satisfaction and availability of information systems.

Only if these additional factors are in good shape will the firm deliver strong financial performance. The balanced scorecard offers important advances over traditional reporting approaches in recognizing the interconnectedness within the business and the importance of measuring and managing "soft" issues. Increasing training of staff about products, for example, will improve sales effectiveness, which in turn will improve sales and margins.

There are limits, though, to the control that a balanced scorecard can achieve if it is not designed to take account of the dynamic interactions that run through the organization's architecture. There are two particularly common failings:

1. What may be good for an indicator under one condition may be bad under other situations. A common example is the winning of new business when the organization cannot cope with what it already has.
2. The optimum balance between different parts of the architecture often shifts substantially as situations develop. Early in the growth of a business, service capacity may need to be a rather minor part of the organization's total activity, but later it can come to dominate as business builds up. Similarly, you may want to keep staff turnover very low when trying to build capability in a rapidly developing organization, but some rate of staff losses may be positively helpful when growth slows in order to make room for new people to develop.

Doing It Right: Avoiding Disappointment With Strategic Architecture

Management techniques often fail or fall from favor not because they are wrong, but because they are not used properly. Superficial work, done in the hope of a quick fix, is a common culprit. The extensive effort required by many otherwise sound methods is often not sustained. As senior managers instruct their people to undertake one initiative after another, none is carried to fruition before the next is begun. Initiative overload is a common cause of poorly implemented strategies.

Strategy dynamics—the basis of the approach in this book—will not work either if badly applied. It is a powerful but demanding approach that needs to be done professionally and thoroughly if accurate findings and good managerial responses are to be obtained. However, it is not typically more time-consuming or analysis-intensive than many planning processes that organizations put themselves through. Indeed, it often eliminates much activity, data processing, and analysis that would otherwise have been carried out.

Who should do this work? *You and your team*. Continuing management of today's dynamically complex organizations in today's dynamically complex markets and environments is not intuitively easy. For this reason, beware of consultants. Though many excellent professionals can carry out all kinds of demanding analysis and give exceedingly sound advice, few have had a thorough education or training in dynamic analysis. This is a tricky skill, and amateurs will usually get it wrong. Moreover, the need to review your performance dynamics will never go away. You cannot subcontract strategic leadership and you cannot subcontract strategic understanding.

Action Checklist: Building and Managing the Strategic Architecture

The action checklist for this topic was already outlined, so in summary:

- Follow the steps explained in Section 5.1 "Building the Strategic Architecture" to develop the strategic architecture of your organization or for an issue it is facing.

- Using that architecture, follow steps 1 to 5 in Section 5.3 “Take Control: Looking for Fixes” to identify how to enable improved and sustainable performance.

Note that this short book can only provide a summary of how this approach works for some simple business examples. For more extensive guidance on more complex situations, see Warren (2008) and http://www.strategydynamics.com.

HomeChapter 8 Strategic Planning and Ten–Ten Planning

To be strategic is to have plans of action that provide directions for operating in an uncertain world. In this section, our focus is on developing strategic plans to compete in a world characterized by monopolistic competition. Notice that the emphasis is on plans of action and not on a single plan. There is no single plan or single planning approach that can deal with the complexity of contemporary markets. What is needed is a continuous process for churning out new plans, for differentiated products and services, in order to compete in a dynamic environment. This chapter presents a brief overview of the various approaches to strategic planning and provides an overview of the planning literature. There is a lot of material to slog through, but each approach to planning has something to offer. This overview will set the stage for presenting the Ten–Ten planning process in the next chapter. The next chapter will integrate the various planning approaches and present a simplified, yet robust approach to planning called the Ten–Ten planning process. The key benefit of the Ten–Ten planning process is that it can be used for developing business plans in a very short time span.

8.1 Planning Concepts

There are two generic planning strategies that a business can pursue.Michael Porter originally identified three generic strategies. He noted that a business can also focus on a market that is not very competitive. Most people consider this to be a special case of the other two strategies. See Porter (1980). It can strive to be efficient, it can differentiate, or both. In other words, a firm can focus on delivering Midas versions of products, Hermes versions of products, or both. A firm that employs a strategy of efficiency strives to be the low-cost producer and compete on the basis of charging less than the other competitors. In contrast, a firm that is competing on the basis of product differentiation can charge premium prices. If charging premium prices yields larger-than-average profits, the market will, of course, attract attentions. Competitors will enter the market with a slightly different product, perhaps even a better product, at a lower price and ultimately drive down the premium prices. The firm will then have to embark on further cost-cutting initiatives, improve their product in order to hold on to market share and survive, or do both. The market is relentless and it demands a two-pronged approach of developing differentiated products and services and cutting costs.

The first mantra of the entrepreneur is “differentiate through innovation or perish” or in simpler terms “differentiate or die.” The second mantra of the entrepreneur is “strive to reduce costs.” The first mantra is accomplished by focusing on Midas versions of products using extravagant engineering and design. Differentiation is not only the engine driving business success under monopolistic competition, but it is also buttressed by attempting to improve costs and product design through frugal engineering. The second mantra is accomplished by focusing on Hermes versions of products using frugal engineering.

As noted earlier, over 99% of the approximately 23 million businesses compete in markets that are characterized by monopolistic competition. That is there are many buyers, many sellers, market entry and exit is easy, and the products are closely related but not identical. There are the two approaches for differentiating products. The first uses marketing and advertising to develop a brand. The second approach is to engage in product development through some sort of research and development (R&D) process and to develop goods and services with updated features. Both approaches are necessary parts of the differentiation process. Marketing and advertising can help illustrate the features and can sometimes delay encroachment by the competition. But in the long run (probably less than a year), successful differentiation depends on product development and R&D.

8.2 The Planning Process

Planning can be accomplished in a variety of ways. Figure 8.1 “The Planning Process (Adapted from May)” presents a typical model of the strategic planning process.Adapted from May (2010). The mantra is an often-repeated phrase that provides the basis for the existence of the company. It is a slogan, a watchword, a byword, or a motto that breathes life into the firm’s existence. The mantra is not a replacement for the mission statement. The mission It describes what the company does, why it exists, and how it satisfes customer needs. statement is an overall view of the business at an abstract level. It describes what the company does and why it exists and how it satisfies customer needs. The mission statement can also include a statement reflecting whether the company will focus on product differentiation and niche markets, focus on being price-competitive, or focus on both. The mantra and the mission are rarely static but ever-changing and emerging throughout the life of the firm.

The essence of the planning process consists of looking-inside and looking-outside analysis. Analysis involves both introspection and extrospection. The *internal* and *external* organization environments are examined using a number of analytical approaches, several of which are included in Table 8.1 “Orientations of Strategic Planning Approaches”. These techniques will be covered in the next section. There is a lot of confusion related to identifying goals and objectives. Many view the terms goals and objectives to be interchangeable. Goals are more abstract and broader than objectives. Objectives are generally more detailed. The important point that will be discussed in the next chapter is to identify the goals and objectives that will help support the mantra, the mission, and the value proposition over a certain time frame. The tactics are the activities the organization will use over the next 3 months to a year to reach their goals and objectives. The tactics can include timetables and schedules related to the goals and objectives. The key to the model in Figure 8.1 “The Planning Process (Adapted from May)” is that this is not a linear process. Sometimes a new mission emerges after analysis has been completed. Mission statements that change, reflect an organization that can adapt to dynamic environments.

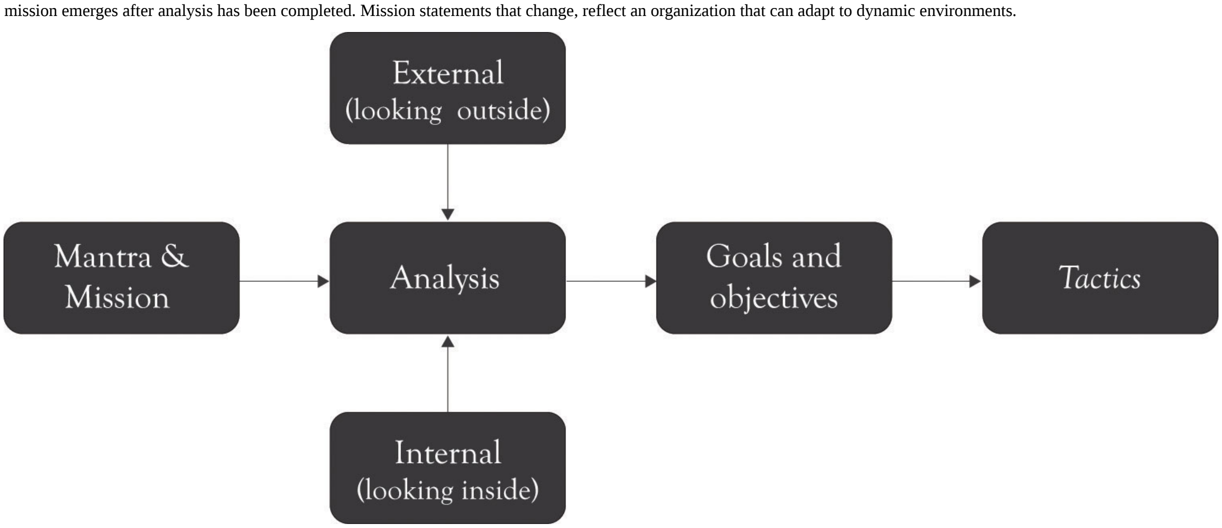


Figure 8.1 The Planning Process (Adapted from May)

Table 8.1 Orientations of Strategic Planning Approaches

Inter organizational focus	External competitive environments focus	Time to execute	
Value and supply chain analysis	High	Low	Moderate
Porter’s five force model	Low	High	Long
Resource-based framework	High	Moderate	Long

Inter organizational focus	External competitive environments focus	Time to execute	
Strategy maps	High	Moderate	Long
Creating Blue Ocean markets using the strategy canvas	Moderate to high	Moderate to high	Short
SWOT analysis	Moderate to high	Moderate to high	Short

We will revisit the definitions in the next chapter and illustrate how the planning process can be streamlined and made more efficient and facilitate the development of business plans in a very short time span using the Ten–Ten planning process.

8.3 Analytical Approaches for Strategic Planning

There are a number of analytical approaches that can be used to develop a process for churning out new plans for differentiation. We will review several of the more popular strategic planning approaches because they all provide insights into the differentiation process. A discussion of planning concepts can be at times boring; however, such discussion is also crucial for developing good plans.

The approaches to be discussed include value chain and supply chain analysis, Porter's five-force model, the resource-based framework, the use of Strategy Maps, creating Blue Ocean markets using the Strategy Canvas, and SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis. As illustrated in Table 8.1 "Orientations of Strategic Planning Approaches", each of the approaches can be classified as having an internal organizational focus (looking inside) or an external environmental focus (looking outside). Several of the strategic analysis approaches are better for understanding the organization and others are better suited for understanding the competitive environment. This table illustrates that there is no "best" approach for conducting strategic analysis and that a combination of approaches is necessary for completing an examination of the inner workings of an organization as well as the organizational context. Each of the strategic analysis tools will be covered in this chapter.

Value Chain and Supply Chain Analysis

Value chain analysisA framework developed by Michael Porter that divides the company into primary and secondary activities related to delivering a product or service. is a framework developed by Michael Porter that divides the company into primary and secondary activities related to delivering a product or service.Porter (1985). The primary activities include inbound logistics, operations, sales and marketing, and outbound logistics. The secondary activities are supporting activities and include the firm infrastructure, human resources, information technology, and procurement. Figure 8.2 "The Value Chain (Adapted from Porter)" illustrates the components of the value chain.

A closely related concept is the supply chain. A supply chain is defined as the connected activities related to the creation of a product or service up through the delivery of the product to the customer. It includes upstream suppliers as well as downstream activities such as wholesalers and distribution warehouses. Figure 8.3 "Supply Chain" illustrates the supply chain.

In general, the terms value chain and supply chain can be used interchangeably; although the value chain is rooted in the strategic planning literature, the supply chain is linked to the work in the operations management area. The key concept is that products and services have to be created and eventually delivered to consumers and the in-between activities can be referred to as the supply chain or the value chain.

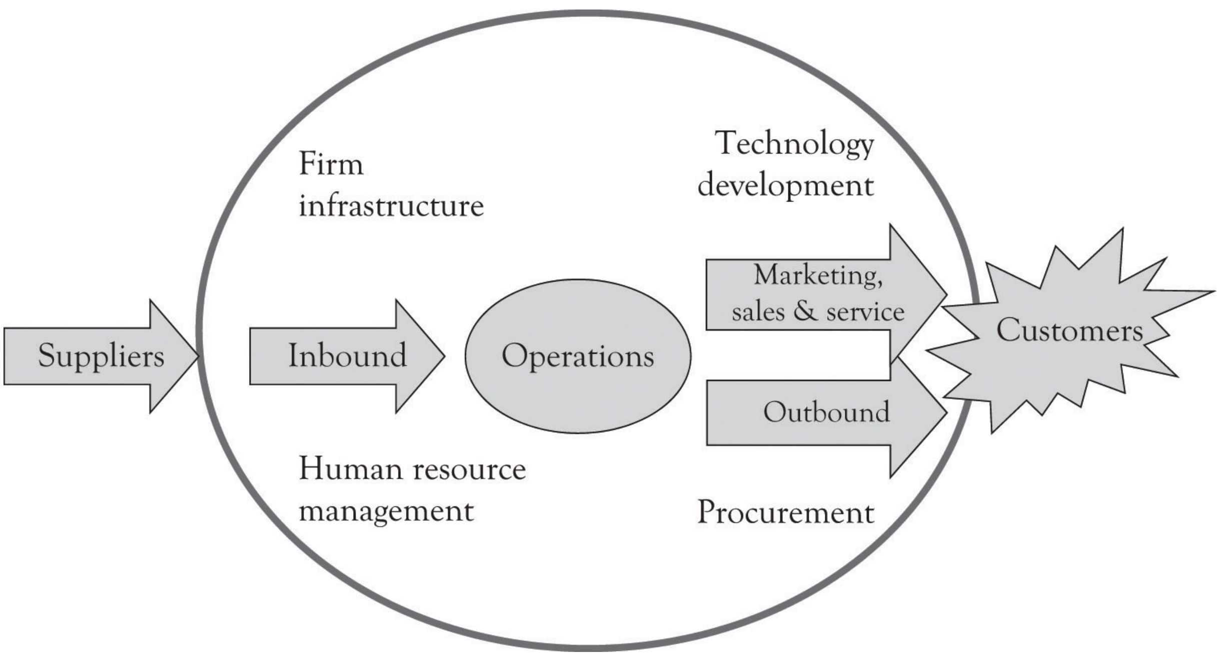


Figure 8.2 The Value Chain (Adapted from Porter)

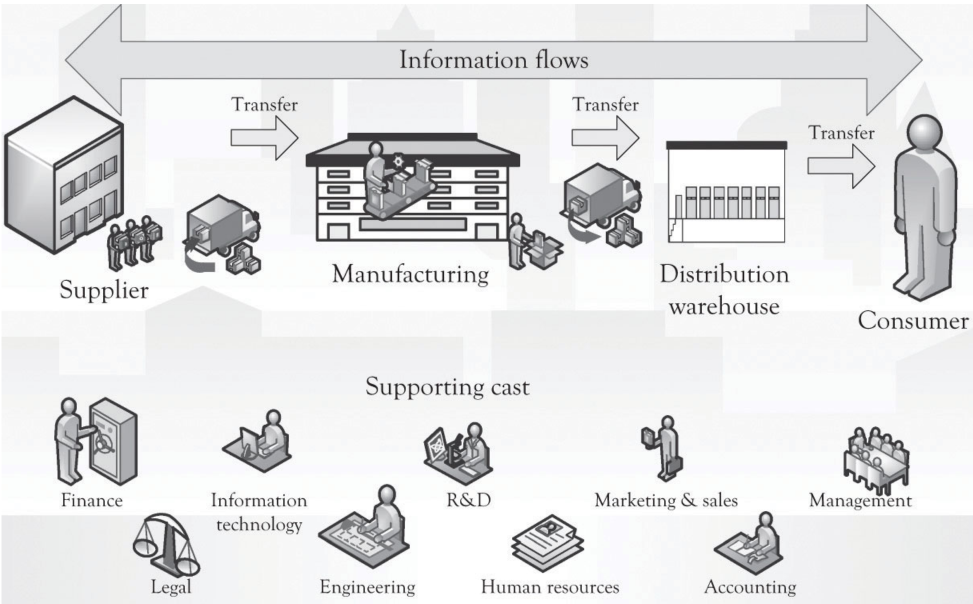


Figure 8.3 Supply Chain

The supply chain is an important visual tool because it can be used to understand where to look for processes that can be reengineered. That is, improvements can be made in connecting, coordinating, and controlling activities across linkages. It can also be used to determine what kind of information should be gathered to improve communications throughout the value chain and where value chain performance could be improved. For example, the firm can investigate where information technology can be marshaled to support the supply chain activity and where technology can be used to automate tasks. The goal, of course, is to reduce transaction costs up and down the supply chain.Coase (1937).Transaction costs refer to the effort that goes into choosing, organizing, negotiating, and entering into agreements for products and services.Williamson (1985). Transaction costs come in a variety of flavors and there is significant overlap among the various costs.

- Search costs: In general, these costs are related to gathering information on a product or service, including the costs associated with locating a product and offering a product for sale.
- Discovery costs: These costs are involved in locating an acceptable price for a product.
- Decision costs: These costs are associated with making a decision on what product to purchase. These include personal cognitive effort and organizational decision processes related to selecting a product or service.
- Negotiation costs: These costs are related to agreeing to the terms of a contract including the price, what will be delivered, how much, and when.
- Acquisition costs: These costs are involved in transporting, receiving, infrastructure development, and managing the product in inventory.
- Enforcement costs: These are the costs that the parties in the contract incur in order to enforce the terms of the contract.
- Settlement costsThese are the costs related to paying and getting paid for a product or service.: These are the costs related to paying and getting paid for a product or service.
- Social costsCosts that are not necessarily picked up by buyers and sellers. Examples include pollution costs, health costs, privacy costs, and bankruptcy costs.: These include costs that are not necessarily picked up by the buyers and the sellers. Examples include pollution costs, health costs, privacy costs, and bankruptcy costs.

Porter’s Five-Force Model

Michael Porter has also developed a technique for assessing the desirability of competing in a particular industry and how a firm can compete in that industry.Porter (2008).Porter’s five-force framework considers the buyers, the sellers, the suppliers, the current competition, and the threat of competition from substitute products. The key idea is that a firm can be more profitable by understanding how the five forces influence the competitive environment, as will be explained next.

Threat of new entrants. This is the degree to which entry into an industry is easy to accomplish. If it is easy to enter an industry and start competing, then there is a threat of new entrants. If an industry has high fixed costs, such as in the case of semiconductor manufacturing, auto manufacturing, or operating systems construction, then there is a low threat of entry. This is in contrast to the situation where entry is easy and relatively inexpensive such as found in online retail stores, home maintenance businesses, and restaurants.

Entry into a market can of course be precluded because of the scarcity of expertise and resources. For example, in the late 1990s, there were very few individuals with expertise in Enterprise Resource Planning systems and in COBOL to handle the Y2K date problem. Numerous firms turned toward India and Singapore to find employees with skills in these areas.This is in part the reason that outsourcing and off-shoring started to increase so dramatically. Resource scarcity can also limit entry into a market. Examples of industries where resource scarcity is critical include diamond mining, where DeBeers owns a substantial amount of the diamond resources, and oil production where Exxon has access to oil production and installed refining capability.

Threat of substitute products. Substitute products are a constant threat in contemporary commerce. If another product can be substituted for a product in the industry under consideration, then there is a threat of substitute products. It is sometimes impossible to know where your competition will come from. For example, video and audio content can be delivered via satellite, wireless, coax cable, cat 5, and fiber optics. The content can in turn be delivered to a variety of devices including mobile phones, televisions, iPODs/MP3 players, game consoles, DVRs, and computers. A similar situation exists for transportation. You can travel via electric car, bus, and air or in the future, by way of a personal jet craft or some type of Segway device. Indeed content delivery can be a substitute for transportation. As video and audio becomes more robust and easy to use, it may be possible to be there without actually being there. Families will soon get together by linking-up and interacting with their plasma and LCD screens using a high bandwidth carrier to communicate video and audio feeds of a birthday party or anniversary. This has already occurred in businesses with the emergence of virtual meetings. This brings up another issue. People set aside a certain amount of dollars for entertainment. However, although technology is not a perfect substitute for entertainment outside of the home, it can be a substitute for spending on entertainment. Thus, a console or a game might threaten the launching of a new movie during the holidays or vice versa.

Bargaining power of buyers. If individuals, companies, or groups of companies can influence the price and the features required in a product or service, then the buyers have the bargaining power. This often occurs when there are few buyers or when the buyer is large. The auto companies have bargaining power over the component manufactures. The same goes for Dell’s component suppliers and Wal-Mart’s suppliers. When a buyer is large and switching costs are small, then the buyer has the bargaining power. Wal-Mart is in such a position with its suppliers. Dell, however, has less buyer power because it cannot simply switch the component suppliers because desktops systems are built around integrated components and the performance of the system can be adversely impacted when components are not integrated.

Bargaining power of suppliers. If a company supplying a product or service can dictate the terms of the transaction, then the supplier has the bargaining power. The bargaining power of suppliers can be derived from many factors including the scarcity of the resource or technology, the number of suppliers, the characteristics and features of the technology, whether the technology is proprietary, and even the brand image. Intel and Microsoft have some bargaining power over Dell, but the hard drive, dram, motherboard, and monitor manufacturers have less bargaining power. The power supply and case manufacturers have even less bargaining power with Dell. The game console and global positioning system (GPS) manufactures have some power over Wal-Mart when they introduce a new model, but a holiday candle manufacturer has much less power. In many ways, the bargaining power is related to the threat of new entrants and the threat of substitute products or services. The key issue surrounding the bargaining power of suppliers is the availability of other sources of the products and services. If alternative or second sourcing is available, then the bargaining power of the supplier is lessened.

Rivalry among existing competitors. This is the degree to which there is competition among the firms. When there are several competitors and the products they are selling are fairly standard or readily obtainable and the competitors cannot easily leave the industry, then the rivalry will be intense. Examples of intense rivalries include breakfast cereals, flash memory, dram and electronics industries, housing construction, online and offline retailing, and the airline industry. Intense rivalries among competitors are again driven by the threat of new entrants and the threat of substitute products and services. In this context, product differentiation is essential in order to reduce the ruinous effect of perfect competition. This is the reason that the producers of GPS systems are constantly refining and adding features to their product line. Airlines, breakfast cereal producers, and the housing industry are constantly looking for ways to differentiate their offerings and at the same time reduce costs.

The Five-Force Model in Practice

The five-force model can be used as the basis for conducting an industry analysis. The goal of an industry analysis is to understand the dynamics of competition and to ascertain how the five forces influence profitability. The following steps are used for conducting an industry analysis:

- Develop a brief description of the target industry
- Identify the competitors, buyers, suppliers, potential entrants, and potential substitutes
- Determine the strength and weaknesses of the forces
- Identify any recent changes in the dynamics of the forces
- Determine the potential for short- and long-term profitability
- Ascertain who in the industry is positioned to be profitable
- Determine where the organization should invest.

Porter’s five-force model provides an overarching view of the competitive environment and is extremely helpful for understanding the competitive environment. It does, however, have several deficiencies. First of all, it takes a long time to conduct a full-blown exposé of the five forces because many devotees to the approach tend to overanalyze the industry and the competition. This in turn leads to organizational fatigue. Overanalysis is related to the second deficiency. The ideas are very abstract and broad, and the technique requires consulting expertise in order to be applied effectively. Finally, it takes too long to implement for small organizations. For the entrepreneur working under extreme pressure, under the umbrella of monopolistic competition, there is very little time to attend to apply the approach effectively. Even though Porter’s ideas are very powerful, they do not resonate with the entrepreneur because they are abstract and difficult to apply.

Resource-based Framework

The resource-based view, also referred to as RBV, is very popular with academics. The intellectual foundations for the RBV approach are many, but the work by Prahalad and Hamel on core competenciesPrahalad and Hamel (1990). and the work by BarneyBarney (1991). on the link between resources and sustained competitive advantage established a strong foundation. The basic idea of RBV is that some organizations are more competitive because they have access to unique resources or special capabilities and competencies. Resources can be tangible or intangible and include raw materials, land, brand, knowledge and expertise of people, reputation with customers and suppliers, plants, equipments, patents, trademarks, copyrights, and funds. A capability or competence is the ability of a firm to turn its resources into customer value and profits. Capabilities or competencies can be manufacturing prowess, order fulfillment and delivery, customer service, marketing, finance and accounting, management expertise and leadership, and in essence any proficiency or prowess in the supply chain and value chain.

Porter’s five force model, and the accompanying industry analysis, tends to focus on locating a firm in an attractive industry and then taking steps to achieve competitive advantage over rival firms. In contrast, the RBV approach suggests focusing on competitive arenas where the firm has unique resources and competencies. For example, if you own property with rich productive topsoil, if your workers are diligent, and if your daughter is an excellent agronomist, you will probably be a successful farmer. The key to being successful in the context of RBV is that the resources and competencies are hard to imitate and help to establish a strong basis for competitive advantage. In essence, the status of the internal resources and competencies will assist in pursuing a particular strategic direction. Amazon has a core competency in selling online and it simply kept pursing that competency by selling construction tools, electronics, audio books, eBooks, and developing partnerships with brick and mortar vendors. Most of Google’s successful ventures are related to its core competency of *search*. Joan’s foray into the jewelry box business discussed earlier was linked to her excellent craftsman skills. Joan had a core competency in jewelry box design and fine woodworking.

Core competencies are the very critical skills that define an organization. For Google, it is their search capability, for Amazon it is their ability to sell online, and for Joan it is her prowess at jewelry box design and her knowledge of the marketplace. In the case of Joan, her knowledge and skills can probably be imitated and replicated in a shorter time frame than the competencies developed by Amazon and Google. But of course, Joan’s jewelry box business is more agile and can change direction much faster than Amazon and Google. Eventually, all capabilities and competencies (even Amazon and Google’s) can be imitated, replicated, and improved. Even scarce resources and monopolies can succumb to the onslaught of new technology, time, and market forces. There are substitutes for oil, diamonds, and operating systems.

The RBV is a powerful idea for understanding strategic direction, but it has several deficiencies. First of all, it is very broad in scope and hard to implement as part of a concrete business plan. Delineating the unique capabilities, competencies, and resources and then using this information in strategic planning are time-consuming. In addition, there is little guidance on how to build competencies. Indeed, some theorists believe that core competencies cannot be built but simply emerge. For additional discussion on RBV, see HenryHenry (2007). and Grant.Grant (2007). Later on, we will discuss how this approach can be effectively integrated with SWOT analysis and, in the next chapter, we will discuss how this approach can be integrated with the Ten–Ten planning process.

Strategy Maps

A strategy map is a visual diagram that represents a causal structure of an organizational strategy. The strategy map is an outgrowth of the balanced scorecard approach developed by Robert Kaplan and David Norton.Cf. Kaplan and Norton (1996, January–February, 2003b) and visit http://www.balancedscorecard.org/BSCResources/AbouttheBalancedScorecard/tabid/55/Default.aspx The purpose of the balanced scorecard is to develop a series of measurable performance indicators that are linked and aligned with organizational missions and objectives. Measurement at the operational and tactical levels is a key part of the balanced scorecard approach and essential for developing and benchmarking best practices. Measurement can be used to identify where management should redirect its attention and also to identify whether best practices are already in place.

There are four primary areas where performance indicators can be used. They are the financial performance indicators, customer performance indicators, performance indicators related to internal organizational processes, and performance indicators related to the ability of the organization and employees to innovate and learn. The strategy map is an overview of the causal relationships related to the four perspectives. Figure 8.4 “Example of a Strategy Map for a Railroad” is an example of a strategy map for a railroad. You are encouraged to use Google’s image search using the keyword strategy map for additional examples.

In general, the balanced scorecard/strategy maps approach is more suitable for older larger organizations with a lot of time for developing and executing a strategic plan. Kaplan and Norton point out that a strategy map presents an integrated overview of the outcome measures and the performance drivers of outcomes using cause-and-effect relationships. The strategy map can serve as a strategic measurement system and strategic control system that align departmental and personal goals with overall strategy.Nørreklit (2000). There are, however, problems in assumptions and the time it takes to implement the approach.Nørreklit (2000). The first problem is that the approach is too hierarchical and not particularly suitable for dynamic and complex environments. Some researchers also question the causal relationships among the variables. For example, are there causal links related to enhancing cost control leading to increases in the rate of competitiveness, which in turn are leading to improvements in customer satisfaction?Nørreklit (2000). In essence, does cost control always lead to customer satisfaction through competitiveness? One hopes that this is the case, but it is not easy to verify from both research and practice perspectives.

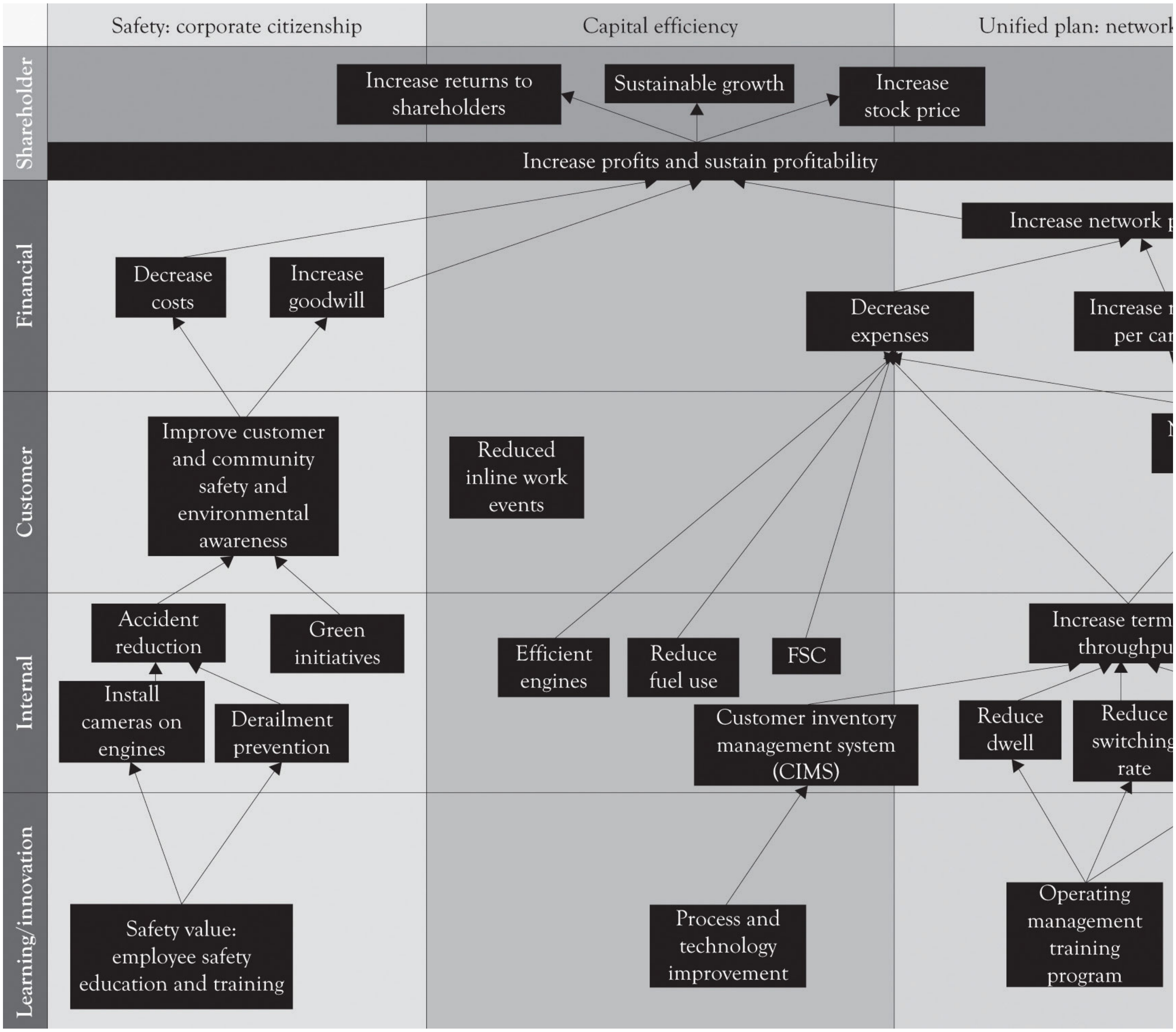


Figure 8.4 Example of a Strategy Map for a Railroad

From the public sector, permission of Wikimedia Commons License Agreement, http://commons.wikimedia.org/wiki/File:StrategyMap.jpg.

The major problem from an entrepreneurial perspective is that the balanced scorecard approach using strategy maps approach is very complex and difficult to implement. In general, strategy maps and the balanced scorecard approach are more applicable to relatively mature companies and are not conducive to new venture development. New ventures, whether they are intrapreneurial or entrepreneurial, need a more adaptive and agile approach. A customer orientation, with an attention to securing and reducing the cash burn rate, a focus on executing the plan by attending to developing internal processes, and focusing on R&D and learning are the most important takeaways from the balanced scorecard/strategy maps approach.

Creating Blue Ocean Markets Using the Strategy Canvas

As noted throughout the earlier chapters we believe that the Blue Ocean concept is an important contribution to the strategic planning literature.Kim and Mauborgne (2005). The idea is very similar to the so-called killer-app concept and lateral marketing approach. The goal of the Blue Ocean approach is to identify uncontested market spaces for profit and growth rather than compete in traditional Red Ocean market spaces where there is a tendency to focus on either cost-cutting or differentiation. Table 8.2 "Red Versus Blue Ocean Strategy" illustrates how the concepts developed in the book with Midas, Atlas, and Hermes products relate to the Blue Ocean concepts. This process of developing a Blue Ocean market is facilitated by developing the Strategy Canvas and by using the FAD template as an input into the Strategy Canvas.

This is in contrast to the competitive strategy where a large and growing already-served market is identified and the entering firm tries to find a way to compete. Several research projects have been conducted on the efficacy of the Blue Ocean approach, and the results suggest that organizations pursuing Blue Ocean markets can in some instances be successful. A Blue Ocean strategy that is focused on intense innovation and on product differentiation and brand creation has been found to be profitable.Burke, Stel, and Thurik (2009). The Blue Ocean approach apparently helps to insulate a firm from intense competition. In many instances, Blue Oceans are not completely blue, but rather have patches of red. The net effect is that it is sometimes necessary to find a niche in a large market and then use Porter's five-forces model to assess the desirability of competing in a particular industry and how a firm can compete in that industry. The key idea is that a firm can be more profitable by understanding how the five forces influence the competitive environment. The most important part of the Blue Ocean approach is to assist in identifying strategic opportunities for product differentiation using the Strategy Canvas. This was discussed in an earlier chapter where we used the FAD template to develop a Strategic Canvas for the Nintendo Wii.

Table 8.2 Red Versus Blue Ocean Strategy

Red Ocean	Blue Ocean

Red Ocean	Blue Ocean
The major goal is to beat the competition in an already established market space.	The major goal is to make the competition irrelevant and superfluous by developing a new product or service in a new market space.
Compete on the existing demand curve in the existing market space. Growth is slow.	Compete and capture a new uncontested demand curve in a new market space. Growth is above average.
Develop either Midas, Atlas or Hermes products and services.	Develop and introduce Midas, Altas and Hermes products and services.
Focused on product differentiation or being a low cost producer.	Focused on product differentiation and also being a low cost producer.
Focused on cost cutting, outsourcing, brand management and advertising.	Focused on research, product design and learning.

SWOT Analysis

The genesis of the SWOT approach to strategic planning is usually attributed to Albert S. Humphrey during his tenure with the Stanford Research Institute.Before he died in 2005, Humphrey wrote a brief history of SWOT development. He indicated that it was initiated in 1960 because long-range planning approaches were not working properly. The research team interviewed 1,100 organizations and had 5,000 executives complete a 250-item questionnaire. The approach was originally called SOFT (Satisfactory, Opportunity, Fault, and Threat) but after subsequent adaptations by a number of consultants and academics, it evolved into SWOT. There are devotees of SWOT that believe it originated at Harvard Business School under the guise of Albert Smith, Roland Christensen, and Kenneth Andrew. See Humphrey (2005); Panagiotou (2003). Even though the SWOT technique can trace its roots to the 1960s, it is still an important and useful tool that is constantly evolving and improving to deal with the ever-increasing complexity of contemporary markets.

The objective of a SWOT analysis is to facilitate the development of a strategy in starting a new venture or large-scale project, completing a large-scale project and diagnosing deficiencies in an existing organization by taking its temperature in a particular environmental context. A SWOT diagram consists of four quadrants (see Figure 8.5 "SWOT Diagram"). The upper two quadrants relate the internal strengths and weaknesses of the organization. The bottom two quadrants relate to the external organizational environment in terms of the opportunities and threats faced by the organization in the marketplace.

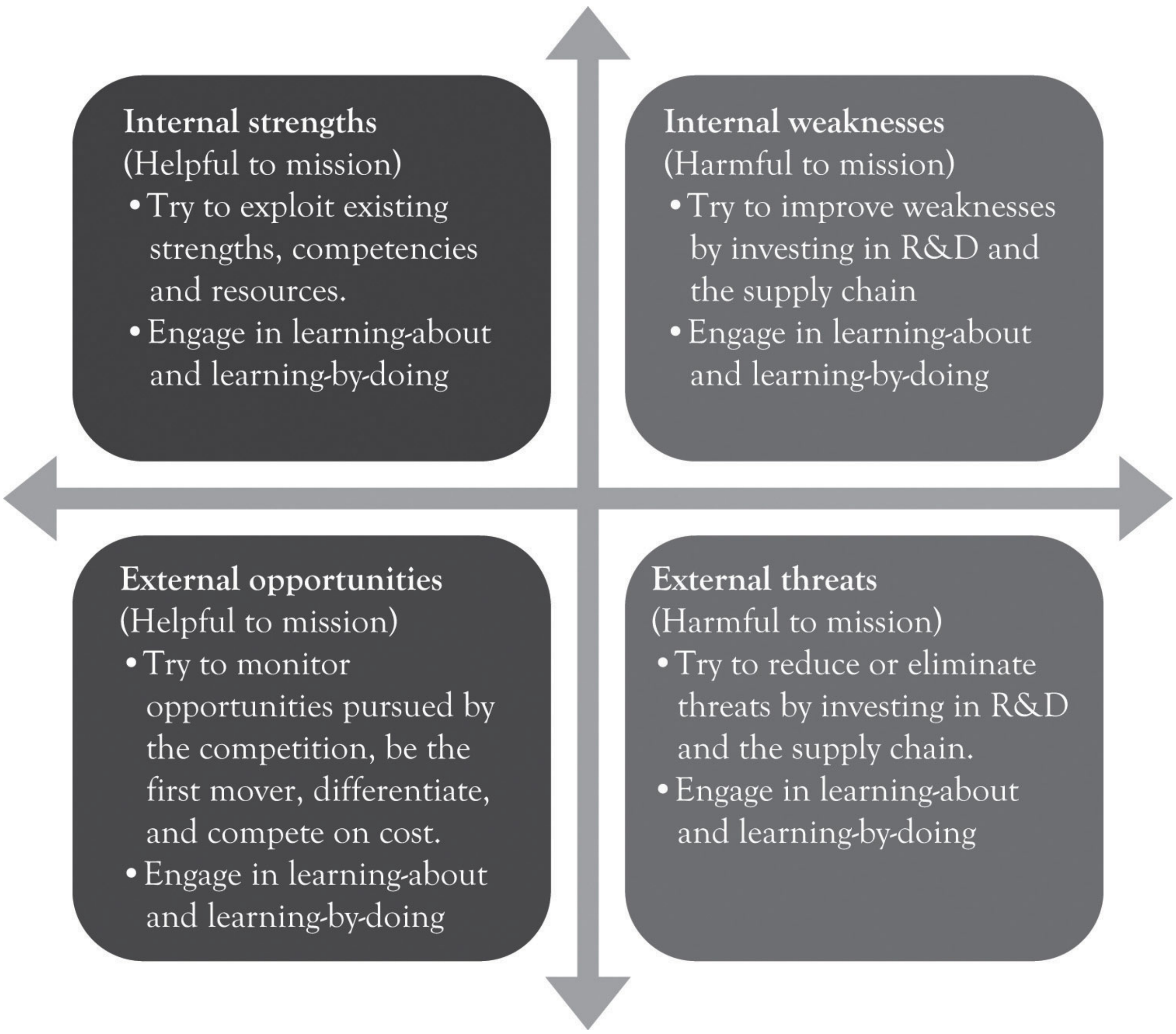


Figure 8.5 SWOT Diagram

One of the benefits of SWOT is that it can be used to analyze the organization as well as the organizational environment in order to identify areas of competitiveness and areas that need attention. It is a very useful tool for looking inside and looking outside to identify the state of the organization and the competitive environment. In an ideal situation, it draws on organizational constituencies and scans the external environment for opportunities and threats. Several examples of how SWOT can be used to analyze the strategic context are presented below.

Example 1: iPhone 4

Figure 8.6 "iPhone 4 SWOT Analysis" illustrates a SWOT analysis for Apple's iPhone 4. Substitute products are the greatest threat; however, Apple has been able to counterbalance such encroachment by paying attention to product differentiation through research and product development and, of course, the coolness index.

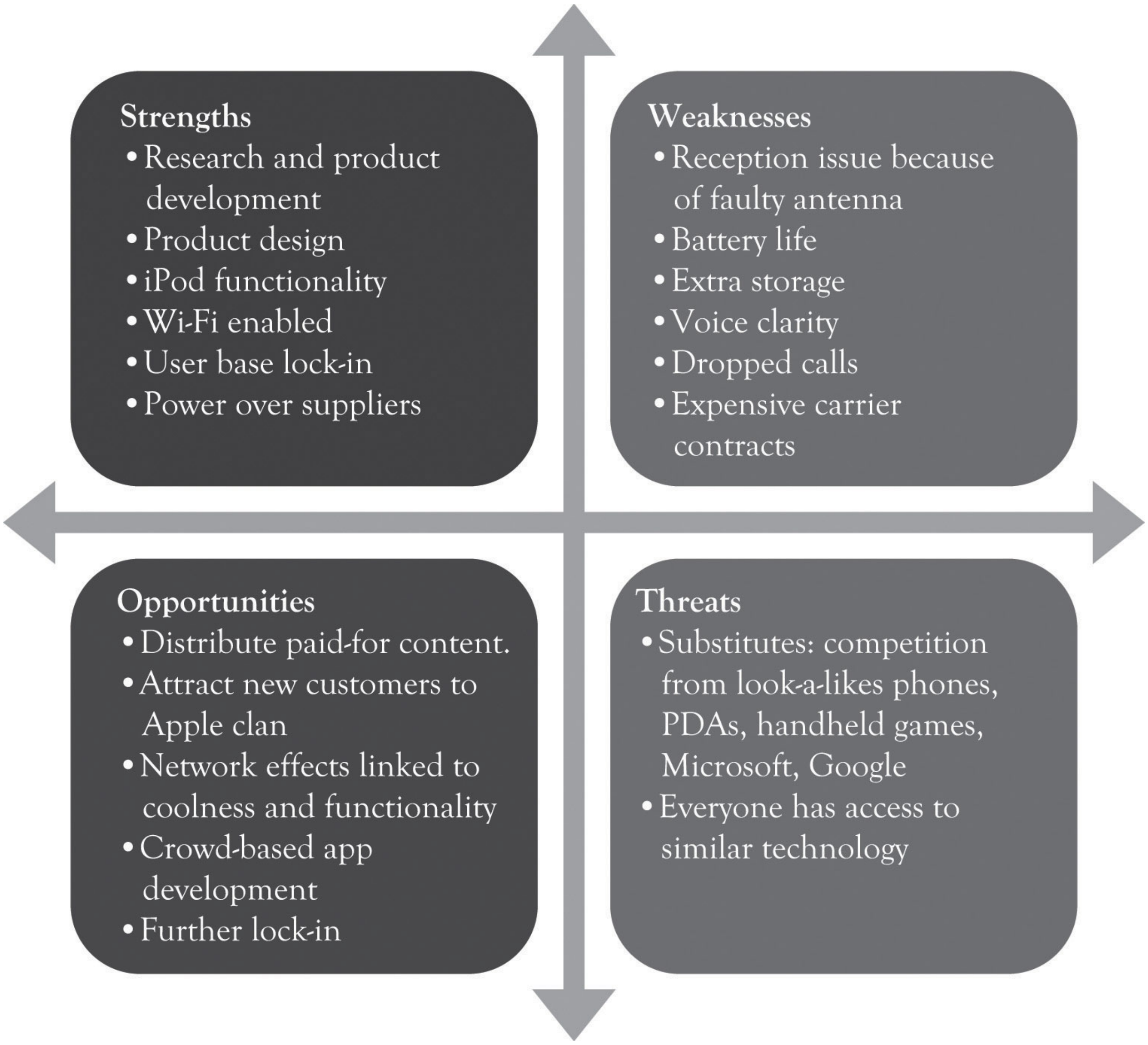


Figure 8.6 iPhone 4 SWOT Analysis

Example 2: Dell's Entrance Into the Chinese Computer Market

Dell decided to enter the Chinese PC market in the 1990s. They faced many impediments to entering such a complex environment. Figure 8.7 "SWOT Analysis for Dell Entering China" illustrates a hypothetical SWOT analysis for Dell as they embark into the Chinese PC market. The Dell supply chain is top-notch as well as their strong commitment to R&D. They have numerous business process patents as well as product patents. One of the earlier knocks on Dell was that the Chinese culture was not conducive to Dell's golden rules of disdaining inventory, always selling directly, and always listening to the customer. They have subsequently begun to listen to the customer and have started to sell through retail outlets.

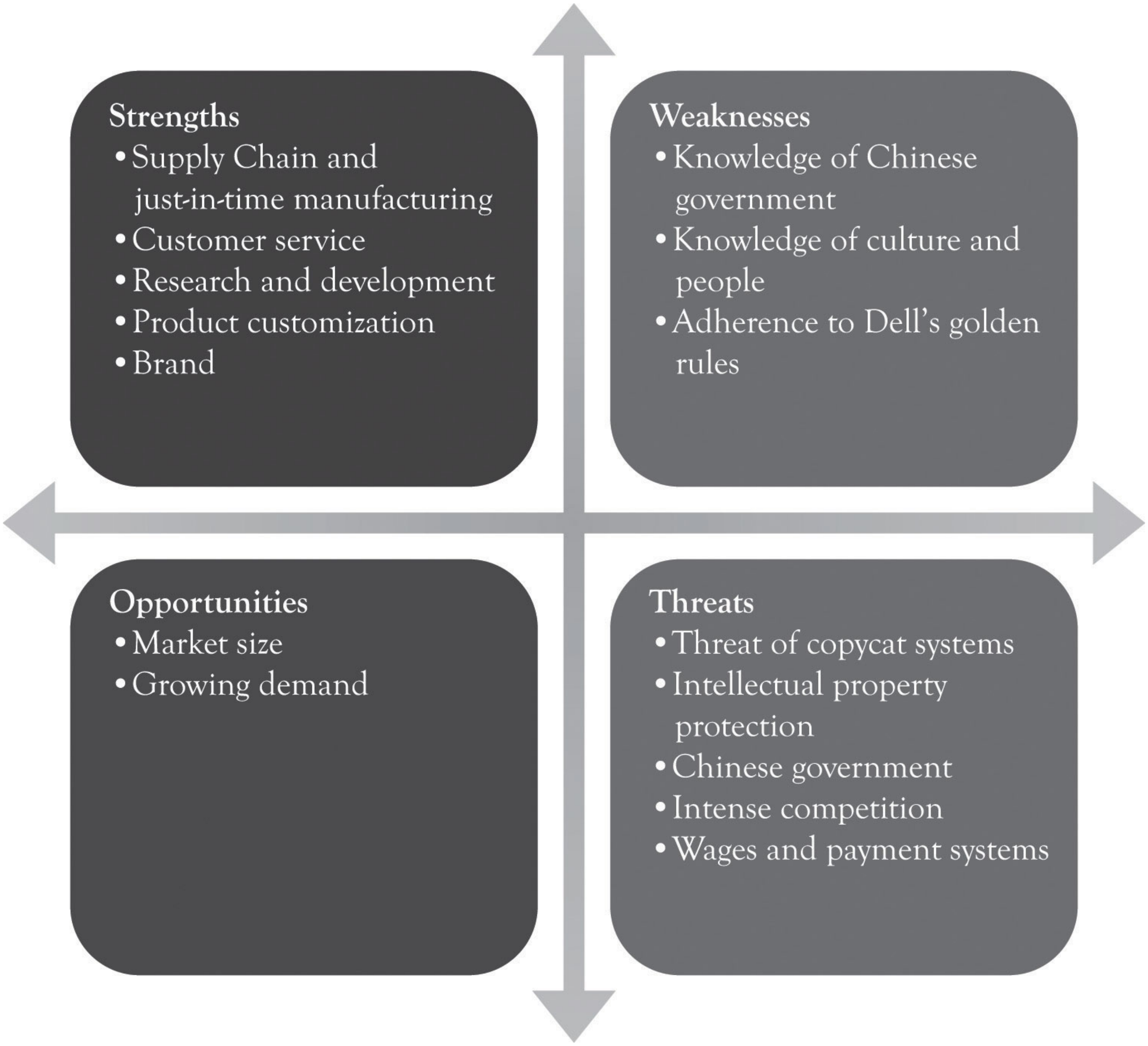


Figure 8.7 SWOT Analysis for Dell Entering China

Integrated SWOT Analysis

Even though a SWOT analysis is fairly easy to understand and apply, it is not necessarily easy to develop a good one. One of the primary criticisms of SWOT is that it leads to a large laundry list of strengths, weaknesses, opportunities, and threat factors. It is also criticized because it lacks direction and focus. The net effect is that strategic planners are not sure what variables are important or where to start in the process. This is particularly relevant in a world characterized by strong domestic and global competition where risk and uncertainty are driven by the winds of technological change, political turmoil, and governmental actions.Panagiotou (2003).

The quick SWOT approach alleviates the deficiencies of traditional SWOT analysis by drawing on the other analytical approaches looking at strategy presented earlier. It takes the key variables in value and supply chain analysis, the five-force model, the resource-based framework, and the technology-based strategy approach and uses them to drive the SWOT process. The critical variables or drivers that influence the SWOT are listed below:

- Internal Organizational Drivers
  - Supply and value chain performance
  - Core competencies and organizational resources
  - Emerging technology
- External Organizational Drivers
  - Threat of substitute products
  - Threat of new entrants
  - Bargaining power of buyers
  - Bargaining power of suppliers
  - Local and world economy, culture, and government influence

Some of the variables influence both the internal and external organizational environment. For example, the supply chain boundary affects the internal environment, but it is also part of the external environment and involves logistics and financial institutions. Similarly, the onslaught of new technologies also influences the internal as well as the external environment. Figure 8.8 "Key Drivers for Quick SWOT Analysis" illustrates the SWOT template along with the key variables that should drive the SWOT analysis.

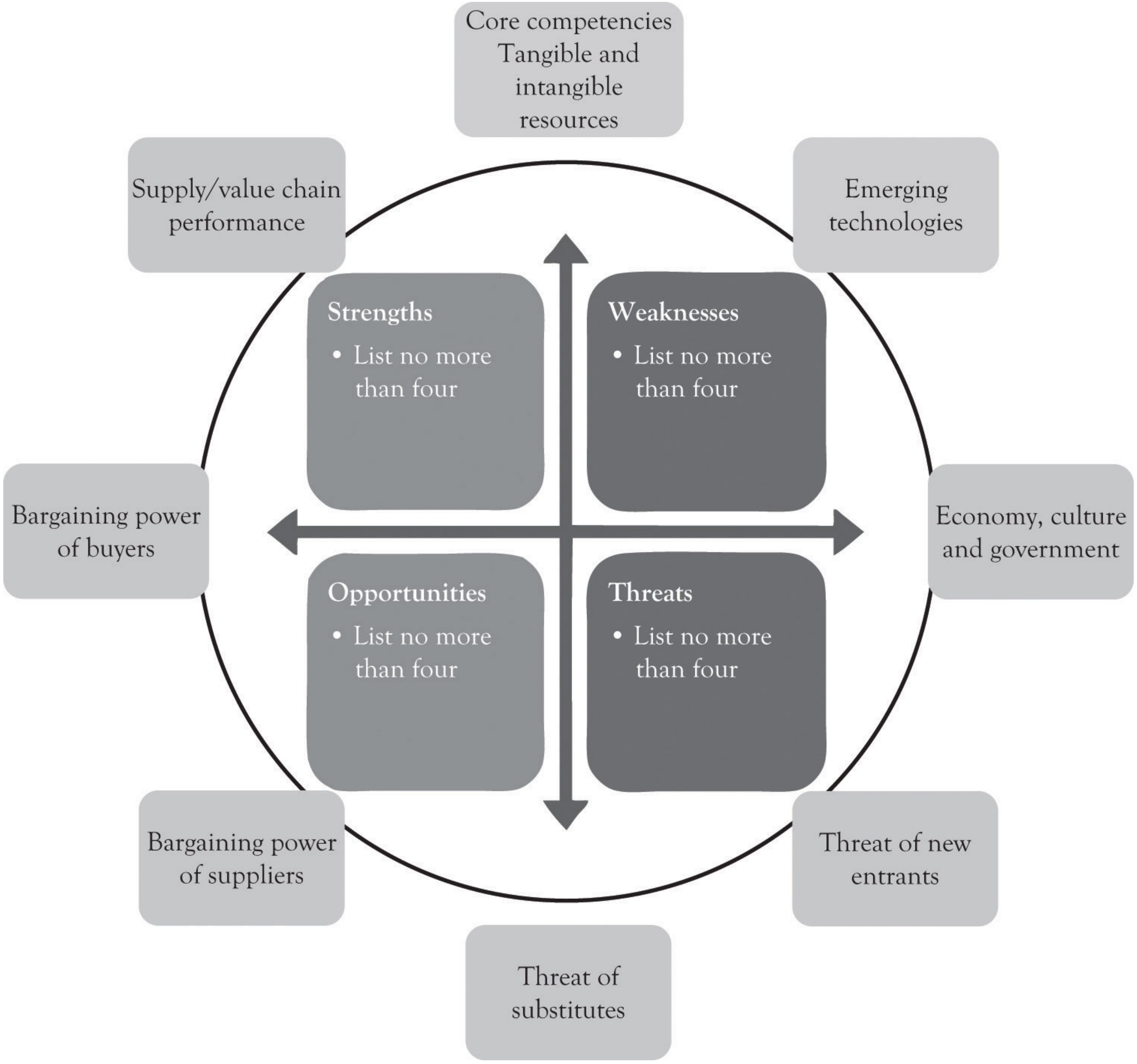


Figure 8.8 Key Drivers for Quick SWOT Analysis

The Quick SWOT Supported With Strategy Canvas

A SWOT analysis should be conducted very quickly as illustrated below:

1. Conduct a brief external industry analysis.
   - Identify the competitors, buyers, suppliers, potential entrants, and potential substitutes.
   - Understand the industry supply chain and how it works.
2. Conduct a brief internal organizational analysis.
   - Identify organizational capabilities/competencies related to manufacturing prowess, order fulfillment and delivery, customer service, marketing, finance, accounting, R&D, employees, and management. This is essentially the internal supply and value chains.
3. Use a strategy canvas to identify how you can add or subtract features for product differentiation. The idea is to identify new opportunities and perhaps Blue Ocean markets.
4. Develop a 4 × 4 SWOT diagram using the template. Try to limit the number of factors in each quadrant to four factors.
5. Start the process over after 4 months.

The next chapter will provide a simple template as part of the Ten–Ten planning process for conducting an organizational and industry analysis that incorporates the quick SWOT approach.

Monopolistic Competition and SWOT

Monopolistic competition involves many buyers and many sellers offering slightly different competitive products. Producers are always searching for markets with potential. In such an environment, there are several strengths that are critical for survival. Figure 8.9 "Competing Under Monopolistic Competition Requires Strength in At Least Two Areas" illustrates the idea that if there are substitute products or emerging technology threats, then you need to have 2 out of 3 critical strengths. The critical strengths are research and product development, a high performance supply chain, and a strong brand. The optimum situation is to be strong in all three areas, but this is not very common. If any of these three are placed in the critical weakness category, the organization is definitely at risk. It should also be noted that an organization could be strong in all three critical strengths and still fail. Survival is still linked to long-term profitability. Many of the very successful companies are 3 for 3 and have above-average performance in R&D and a strong brand and excellent supply chain.

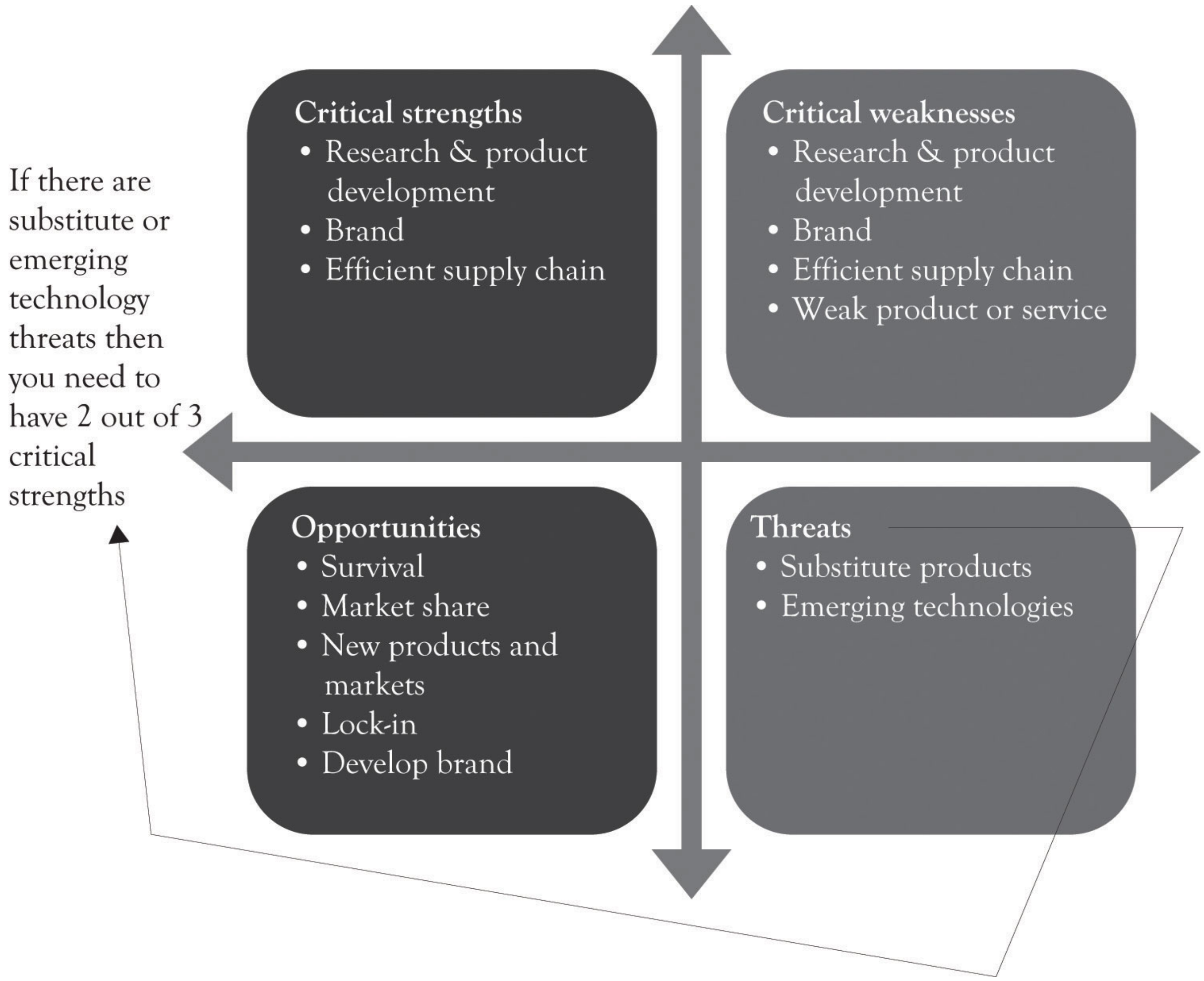


Figure 8.9 Competing Under Monopolistic Competition Requires Strength in At Least Two Areas

8.4 Conclusion

In this chapter, we have reviewed many popular approaches for strategic planning. The key points are the following:

- The two basic strategies for business planning include product differentiation and striving to be the low-cost producer.
- Product differentiation can be accomplished by focusing on Midas versions of products using extravagant engineering and design. Being the low-cost producer can be accomplished by focusing on Hermes versions of products using frugal engineering and design.
- Planning approaches can be classified as having an internal organizational focus (looking inside) or an external or environmental focus (looking outside).
- The development of an abbreviated SWOT analysis that is supported with a strategy analysis can be used to integrate the key attributes of the various strategic planning approaches.
- The planning process never ends. With continuous pressure from market and competition, firms are suggested to develop new strategy and planning from time to time.

This chapter reviewed the various analytic approaches for strategic planning. There is no single business plan that can be used to deal with the complexity of monopolistic competition nor is there a single planning approach that will take the organization down the right path. A revised analysis tool, called quick SWOT analysis, was introduced that combines the various strategic planning approaches.

This chapter also sets the stage for the Ten–Ten planning process, a simplified yet robust approach to planning. The next chapter will present two templates for developing a business plan. The first template is the Organizational and Industry Analysis template and it incorporates the quick SWOT approach along with concepts from value chain analysis, the resource-based approach, Blue Ocean market analysis, and the other strategic analysis approaches discussed in this chapter. This information is then used to fill in the Business Plan Overview template. The use of the two templates is part of the Ten–Ten planning process. The approach can be used to produce one plan and also to churn out new plans in order to compete in dynamic environments characterized by monopolistic competition.