Strategy in a Time of Change

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Not so long ago – in fact in the memory of the generation of men and women who lead global enterprises today – people known as strategic planners sat in corporate offices and made strategy. These strategists were generally far removed from the day-to-day business of R&D, manufacturing, marketing, and customer service. Their strategies spanned lengthy periods of time and were designed to guide their organizations from success to success – dictating the structure and the allocation of resources to keep their companies profitable and growing.

That model is no more. Today, strategy-making as a process has come under heavy pressure from both internal and external forces. With change accelerating in competition, technology, regulation, and society at large, some organizations are questioning whether strategy is worth doing at all. Many companies are pushing strategy-making down and out across their organizations, putting it into the hands of those people closest to markets and customers. Some companies are formulating strategy continuously rather than periodically. Some are erecting strategy on a foundation of multiple hypothetical scenarios, while others are looking backward to the durable threads of corporate DNA that persist and guide purpose. And still others are defining strategy as capabilities plus principles, declaring, in effect, that the culture is the strategy. Of necessity, strategy-making has become ever more flexible and various. Strategy, in short, is all over the map.

Even the aim of strategy is evolving. For some, it is the successful management of risk and uncertainty. For many, the ultimate aim is to create shareholder value or, more broadly, stakeholder satisfaction. Finally, some organizations have gone so far as to define strategy as the successful exploitation of change.

Which isn't to say that strategy-making is being done badly. Quite the contrary. When Arthur D. Little invited the most senior strategy officers from a dozen or so leading companies – in some cases CEOs themselves – to one of our Best of the Best Colloquia to share their best practices in strategy, the results were both valuable and provocative. (The Arthur D. Little Colloquia program, described in previous issues of *Prism,* invites senior executives from distinguished companies to exchange knowledge and insights about functional management issues.)

As the business leaders at the Strategy Colloquium grappled with the very real problem of defining strategy, it became clear that current understanding of strategy-making is as fluid and various as the changing business environment itself. The Colloquium participants did agree that ensuring the continued well-being and future growth of the enterprise is inarguably the bottom-line objective of strategy. But strategy also embraces ambition and purpose. What a company wants to *be* drives what it must *do*. And what a company wants to *be* is in some sense rooted in what it has *been* – its historic markets and competencies, its culture.

Key Strategic Questions

Shaping the discussion at the Colloquium were a series of questions designed to map out what the assembled group of proficient strategy-makers considered their domain.

The Question of Strategy and Structure. In the classic distinction between strategy and structure, strategy precedes structure. In practice, however, strategy-making happens in organizations, and organizations are structured. The question is, where in the organization should strategy be formulated? At the ADL Strategy Colloquium, P. W De Leeuw, Vice President of Shell Chemical Company, reported that the new CEO of Shell Oil, Shell Chemical's parent, is ceding responsibility for strategy to his operating companies. De Leeuw described the transition in strategy-making at Shell Chemical (a $14 billion company). The company has migrated from a fixed and formal five-year cycle run by individual business managers to a continuous, fluid, iterative process in the hands of multifunctional teams. This „deconstruction“ of the corporate center is a theme being repeated in other global companies. Hoechst, for example, is adopting a minimalist corporate center that acts as a portfolio manager for a group of highly autonomous subsidiaries. Asea Brown Boveri (ABB) also fits this description.

Edward H. Bowman, a professor at Penn's Wharton School, reported on studies that find that the average corporate center contributes nothing to the firm's profitability. Certainly the contribution of corporate centers – sometimes referred to as „parenting value-added“ – is coming under increasing scrutiny. For cases in which the costs of being parented outweigh the benefits, organizations are liberating their business units through a variety of mechanisms, including spin-outs, carve-outs, outsourcing of shared services, and pushing both governance and strategy down and out to business units below.

The Question of Strategy's Effects. How do we measure the effects of our strategy – how do we harden its linkages to profit and growth? Measurement of cause and effect in strategy continues to challenge not only chief executives but chief financial officers and the analysts in capital markets. Whereas historically, strategic and financial planning were viewed as highly complementary – but separate – functions, today the chief financial

officer has to think in strategic terms and the chief strategist in financial terms. For example, in the early 1990s, a local gas utility in the US. Midwest acquired a cable television (CATV) franchise operating in its territory. Strategically, the acquisition made good sense. The two companies had common customers, similar services, and redundant costs, all of which pointed to synergies and value creation. However, the gas utility soon realized that its investor base (or shareholders) valued their investments not on the basis of synergies, growth potential, or risk taking. Instead, they sought the capital preservation, low risk, and high dividends provided by a regulated, mature monopoly such as a gas utility. Hence, the utility eventually sold its CATV business, realizing that its business strategy was inconsistent with the financial expectation of its owners.

Strategy tends to persist over time and to get so embedded in corporate culture that it becomes almost a strand of the company's DNA, its unique character. At an earlier Best of the Best Colloquium on Manufacturing Strategy, Sherita Ceasar of Motorola Corporation's Paging Products Group quoted a line from the electronics company's 1995 annual report: „Quality is the universal language of a global company." Ceasar said tenfold improvement in defect reduction every two years was moving the company into the rarefied air of defects measured in parts per billion – and that the savings from this improvement translate immediately and measurably into financial value.

Strategies that drive companies to focus on competencies that differentiate them from competitors do produce measurable profit and growth. At the Strategy Colloquium, participants cited the institutionalization of a strategic commitment to innovation and rapid refreshment of current offerings – the essence of the Post-It Notes culture at 3M – as an engine of growth. Similarly, strategies that allocate considerable resources to creating a culture of customer satisfaction have made winners of FedEx and L.L. Bean. In both those examples, the strategies reflect the values of the founders – illustrating the circular chain of causality between culture, context, values, strategy, and results.

The Question of Measuring Value. What are the true measurements of value created by strategy? What do capital markets want? What do communities and regional and national governments expect of the strategies of their corporate citizens? How about employees or customers? While there is an art to good strategy, strategists still need effective, fact-based measures of progress and results. The most common expression of change in value is in financial terms – the language of capital markets, of economists, and of the senior executives of a company. Increasingly, corporate leaders are no longer satisfied with strategies that mouth „motherhood" objectives as the keys to success without an analytical basis for how these will create value. For example, is „improved customer satisfaction" a worthy investment objective if it doesn't improve loyalty, retention, market potential, and, ultimately, account profitability?

Ultimately, strategists (and business leaders in general) face the challenge of relying on accounting and economic tools that were developed for late 19th and early 20th century capitalism – as we move into the 21st century. In the former period, land and „real" assets such as long-lived equipment were capitalized, while labor and technology were treated as expenses. *Yet* in today's environment, often the most important assets a firm possesses are people and technological know-how – in addition to capabilities, knowledge, and the ability to innovate. As we move from an economy based on property, plants, and equipment as the primary agents of capital formation, to an economy based on information and knowledge, the value of the combined experience of a company's work force – its global reach and local knowledge in far-flung markets, its accumulated brand equity, its corporate social responsibility – are all additions to the value measurement equation. New tools that measure the intangibles of the changing corporation are finding their way into strategists' toolkits. They carry proprietary names such as Economic Value Added (EVA) and the Balanced Scorecard. EVA measures a company's returns relative to the cost of its capital, focusing not only on the operating statement but the balance sheet as well. Scoring systems that measure the balance among a long array of operational performance measures seek to link success in functional tasks with strategy. Although Hewlett-Packard doesn't operate with a balanced scorecard, H-P's Director of Corporate Development, David Logan, told the Strategy Colloquium that H-P actively fosters a culture that measures – and excels at – operational excellence across the board. In fact, said Logan, H-P's former CEO, John Young, preached execution over strategy – which is itself a kind of strategy.

The Question of Strategic Boundaries. What is our business? Where does it begin and end? General Motors, the world's largest automotive manufacturer, is building a plant in southern Brazil in which virtually the entire assembly of the cars will be performed not by GM, but by its parts and systems suppliers, working inside GM premises.

Similarly, Hewlett-Packard actively courts best-in-class alliance partners, even including traditional competitors such as Intel, Canon, and Microsoft. New strategies are blurring corporate boundaries. On the other hand, while outsourcing and virtualization are important means of lowering costs, reducing hierarchy, and instilling a market discipline into formally captive operations, there are risks. In its drive to be fastest to market in personal computers, IBM elected to outsource the design and development of two key components – operating systems software and microprocessors – to Microsoft and Intel, respectively. Today, the market capitalization of these two companies exceeds that of IBM.

The Question of Change and Growth. What does our company want to be? Ambition is a powerful driver of strategy. In thinking about what kind of business it should be well into the future, Toyota has chosen, in a contrarian way, a vision of itself a decade from now. Toyota's vision invokes not the usual business imperatives and competitive edge, but rather the idea of harmony. The company envisions growth that harmonizes with „the larger interests of the global community." Toyota Executive Vice President Kosuke Yamamoto describes three kinds of harmony Toyota seeks to pursue in shaping its operations:

• *Harmony with society* – "We need to make a real contribution to enhancing the quality of life – which means maximizing the positive value of our products while minimizing any adverse effects that they might have," said Yamamoto, who went on to specify safe, high-quality, affordable products, the development of intelligent traffic systems, and systems to recycle virtually all the material in an automobile.

• *Harmony with the natural environment* – Saying that automobile sales growth in emerging markets will burden the environment and spur petroleum use, Yamamoto envisioned a strategic framework at Toyota that continues to improve energy efficiency, reduces noxious emissions, and develops alternative power systems for cars – electric and electric-hybrid vehicles.

• *Harmony with the international community* – To Toyota, this means a commitment to localizing operations and contributing to economic development in each country in which it operates. In industrialized nations, said Yamamoto, international harmony means cooperation with other automakers to alleviate trade friction. In developing nations, local assembly or genuine local production may be the agent of development.

Six Rules for the Strategy-Making Process

In our work with leading companies that are striving to answer all these strategic questions, we have developed a set of rules for good strategy-making (see the box on this page). These rules can prove useful to the strategist at any level and at any point in the strategy-development process.

Honest Assessment. A solid grasp of current reality is indispensable to good strategy. In a time when information technology enables companies to slice and dice data in ever finer and more sophisticated ways, they must still use the information to create meaning. Here is one place where strategy functions less as a management discipline than as an art. Faced with an array of measures of operational performance, the strategist must combine experience, judgment, and impeccable candor to make sure that the strategic process is based on a clear view of the current reality.

Arthur D. Little's Six Rules for Strategy Development

• Strategy development must force participants to assess their true strengths and weaknesses honestly and completely.

• The strategy development process ought to make participants very uncomfortable.

• The process must begin and end with a clearly understood ambition and objectives.

• The output of a good strategy must include a comprehensive implementation plan.

• While the process must be logical, rational, and fact-based, one cannot ignore the creative, intuitive, and instinctive elements of strategic insight.

• The process is fundamentally a learning and consensus process; one should come away with new insights and clearer communications.

However, assessing current reality also requires understanding how longer-term trends are converging toward a new reality. For example, with the tremendous influx of new entrants into the mutual funds industry, and the increasing difficulty of sustaining consistent above-average returns as a primary marketing advantage, Fidelity is beginning to view the provision of information services as a possible future mission. Seeing the broader and longer-term context of current reality is extremely important to the strategic planner.

Current reality is brought home instantaneously to Fidelity Investments, the largest mutual fund company in the world. Global financial markets and their mutual fund customers tell Fidelity minute by minute how its funds are performing. Fidelity has chosen to make substantial investments in information technology to measure its internal performance as well. Just as its fund managers operate portfolios, Fidelity is itself a portfolio of decentralized and largely autonomous funds and related businesses. Spanning and linking 228 funds and more than 200 other business units is a web of information technology that allows Fidelity to assess its productivity, capital efficiency, and comparative competitive position. Fidelity knows where it is. The company's success testifies to its ability to turn its understanding of current conditions into strategic action that keeps it growing.

More Than a Bit of Discomfort. The strategy development process ought to make us very uncomfortable. The honest assessment of current reality is one source of discomfort. It should force us to confront sacred cows, consider the unthinkable, imagine the impossible, and dream the incredible. Complacency and arrogance are the enemies of robust strategic thinking. Self-doubt and ambition are its allies. Another source of discomfort is the stretch of ambition. As we've said, the context of strategy is risk and uncertainty.

The word „risk" derives from an early Italian word, *risicare,* which means „to dare." In this sense, as Peter Bernstein in his 1996 book, *Against the Gods – the Remarkable Story of Risk,* points out, „Risk is a choice, not a fate." The freedom to make strategic choices should involve enough risk to justify the rewards and to ensure that something is learned. Strategic choice still involves imperfect knowledge. If companies knew the future, competition would turn on operational efficiency; everyone would be in the same markets. But because companies are not seers, strategic ambition without a little constriction in the gut isn't ambitious enough. As DuPont's Terry Ennis told the Strategy Colloquium, „A little paranoia can be one key" to strategic success.

Clear Ambitions and Objectives. The strategy-making process must begin and end with a clearly understood ambition and objectives. Strategies driven by ambition must both envision the future and define the ambition. While it would seem logical that envisioning the future *precedes* ambition-setting, in fact, ambitions can be used to shape the future. Microsoft, for example, sees an important future in electronic commerce. At the same time, Microsoft's ambition – to have a stake in creating this market and to be central to its function through the technology and services it provides – will help shape the market for electronic commerce in a way that could create tremendous value for Microsoft. The process of envisioning multiple strategic futures demands that strategists identify drivers of change within and beyond the organization, then develop alternative futures, and finally understand the implications of these futures to the business. Defining the strategic ambitions that set a direction for the business requires that strategists identify the most exciting opportunities they've envisioned; understand the kind of business that would succeed in the scenario; analyze gaps, competencies, and the expectations of stakeholders; assess the stretch needed; and finally develop a profile that combines the optimal vision with the optimal capabilities.

A Comprehensive Plan for Implementation.

The output of a good strategy must include a comprehensive implementation plan. Executing a strategy demands action plans that are detailed and specific. In Arthur D. Little's strategy work with leading companies, we've found it necessary – but not sufficient – to define programs in terms of tasks, milestones, budgets, timing, staff assignments, and control and measurement mechanisms. The best strategic implementation plans also devise ways to communicate relentlessly, to identify points of possible implementation disconnects, to reward and reinforce the people implementing the strategy, to build consensus, and to create mechanisms that capture knowledge from the process to use over and over to leverage value.

Strategic Insight – the Role of Creativity. While the strategic planning process must be logical, rational, and fact-based, we cannot afford to become driven by (simply) completing a methodological process while ignoring the creative, intuitive, and instinctive elements of strategic insight. Strategic planning is always part science, part art. Communication, as the discussion of implementation plans suggests, is critical to strategy. Businesses are human enterprises, and their strategy-making must incorporate the experience and intuition of their people. Judging change and uncertainty requires, finally, a leap of insight. Someone, somewhere in Dearborn, had to decide that at Ford, quality really was job one. Committing Komatsu, the Japanese heavy equipment maker, to the monolithic strategic mission of encircling Caterpillar, its largest competitor, required ambition and a gut check that said, „This is right for us. Making very good tractors just isn't enough." The intuitive aspect of strategy is the hardest to define, codify, or measure – and perhaps the most important.

Learning to Change. Strategy development is fundamentally a learning and consensus process; we should come away with new insights and clearer communications. How does a company rally around a driving mechanism for change – a discontent – and still retain and build on institutional memory and knowledge? Strategic design means, among other things, changing existing situations into preferred ones. And the notion of a preferred state implies a discontent with the existing one. Communication about the discontent and the process of change is a precursor to learning. As strategy development moves out across global business units and down into lower levels of the organization, people with competencies that cut across business units are finding ways to come together and share knowledge. So changing strategic imperatives are driving organizational learning.

This capacity for organizational learning can be both a means to an end – manufacturing excellence or competitive preeminence, for example – and a strategic end in itself. In a world that is continuously changing, organizations must practice continuous learning to renew the basis for new strategy. To remain open to this essential learning, it's important to remember that complacency and arrogance are the enemies of robust strategic planning, while self-doubt and ambition are its allies.

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