Strategy: In Search of a Method

Willie Pietersen

Strategy is Broken

Companies create their futures through the strategies they pursue. These strategies may be explicit or implicit; they may be developed in a thoughtful, systematic way, or allowed to emerge haphazardly in a series of random, *ad hoc* decisions made in response to daily pressures. But in one way or another, the strategy a company follows – that is, the choices it makes – determines its likely success. And in today's fast-changing environment, the ability to generate breakthrough strategy, and to do so not once but repeatedly, has become more important than ever.

Unfortunately, strategy is broken – at least as practiced in many corporations today. The rising corporate casualty rate amply demonstrates this fact, underscoring the importance for companies of learning how to do strategy well.

Consider the following sobering statistics (adapted from *Creative Destruction* by Richard Foster and Sarah Kaplan): In the 1920s and 30s, the turnover rate of the S&P 90 (the original Standard & Poor's list of major US companies) averaged about 1.5% per year. Thus, a new member of the S&P 90 list could expect to remain on the list, on average, for over sixty-five years. By contrast, the turnover rate in the S&P 500 in 1998 was close to 10%, implying an average lifetime on that list of only ten years.

Of course, strategic innovations do occur, but it is often newcomers rather than established firms that create the big breakthroughs:

- When the first twenty-four-hour all-news television network was created, the innovation was launched not by CBS or NBC, but by an Atlanta-based upstart called CNN.
- When a new build-to-order, direct-selling model for personal computers was created, the innovation came not from IBM or Compaq but from an entrepreneurial firm called Dell.
- When digitization made the traditional encyclopedia obsolete, the innovative response came not from Encyclopedia Britannica but from a software company—Microsoft—with its Encarta Encyclopedia.

Why are so many established companies ineffective when it comes to strategic innovation? I believe a crucial reason is the lack of an effective *process* for strategy creation. In this article, I'll explain why a separate and distinct strategy creation process is crucial, examine why most firms lack such a process and describe an approach that has been shown to be an effective tool for creating and implementing breakthrough strategies.

Strategy Is Not Planning

Although most business executives recognize the importance of strategy, many companies employ a process that merges strategy with planning, often under the rubric of "strategic planning." As a result, strategy and planning have become blurred in people's minds. In reality, they are completely different things, and confusing them has created a major impediment to strategic innovation.

Simply stated, strategy is about where to compete and how to win. It involves the art of making the most intelligent choices – those that will make the best use of a firm's limited resources to win the competition for value creation. It enables leaders to lead by creating an intense focus on the right things. A firm's "winning proposition" – the heart of its strategy – is the result of that choice making. The winning proposition defines simply and clearly what a firm will do differently or better than its competitors to create greater value for its customers and superior profits for itself (and hence superior returns for its shareholders).

Planning, by contrast, is about developing financial and managerial blueprints for running the organization efficiently. Its purpose is to provide budgets and forecasts for the sake of orderliness and operating discipline.

The differences between the two activities are profound; in fact, in many ways they are diametrically opposed (see figure 1). Strategy creation is a *leadership* process – one that is driven by learning and discovery. It involves divergent thinking that challenges existing assumptions and mental models. The focus is outside-in. It employs techniques to create superior insights about the needs of customers, the competition, the dynamics of the marketplace and the firm's own realities. It translates these insights into action by means of intelligent choice-making. The product of strategy is a core concept – a simple, compelling statement of how a firm aims to win. It is mainly about ideas.

Planning, on the other hand, is a *management* process. It is driven by the need for discipline. Its role is not to make strategy but to operationalize it. It is thus an exercise in convergent thinking which takes existing assumptions as a given, and uses them as a platform for developing action standards, forecasts, operating logistics, and budgets. It focuses largely on the internal operating mechanisms of the firm. It is mainly about numbers.

STRATEGY	PLANNING
About Ideas	About Numbers
Outside-In	Inside-Out
Divergent Process	Convergent Process
Invents the Future	Extends the Past
Often Transformational	Mostly Incremental
About Leadership	About Management

Figure 1. Strategy Versus Planning

Both strategy and planning are essential. A firm cannot hope to excel without robust capabilities in each. But while they are related, their aims are entirely different, and so are the methods and mindset necessary to do each successfully. It is vital, therefore, to create a dedicated and distinct process for each, and then to connect them seamlessly. The correct sequence is critical to success: strategy first, planning afterwards.

Nonetheless, many companies mix strategy and planning in a single process. The mixture is a toxic one. As Henry Mintzberg has shown, companies that blend strategy with planning inevitably produce something that is 90% planning and only 10% strategy. The harsh truth is that, when planning and strategy are combined, *planning kills strategy.*

This merging of strategy and planning has produced serious detrimental effects. First, planning has increasingly become a substitute for strategy. Second, over time, many companies have simply lost the understanding of what strategy really is. And finally, such firms have developed little organizational capability to think and act strategically.

How did this state of affairs come about? An explanation can be found in the life-cycle changes that companies undergo as they evolve from start-up through rapid growth and into maturity (see figure 2).

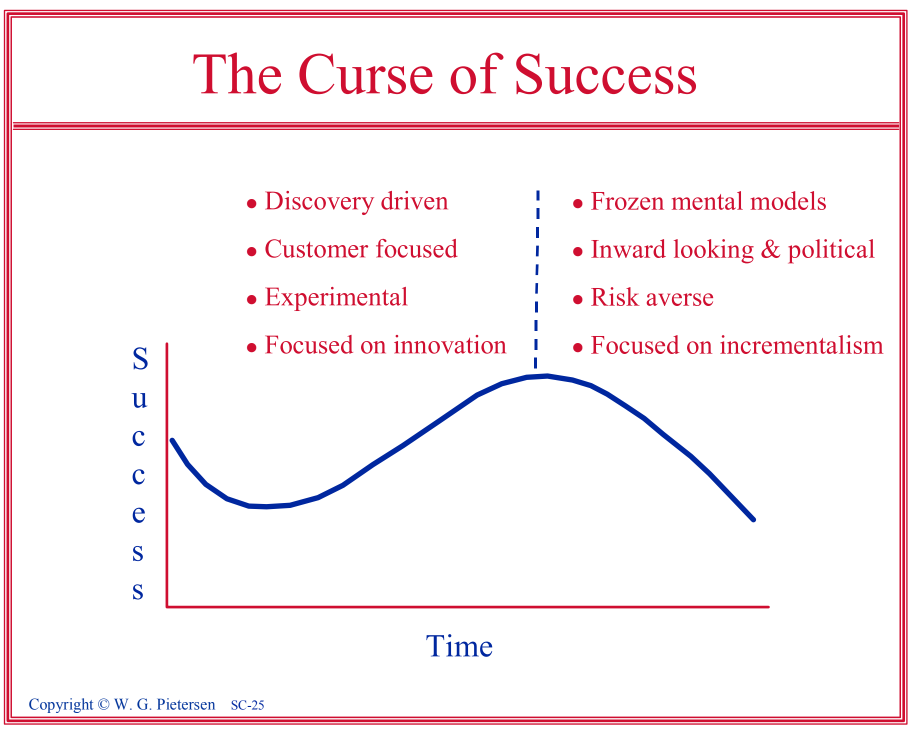

Figure 2. The Curse of Success

Successful start-ups are typically driven by the momentum of an initial breakthrough idea. During the growth phase, the overwhelming focus is on generating customers and satisfying their needs. The emphasis is on experimentation and discovery. Risk-taking is a way of life. Speed and flexibility are the norm.

As companies become large, established, and more complex, they begin to display a set of symptoms which some have called "the curse of success":

- *Locked into frozen mental models:* Success breeds complacency. Managers in mature organizations often harbor fixed ideas on how the world works, what customers want, and how to compete effectively. Lulled by success, they see no need to question these assumptions until a crisis strikes, by which time it is often too late.
- *Inward-looking and political:* It's a challenge to manage and co-ordinate a large, complex system. Hence the tendency grows for established companies to look inwards at their own processes and structures rather than outwards to their customers. Their cultures become more political and rife with personal agendas, internal competition, and power plays.
- *Risk-averse:* Leaders in established organizations often fear cannibalizing the existing business, and shun the uncertainties and pain which change can bring.
- *Focused on incrementalism:* As companies mature and their growth rate slows, they turn their attention increasingly to cost savings and operational efficiency to drive earnings growth. They copy competitors on key measures

of performance rather than seeking different and better ways of creating value for customers. The pursuit of operational efficiency is preferred as being concrete, measurable, and safe.

In combination, these symptoms of the Curse of Success produce a corporate culture in which change and creativity are lauded in theory, but stifled in practice. The decision-making processes reflect these biases. “Strategic planning” degenerates into a mechanical ritual of number crunching, forecasting, and budgeting, while strategic innovation, without a separate process to drive it, generally grinds to a halt.

Companies which are driven purely by planning processes sometimes take comfort in periodically engaging consulting firms to do strategic studies for them. The perilous result is that they end up outsourcing their thinking to third parties, and lose the vital life force of strategic self-sufficiency. Let me be clear: I have no objection to the use of consultants. But they must supplement rather than substitute for a firm’s own capacity for strategy creation.

Preventing the Curse of Success from controlling the firm’s destiny is a major leadership challenge for executives in large companies. As I’ll argue later in this article, an effective strategy creation process is itself a vehicle for meeting this leadership challenge.

Who Does It Right?

There are a few companies that understand the crucial differences between strategy and planning and clearly separate their strategy and planning processes. Two of these are GE and Procter and Gamble, which are among the handful of American firms which have survived and flourished for well over 100 years. They have done so through continuous innovation, driven by dedicated and systematic strategy creation processes. Let's look briefly at each.

Strategy and planning at GE. In an ongoing process, GE's Executive Council, comprising the top 35 leaders in the corporation, meets every quarter for two and a half days. The primary purpose is to conduct a strategic dialogue and share learning. At these meetings, the external environment is analyzed, threats and opportunities are examined, and best practices are shared. The Executive Council's role exemplifies ex-chairman Jack Welch's vision of GE operating like "one giant learning laboratory."

With this corporate-level strategic assessment as a guide, GE conducts two major annual meetings at the business unit level. The S-1 meetings held toward the end of the second quarter deal exclusively with strategy. Each business unit presents its strategy for the next three years together with the supporting logic. The insights which Executive Council members have generated at their quarterly meetings are fed into these reviews as part of a robust discussion which leads to agreement on the strategy for each business unit. The subsequent S-2 meetings, held in the fourth quarter, concentrate on planning. At these meetings, the business units submit for discussion and approval their priorities, plans, and budgets based on the strategies which have been agreed.

Strategy and planning at Procter & Gamble. P&G applies the same principles in a slightly different way. Its approach is both top down and bottom up.

To begin with, the corporation defines a clear set of goals and action standards for the overall business and thus establishes a common purpose.

During the first quarter, each of P&G's five global business units develops strategies based on the goals set by the corporation. Typically there are two highly interactive strategy reviews within the business units. At the first meeting, changes in the external environment, along with important internal developments, are examined, and the alternative strategic options are analyzed and debated. At the second meeting, the preferred option is presented and discussed, together with the supporting evidence for this choice, and the business unit strategy is finalized.

Then, in the second quarter, the business unit leaders present and defend their proposed strategies before the CEO and corporate team, and secure their approval. This concludes the strategy creation phase.

Finally, by the beginning of the fourth quarter, plans and budgets are proposed by the business units based on the agreed strategies and, once again, reviewed and approved by the CEO and corporate team.

GE and P&G recognize that both strategy and planning are crucial – but that separating them is essential. They have created interlocking systems allowing for a smooth changing of gears from the one to the other. They understand the golden rule: strategy first, planning afterwards. By working to a disciplined strategy creation process, they have set aside the essential reflection time that strategy requires. And as a result of these processes, they have embedded the ability to think and act strategically deeply within their cultures.

No Process, No Strategy

Many companies recognize, at least intuitively, that they are failing at strategy creation. In response, we hear, from both corporate leaders and the legions of consultants and gurus, endless exhortations to innovate. But what is missing from all the rhetoric is the *how*: a *practical process* for creating strategy.

It is axiomatic that if you want to achieve an important outcome, the key is to develop a process that will take you there. However, surprisingly few established companies follow GE and P&G's example by employing a dedicated process for strategy creation. Companies have developed sophisticated processes for a host of operational tasks, including budgeting, procurement, quality control, employee recruitment and evaluation, succession planning, and many others. If you ask a manager for a sales forecast or a capital budget, he or she will pick up the well-honed corporate tools and get the job done. The *how* is well understood.

Strategy, by contrast, tends to be an *ad hoc* affair. If you ask a manager for a strategy, chances are he won't know where to begin or what the end product should look like. More often than not, what is produced is a plan rather than a strategy.

The absence of a method for strategy creation constitutes a serious void in organizational capability. If organizations want to improve their ability to adapt and survive in today's demanding environment, they will need to develop and embed an effective process for strategy creation.

Strategy as Continuous Adaptation

What are the essential features of an effective strategy creation process? First, we need to understand what we are trying to do. We are not simply trying to achieve a one-time hit with a new product or service. This will not provide lasting success. Rather, we need to create a *new organizational capability*—the ability to adapt continuously; that is, to innovate strategically again and again. This vital organizational capability is today's only sustainable competitive advantage.

What this means is that we need to reinvent strategy. Its traditional role of creating one-time change—a method for going from Point A to Point B—is no longer sufficient. *Today, the central mission of strategy must be to create and sustain an adaptive organization—one that continuously scans and makes sense of its changing environment. learns from its own actions, and modifies its strategies accordingly.*

Given this mission of adaptiveness, I would argue that the following are the essential outcomes of a process for creating winning strategies on a continuous basis. The process must:

- Employ *divergent thinking*, a deep questioning of existing assumptions and beliefs as a basis for testing their validity;

- Produce *superior insights* about customer needs, the competitive environment, and the firm's own realities;
- Enable the firm, through these insights, to make the *most intelligent choices*, and thus create an *intense focus on the right things;*
- Provide an effective way to *align and mobilize the entire organization* behind this focus;
- Promote *ongoing experimentation* with new ideas to fuel further learning; and
- Constantly repeat these activities in a *dynamic cycle* of learning and renewal.

Most executives will probably agree with these propositions. Many no doubt do some of these things all the time, or all of them some of the time. But the key to success is to apply *all* of them *systematically*, in a single integrated process which never stops. This is the central leadership challenge that underlies the strategy dilemma.

The Strategic Learning Process

A process I call Strategic Learning has proven to be an effective approach for mobilizing and repeating these key actions of an adaptive organization. Its aim is to fill the void by providing a method for the creation of strategy. The method has been taught and applied in a number of organizations, including Ericsson, SAP, Sony Corporation, the Sony/Ericsson joint venture, Deloitte Touche Tomatsu, Chubb Insurance, Henry Schein, Inc., Aviva, and Progress Energy.

The Sony Corporation credits Strategic Learning with turning around a loss-making division, its Sony Media Solutions Company. And many other organizations—from the Institute for the Future, a research-based think tank in Menlo Park, California (where I am a board member) to a nonprofit youth orchestra, an urban housing program, and a Florida drug rehabilitation project—have applied it to their own specific needs.

Strategic Learning is not a "magic bullet" for strategy creation. There is no such thing. But in working with executive teams, I have found that those who follow the process with imagination, passion and determination have achieved a real difference both for their organizations and for themselves. The key is to pursue the *outcomes* of the process rather than simply following it mechanically.

As shown in Figure 3, the process has four linked steps—*learn, focus, align* and *execute*—which build on one another and are repeated in a continuous cycle.

The first two steps form the basis of a firm's strategy creation. The third and fourth steps are the foundations of strategy implementation. Thus, strategy creation and implementation are integrated into a mutually reinforcing process.

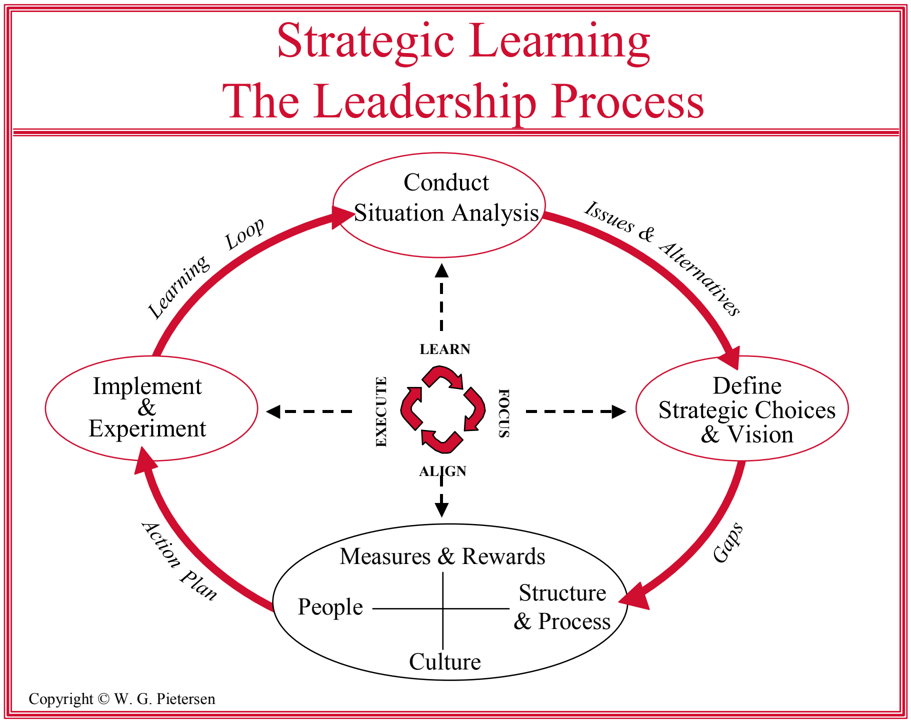

Figure 3. The Strategic Learning Cycle

Strategic Learning is a leadership process that generates a cycle of ongoing discovery and adaptation. It strives to balance focus with flexibility, and thoughtful analysis with creative thinking which is continually sharpened through learning and experience. It is designed to engage the creative and intellectual energies of the organization as broadly as possible.

What follows is a brief overview of the Strategic Learning process in action.

Step One: The Situation Analysis *(Learn)*

All breakthrough strategies are based on superior insight. Therefore, the essential starting point in the Strategic Learning process is what I call the Situation Analysis—a systematic exercise in diagnostic learning. Its aim is very specific: to develop superior insights as the basis for the firm's strategic choices. The search for superior insight is where the competitive battle begins. Lose this battle, and you are likely to lose the war.

The goal of this step is to create *asymmetry* between a company and its competitors—to understand the competition, the marketplace, and the customers better than the competition does. These superior insights will enable a firm to make the most intelligent choices and to define its winning proposition—its statement of how it will win the competition for value creation.

The Situation Analysis is a process of divergent learning with an outside-in focus, conducted by cross-functional teams who are charged with generating superior insights in the following key areas:

- Customers
- Competitors
- The firm's own realities
- Industry economics
- The broader environment

The technique is to ask and answer the right questions—penetrating questions that will provoke insights. (See Sidebar A for a set of sample questions.) The aim is to scan and interpret the firm's external environment and its internal realities in a combination of analysis and creative brainstorming. The emphasis is on challenging existing assumptions and producing fresh, innovative thinking. It is important to probe and explore, always searching for trends, root causes, and ultimate consequences—not just stacks of data.

Wolf Berndt, former president of Procter & Gamble's Global Fabric and Home Care sector, comments on the crucial role of the firm's senior leadership in this stage of the process. "At P&G, we found that, for a strategic choice to be compelling and win broad commitment, it must be based on valid data and sound logic. Reaching agreement up front about what this will involve creates a clarity that helps the organization move forward in a focused fashion. Thus, management's emphasis during the Situation Analysis is on ensuring that the divergent thinking has been expansive enough and that no relevant ideas have been overlooked."

History shows that business failures seldom happen because of a lack of information. Troubled firms like General Motors in the 1980s and IBM in the early 1990s generally have access to all the same information as their competitors. What they lack is the ability to turn that information into insights and then to act on them. The Strategic Learning process is designed to help generate superior insights and ensure that a company doesn't ignore them.

The insights derived from the Situation Analysis enable the organization to define the key business issues it faces and the alternative options for tackling those issues. This sets up the decision-making stage that constitutes step two of the Strategic Learning process.

Step Two: Strategic Choices *(Focus)*

The firm is now in a position to make the key strategic choices on which the company's future will be built (see Figure 4).

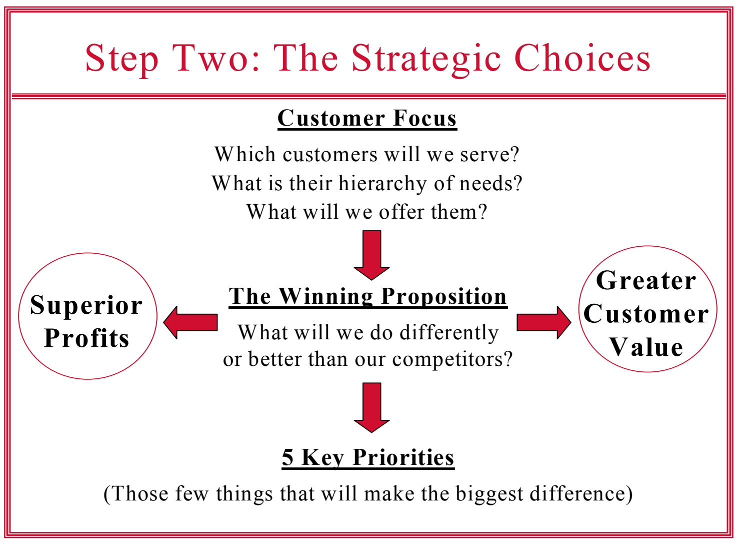

Figure 4. The Strategic Choices

The Strategic Choices are the key deliverables of strategy creation. They are based on the insights generated in the Situation Analysis and represent the strategic focus of the firm.

The heart of the strategic choices is the firm's winning proposition. It answers the question, "What will we do differently or better than our competitors to achieve greater value for our customers and superior profits for our firm?"

Here is one of the places where strategy and leadership most directly intersect.

One of the crucial skills of the leader is the ability to distill a company's strategic focus into a simple, compelling winning proposition which anyone can understand and follow.

For example, the California-based think tank, the Institute for the Future, has used the Strategic Learning process to develop its competitive strategy. Here is the winning proposition developed by the Institute's leaders: "We are sensemakers about alternative futures in areas which are important to society, to help organizations make better decisions in the present."

Note the brevity, directness, and specificity of the statement. The lesson is that strategy is an exercise in the art of simplicity. Organizations tend to be paralyzed by vague or complex strategic pronouncements. Achieving simplicity is hard work—but it is essential.

Step Three: Align the Organization *(Align)*

Once the Strategic Choices have been clearly defined, it is necessary to tackle strategy implementation. In large, complex organizations, this can be a daunting leadership challenge. For many executives, this is the hardest part of all.

Successful implementation requires that all the key supporting elements of the business system, including Measures and Rewards, Structure and Process, Culture, and People, be aligned behind the chosen strategy. (Refer to the oval at the bottom of the diagram in Figure 3.) At any given moment, the existing alignment has been put in place over time to support *yesterday's* strategy. It is now essential to realign the business system behind *tomorrow's* strategy. Otherwise, that strategy will fail.

Think of an organization as an ecosystem—a rain forest or an oasis in the desert. Such an ecosystem functions successfully only when its interdependent elements support one another. When an element does not play its supporting role, or when elements work against each other, then the system will fail.

The key elements in any business system are similarly interdependent. Thus, success comes not from a single action, such as changing the organizational structure. Instead, it comes from orchestrating the right *interactions* so that all the key elements of the business system are working together synergistically to support the new strategy.

Notice once more the vital link between strategy and leadership. Producing the kind of broadly-based organizational change that is required is a major leadership challenge, one that demands honesty, determination, and the ability to align and motivate the entire organization behind a winning strategy.

Step Four: Implement & Experiment *(Execute)*

Step four is the actual implementation phase of Strategic Learning (see the left-hand portion of Figure 3). It should include a deliberate set of experiments to fuel organizational learning. You can never know for sure what is going to work. Just as the Darwinian process of evolution is based on constant experimentation through variation, selection, and retention, so adaptive organizations must maximize their chances of finding favorable strategic variations through continuous experimentation.

Many consider the 3M Corporation the gold standard of innovation. With over 50,000 products made in sixty countries, 3M has developed a powerful process for product innovation, which might be described as “internal incubation”—nurturing hundreds of prospective businesses within the walls of 3M and looking for the handful that will become the drivers of the company’s future revenues and profits. It’s a simple philosophy: Place many bets, and “double down” on the winners.

Step four then feeds back into the Situation Analysis. The firm updates its insights, learning by examining its own actions and by re-scanning the environment, and then modifies its strategies accordingly. The process never stops.

“Emergent Strategy” versus a Strategy Process

There are those who argue against having a process for strategy creation. They say it is too rigid and prescriptive. Strategy, they insist, must simply be allowed to emerge under the pressure of day-to-day business challenges, not through a deliberate business process.

I disagree. Experience shows that winning strategies don’t just emerge without effective leadership and a process that stimulates and facilitates focused, creative thinking. “Emergent strategy” may work in a small, entrepreneurial firm. But in larger, more complex firms, where alignment cannot be achieved on a purely casual basis desired outcomes can only be accomplished through effective processes.

Of course, there are good processes and bad ones. To be effective, a process must fit the task for which it is designed. Strategy creation requires the right balance of creativity and discipline, so that fresh ideas that bubble up from brainstorming events within the organization can be identified, evaluated, and acted on by integrating them into the strategy creation process. Properly implemented, Strategic Learning is designed to provide the necessary balance.

Consider this analogy. Over a century ago, R&D was done on an ad hoc basis. Then it was revolutionized by the advent of systematic R&D. Pioneered by such firms as I.G. Farben in Germany, R&D was transformed from an ad hoc approach into a systematic process for the invention of new technologies. This led to a surge in innovation, and today the systematic approach to R&D is commonplace.

In the same way, strategic innovation is too important to be left to chance, or to random, ad hoc initiatives. Just as companies invest in R&D processes to deliberately spur technical innovation, we need a systematic process to mobilize strategic innovation. That is the objective of Strategic Learning.

Strategy and the Leadership Challenge

A interactive, dynamic process like Strategic Learning is thus an essential tool in the quest for strategic innovation. But such a process cannot operate at its full potential in the absence of strong leadership. While strategy has little to do with planning, it has everything to do with leadership. In fact, strategy and leadership are essential parts of each other, and the creation and implementation of winning strategies represent the most profound leadership challenges any executive will face.

One of the central reasons for the link between strategy and leadership is this simple truth: *Strategy takes courage.* Here's why:

- Strategy is about asking tough questions, challenging existing assumptions, and dealing fearlessly with the consequences. It is about seeing the world as it is, not just as you wish it to be. Therefore, creating strategy demands a high degree of realism and intellectual honesty.
- Strategy demands difficult choices. As the saying goes, “Positioning is sacrifice.” Every strategic choice is like placing a bet that can be won or lost, entailing a risk of failure, both organizational and personal.
- Strategy almost always involves dealing with change, and change is inherently stressful. Organizations tend to resist change, even to sabotage it particularly while they are successful. Yet the evidence shows that the best time for a company to change is when it is still successful. Thus, overcoming resistance to change and converting it into active support is the ultimate test of leadership.

For all these reasons, strategy requires not only business acumen and superior insight but also a combination of intestinal fortitude, personal integrity, and (in Hemingway’s phrase) the kind of “grace under pressure” that constitutes courage. It’s a quality that isn’t taught—and probably cannot be taught—in business schools.

Fortunately, however, leadership courage is not *merely* a personal quality that is either absent or present in an individual, without reference to the organizational environment. In fact, the courage to lead can be significantly enhanced—or undermined—by the processes within which individual executives operate. A strong leader is much stronger when equipped with a good set of tools.

Where strategy is shaped through an organization-wide process, the leaders are not merely directing the company through the current year's business plan. They are also building a crucial organizational capability: the ability to think and act strategically. Over time, the members of the organization internalize the strategy-making process, grow increasingly skilled at using it, and therefore continually sharpen the company's adaptive capability.

An effective strategy process doesn't reduce the need for leadership courage. But it provides the insights, decision framework and organizational support to help make and implement the tough—and courageous—decisions that strategy demands.

Applying such a system is in itself an act of leadership.

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SIDEBAR A: Sample Questions for the Situation Analysis

Customers

- What are the underlying trends in our customers' expectations? How is today different from yesterday? How will tomorrow be different from today?
- Which customer segments will we target? Which will we not serve?
- What is the *hierarchy* of customer needs? What do they value most?
- How well do we currently serve those needs?

Competitors

- In what distinctive ways are our traditional competitors providing value to customers?
- Who are our nontraditional competitors and what unique benefits are they offering?
- What will be the next big breakthrough in serving customer needs? Who is most likely to launch it?

The Firm's Own Realities

- What are the five-year trends on our critical performance measures? What do they tell us?
- Where are we making money and where not? Are we addressing our losing propositions?
- What are our key strengths that we can leverage for competitive advantage? What are our weaknesses that represent barriers to better performance?

Industry Dynamics

- Which trends in our industry are the most important? How will they change the rules of success?
- What is the key to exploiting these developments so that they produce greater value for our customers?
- What barriers must we overcome to take the lead in profitably exploiting these trends?

The Broader Environment

What is happening around us that will impact our business in regard to:

- Economic trends
- Social habits and attitudes
- Technology
- Demographics
- Government regulation

SIDEBAR B: Documenting the Strategy

A strategy based on Strategic Learning should be captured in a concise document which answers the following five questions:

1. **<u>What are our key insights?</u>**

   What key insights will drive our strategic choices?

2. **<u>Where will we compete (and where not)?</u>**

   What markets, products/services, customers, geography?

3. **<u>How will we win?</u>**

   Winning Proposition and Strategic Priorities.

4. **<u>How will we make superior profits?</u>**

   What are the unique aspects of how we make, sell, or distribute which create superior profits?

5. **<u>How will we execute?</u>**

   How will we align and motivate the organization?

The emphasis should be on brevity and clarity: Ten pages is the limit. Long, rambling documents simply cloud the issues and often go unread. The operating plan is a separate document which will contain the financial projections, capital budgets, and other important details.