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The Strategic Planning Process – Tag list for board members

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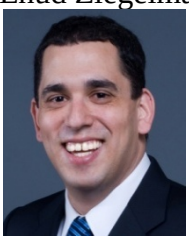

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Strategic planning usually raises thoughts of endless discussions - that end in an ambitious, albeit impractical, plan. Indeed, many strategic programs remain declarative, as the firms fail to mobilize the managerial resources needed for implementation. If so, how can the Board of Directors control the process of strategic planning and lead the implementation of the resulting strategic program?

The BoD's first task in the strategic planning process is to identify the strategic issue that requires attention within the scope of the year's Board schedule. Once the Board has identified the right issue, it faces the fact that real solutions to strategic issues involve fundamental corporate change. During the implementation phase, thus, the Board need not only communicate its vision, but also actively drive the reallocation of resources, personnel changes and other actions that in the end will create a new corporate identity and culture.

The biggest difficulty is often to uncover the real strategic issue. We have identified seven generic strategic issues that Boards ought to address. While all seven issues require continuous monitoring, usually only one or two require Board action at any given time. This focused approach coincides with the BoD's normal attention span.

First Issue: Firm Size and Growth Mechanisms

The current size of the company and its target size may seem trivial matters, but in many companies there is a disconnection between size and abilities, whether current or future. A company operating at a non-optimal size will not reach its full profit potential, or may even incur losses. The Board should be wary of three common strategic traps with regards to size:

A. Critical Mass

Critical mass is the minimal amount of money required for marketing, or research and development (R&D) in order to sustain a long-term competitive position. Critical mass is measured in absolute expenses, not in percentages. For example, the critical mass required to manufacture an executive jet was sales of about one billion dollars a year in the mid-1990s. This number is derived from accepted aerospace industry standards of about5% of sales for R&D, the $ 250 million cost of developing a next generation aircraft, as well as the competitive requirement to introduce a new generation aircraft every five years. Critical mass in the consumer product market derives in a similar fashion from marketing and advertising costs, or the span of the product basket. A firm that is below critical mass will likely not reach reasonable yields under its current business model , and it is in constant danger of business failure. A common Board misconception is that "we need to grow the company to spread the overhead around." However, if the company is operating below critical mass, the issue is not too much overhead, but rather **not enough**. The most straightforward solution to the critical mass trap is rapid growth through a capital injection followed by acquisitions, or, abandoning the main markets to become a niche player.

B. Target Size

Typically, a strategic plan sets challenging growth targets for the firm. This subject requires close monitoring by the Board . On the one hand, a too ambitious goal will lead to precious resources wasted in pursuit of unachievable market share. Unattainable strategic objectives also have a tendency to demoralize management, or even to delegitimize the entire process of strategic planning. A common mistake is setting un-realistic objectives for export market penetration. On the other hand, too narrow strategic objectives will result in loss of opportunities for the benefit of competitors, and may foster a culture of underachievement.

Most firms exist in a fairly stable environment, where industry growth is predictable and company growth targets carry over from year to year. However, in times of turbulence the Board must step in to establish a new target size for the firm, whether it involves accelerated growth, down-sizing or maintaining steady-state. There is no easy formula for calculating the optimal size for the firm. The Board must ensure that the planning process has expended sufficient effort in addressing the size issue, and in the end the Board members have to use their own acumen in approving the strategic goals. It is important to keep in mind that not every firm has the potential for significant growth. At times the Board should be satisfied with strategic growth in profitability rather than in sales.

C. Growth Engines

Every firm whose owners seek significant growth has a number of potential growth engines. The two generic options are organic growth through internal resources such as new product introduction and new market penetration, and structural growth achieved through mergers and acquisitions (M & A). The core of any strategic discourse on size is an honest evaluation of available growth engines, and a true assessment of growth potential and required resource consumption. When a firm

establishes an ambitious growth plan, its Board of Directors is required to assume a high level of readiness to lead and control. Board members should constantly be asking questions such as: "Are the non-growth divisions really yielding resources for the benefit of the targeted growth division?"Are we really growing at the true rate of our potential, or are we blinded by perceived success?" "If we're not meeting targets, have we over-estimated the potential and over-allocated resources?" "Is the growth division really receiving the required corporate support and our best talents?"

Second Issue – Threat Management

The Board and Executive Management should monitor threats on an ongoing basis. But sometimes threat management becomes the dominant strategic issue, and thus requires forceful action by the Board. Examples of strategic threats that endanger the medium or long-term profitability, or even survival, of a firm are: (1) changes in regulation (example: the asbestos industry and new regulatory conditions), (2) technology leaps (example: the Swiss watch industry versus digital watches), and (3) accelerated industry-wide consolidation which quickly raises the required critical mass. Existential threats is no trivial matter, and they often test the Board's collective creativity and ability to lead a reinvention of the firm. Sometimes a firm can neutralize a strategic threat, as with pending regulation, but more often the response lies within drastic strategic changes.

The Third Issue – Business Model

Business models lie deep in a firm's DNA, and therefore are very difficult to modify. An innovative business model is often the core of an un-shakable competitive advantage. To name but a few recent examples from the IT industry – Google (click-through advertising) and Dell (custom-configurated PCs). However, sometimes a model gets out of sync with the market or competition. For example, for over a decade we have witnessed a wave of bankruptcies among traditional full-fare airlines, while at the same time discount airlines have been thriving. Some large airlines have

established discount subsidiaries, with very mixed results, and none has been able to change its business model to emulate the low-cost start-ups. Similarly, none of the traditional retailers has been able to emulate the Wal-Mart business model, even though several have tried. , If the Board decides on a radical change in the business model, the company is embarking on a long and difficult journey to re-invent itself. The Board should not only be directly involved in day-to-day monitoring, but take charge of the required changes in senior management.

The Fourth Issue – The Ownership and Balance Sheet Structures

Although a firm's owners* have the final say on the ownership and balance sheet structures, it is not possible to isolate these issues from the control mandate given to the Board of Directors. The amount of leverage is fairly straightforward high leverage may bring excess returns, but that has the price of greater financial risk. The Board must continuously monitor and manage a fine balancing act between target ROE, industry profitability, financial risk and business risk. In the past year, we have witnessed firms' efforts to lower their leverage level, even at the cost of damage to growth or to other strategic objectives.

Board decisions regarding the ownership structure are relevant only in a few cases, for example the decision to be or cease to be a publicly traded firm, or deciding on the partnership structure of a subsidiary. In many family firms, it befalls the Board (in case there are independent directors) to lead the revolution of raising outside capital.

*Obviously, the Board usurps this power in public firms with a dispersed ownership.

The Fifth Issue – Competitive Advantage

It was once customary to think that strategic planning is concerned primarily with creating or improving a competitive advantage. This topic is always on the Board's table but not always as a major one. Competitive advantage can be based on a strong brand, unique technology, broad product basket, or even on more trivial factors such as geographical spread or retail regulation. In a well-run organization, management

maintains and builds the competitive advantage in day-to-day operations, and by investing in R&D, marketing, M&As. However, sometimes it is necessary that the Board steps in, for example when a previously critical business asset has ceased to yield a clear competitive advantage due to changes in the market. The search for, and nurturing of, new competitive assets requires a clear Board vision, allocation of corporate resources, and a fair amount of risk taking.

The Sixth Issue – Operational Efficiencies

A firm that fails to achieve operational efficiencies similar to those achieved by its competitors is doomed to fold sooner or later. There is no doubt that for inefficient firms, improving operational efficiency is of the highest priority for Board attention. Internal efficiency will not improve by targeting growth or other strategic issues, internal efficiency will improve only when the Board and management acknowledge and focus on the issue. Of all strategic issues, internal operations is the most straightforward to resolve, and usually one or two years of forceful action will suffice. If the firm tries to achieve other strategic objectives simultaneously, such as growth, then it jeopardizes the operational goals. One example is GM, which focused on market share during the 1980s and 1990s instead of taking the necessary, and painful, steps to streamline operations. The drawback lies in the fact, that it is a lot sexier for management and the Board to discuss growth than to discuss yield data, quality issues, layoffs or plant closings.

The Seventh Issue – Business Portfolio

Finally, the seventh issue relates to the internal flow of resources, most notably management talent, technology or cash between the firm's various business units. It is customary to examine which of the organizational units create cash, and which consume it, through investments not losses. This question is applicable not only to large firms running divisions, but also to smaller firms holding a portfolio of technologies, product lines or markets. The Board must monitor the portfolio continuously, but usually rebalancing is required only every few years. As with the

previous six strategic issues, the Board's vision and weight are necessary to overcome corporate inertia and drive change. For example, divisional managers will usually accept their role as a cash contributor if the corporate portfolio has been explained adequately.

Summary

An active Board of Directors should participate in the firm's strategic planning process. Direct participation ensures that the plan includes identification of the true strategic bottlenecks, as well as place thoese issues where they belong: At the top of the Board agenda. We have compiled a list of seven generic strategic issues, and in most cases the Board will find that it needs to focus only on one of the seven at any given time. Real solutions to strategic issues within the realm of the seven issues will require fundamental corporate change.

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