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How to improve **strategic planning**

It can be a frustrating exercise, but there are ways to increase its value.

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In conference rooms everywhere, corporate planners are in the midst of the annual strategic-planning process. For the better part of a year, they collect financial and operational data, make forecasts, and prepare lengthy presentations with the CEO and other senior managers about the future direction of the business. But at the end of this expensive and time-consuming process, many participants say they are frustrated by its lack of impact on either their own actions or the strategic direction of the company.

This sense of disappointment was captured in a recent *McKinsey Quarterly* survey of nearly 800 executives: just 45 percent of the respondents said they were satisfied with the strategic-planning process.[1] Moreover, only 23 percent indicated that major strategic decisions were made within its confines. Given these results, managers might well be tempted to jettison the planning process altogether.

But for those working in the overwhelming majority of corporations, the annual planning process plays an essential role. In addition to formulating

[1] "Improving strategic planning: A McKinsey Survey," *The McKinsey Quarterly*, Web exclusive, September 2006. The survey, conducted in late July and early August 2006, received 796 responses from a panel of executives from around the world. All panelists have mostly financial or strategic responsibilities and work in a wide range of industries for organizations with revenues of at least $500 million.

Article at a glance

Almost all large companies undertake a time-consuming strategic-planning process that leaves many executives frustrated with the results.

Executives in the satisfied minority work for companies that go beyond budgets and financial targets to give the annual process a more important role in developing strategy.

One approach is to start the exercise not by examining the numbers but by identifying the long-term issues facing the company; another is to ensure that strategic-review meetings involve frank conversations among the ultimate decision makers.

Some companies use tailored strategic metrics to track the implementation of the annual plan, and others link its implementation to human-resources systems that influence the behavior of the managers who execute the strategy.

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at least some elements of a company's strategy, the process results in a budget, which establishes the resource allocation map for the coming 12 to 18 months; sets financial and operating targets, often used to determine compensation metrics and to provide guidance for financial markets; and aligns the management team on its strategic priorities. The operative question for chief executives is how to make the planning process more effective—not whether it is the sole mechanism used to design strategy. CEOs know that strategy is often formulated through ad hoc meetings or brand reviews, or as a result of decisions about mergers and acquisitions.

Our research shows that formal strategic-planning processes play an important role in improving overall satisfaction with strategy development. That role can be seen in the responses of the 79 percent of managers who claimed that the formal planning process played a significant role in developing strategies and were satisfied with the approach of their companies, compared with only 21 percent of the respondents who felt that the process did not play a significant role. Looked at another way, 51 percent of the respondents whose companies had no formal process were dissatisfied with their approach to the development of strategy, against only 20 percent of those at companies with a formal process.

So what can managers do to improve the process? There are many ways to conduct strategic planning, but determining the ideal method goes beyond the scope of this article. Instead we offer, from our research, five emergent ideas that executives can employ immediately to make existing processes run better. The changes we discuss here (such as a focus on important strategic issues or a connection to core-management processes) are the elements most linked with the satisfaction of employees and their perceptions of the significance of the process. These steps cannot guarantee that the right strategic decisions will be made or that strategy will be better executed, but by enhancing the planning process—and thus increasing satisfaction with the development of strategy—they will improve the odds for success.

Start with the issues

Ask CEOs what they think strategic planning should involve and they will talk about anticipating big challenges and spotting important trends. At many companies, however, this noble purpose has taken a backseat to rigid, data-driven processes dominated by the production of budgets and financial forecasts. If the calendar-based process is to play a more valuable role in a company's overall strategy efforts, it must complement budgeting with a focus on strategic issues. In our experience, the first liberating change managers can make to improve the quality of the planning process is to begin it by deliberately and thoughtfully identifying and discussing the strategic issues that will have the greatest impact on future business performance.

Granted, an approach based on issues will not necessarily yield better strategic results. The music business, for instance, has discussed the threat posed by digital-file sharing for years without finding an effective way of dealing with the problem. But as a first step, identifying the key issues will ensure that management does not waste time and energy on less important topics.

We found a variety of practical ways in which companies can impose a fresh strategic perspective. For instance, the CEO of one large health care company asks the leaders of each business unit to imagine how a set of specific economic, social, and business trends will affect their businesses, as well as ways to capture the opportunities—or counter the threats—that these trends pose. Only after such an analysis and discussion do the leaders settle into the more typical planning exercises of financial forecasting and identifying strategic initiatives.

One consumer goods organization takes a more directed approach. The CEO, supported by the corporate-strategy function, compiles a list of three to six priorities for the coming year. Distributed to the managers responsible for functions, geographies, and brands, the list then becomes the basis for an offsite strategy-alignment meeting, where managers debate the implications of the priorities for their particular organizations. The corporate-strategy function summarizes the results, adds appropriate corporate targets, and shares them with the organization in the form of a strategy memo, which serves as the basis for more detailed strategic planning at the division and business-unit levels.

A packaged-goods company offers an even more tailored example. Every December the corporate senior-management team produces a list of ten strategic questions tailored to each of the three business units. The leaders of these businesses have six months to explore and debate the questions internally and to come up with answers. In June each unit convenes with the senior-management team in a one-day meeting to discuss proposed actions and reach decisions.

Some companies prefer to use a bottom-up rather than top-down process. We recently worked with a sales company to design a strategic-planning process that begins with in-depth interviews (involving all of the senior managers and selected corporate and business executives) to generate a list of the most important strategic issues facing the company. The senior-management team prioritizes the list and assigns managers to explore each issue and report back in four to six weeks. Such an approach can be especially valuable in companies where internal consensus building is an imperative.

Bring together the right people

An issues-based approach won't do much good unless the most relevant people are involved in the debate. We found that survey respondents who were satisfied with the strategic-planning process rated it highly on dimensions such as including the most knowledgeable and influential participants, stimulating and challenging the participants' thinking, and having honest, open discussions about difficult issues. In contrast, 27 percent of the dissatisfied respondents reported that their company's strategic planning had not a single one of these virtues. Such results suggest that too many companies focus on the data-gathering and packaging elements of strategic planning and neglect the crucial interactive components.

Strategic conversations will have little impact if they involve only strategic planners from both the business unit and the corporate levels. One of our core beliefs is that those who carry out strategy should also develop it. The key strategy conversation should take place among corporate decision makers, business unit leaders, and people with expertise essential to the discussion. In addition to leading the corporate review, the CEO, aided by members of the executive team, should as a rule lead the strategy review for business units as well. The head of a business unit, supported by four to six people, should direct the discussion from its side of the table (see sidebar, "Things to ask in any business unit review").

One pharmaceutical company invites business unit leaders to take part in the strategy reviews of their peers in other units. This approach can help build a better understanding of the entire company and, especially, of the issues that span business units. The risk is that such interactions might constrain the honesty and vigor of the dialogue and put executives at the focus of the discussion on the defensive.

Corporate senior-management teams can dedicate only a few hours or at most a few days to a business unit under review. So team members should spend this time in challenging yet collaborative discussions with business unit leaders rather than trying to absorb many facts during the review itself. To provide some context for the discussion, best-practice companies disseminate important operational and financial information to the corporate review team well in advance of such sessions. This reading material should also tee up the most important issues facing the business and outline the proposed strategy, ensuring that the review team is prepared with well-thought-out questions. In our experience, the right 10 pages provide ample fuel to fire a vigorous discussion, but more than 25 pages will likely douse the level of energy or engagement in the room.

Things to ask in any business unit review

1. Are major trends and changes in your business unit's environment affecting your strategic plan? Specifically, what potential developments in customer demand, technology, or the regulatory environment could have enough impact on the industry to change the entire plan?
2. How and why is this plan different from last year's?
3. What were your forecasts for market growth, sales, and profitability last year, two years ago, and three years ago? How right or wrong were they? What did the business unit learn from those experiences?
4. What would it take to double your business unit's growth rate and profits? Where will growth come from: expansion or gains in market share?
5. If your business unit plans to take market share from competitors, how will it do so, and how will they respond? Are you counting on a strategic advantage or superior execution?
6. What are your business unit's distinctive competitive strengths, and how does the plan build on them?
7. How different is the strategy from those of competitors, and why? Is that a good or a bad thing?
8. Beyond the immediate planning cycle, what are the key issues, risks, and opportunities that we should discuss today?
9. What would a private-equity owner do with this business?
10. How will the business unit monitor the execution of this strategy?

Adapt planning cycles to the needs of each business

Managers are justifiably concerned about the resources and time required to implement an issues-based strategic-planning approach. One easy—yet rarely adopted—solution is to free business units from the need to conduct this rigorous process every single year. In all but the most volatile, high-velocity industries, it is hard to imagine that a major strategic redirection will be necessary every planning cycle. In fact, forcing businesses to undertake this exercise annually is distracting and may even be detrimental. Managers need to focus on executing the last plan's major initiatives, many of which can take 18 to 36 months to implement fully.

Some companies alternate the business units that undergo the complete strategic-planning process (as opposed to abbreviated annual updates of the existing plan). One media company, for example, requires individual business units to undertake strategic planning only every two or three years. This cadence enables the corporate senior-management team and its strategy group to devote more energy to the business units that are "at bat." More important, it frees the corporate-strategy group to work directly with the senior team on critical issues that affect the entire company—issues such as developing an integrated digitization strategy and addressing unforeseen changes in the fast-moving digital-media landscape.

Other companies use trigger mechanisms to decide which business units will undergo a full strategic-planning exercise in a given year. One industrial company assigns each business unit a color-coded grade—green, yellow, or red—based on the unit's success in executing the existing strategic plan. "Code red," for example, would slate a business unit for a strategy review. Although many of the metrics that determine the grade are financial, some may be operational to provide a more complete assessment of the unit's performance.

Freeing business units from participating in the strategic-planning process every year raises a caveat, however. When important changes in the external environment occur, senior managers must be able to engage with business units that are not under review and make major strategic decisions on an ad hoc basis. For instance, a major merger in any industry would prompt competitors in it to revisit their strategies. Indeed, one advantage of a tailored planning cycle is that it builds slack into the strategic-review system, enabling management to address unforeseen but pressing strategic issues as they arise.

Implement a strategic-performance-management system

In the end, many companies fail to execute the chosen strategy. More than a quarter of our survey respondents said that their companies had plans but no execution path. Forty-five percent reported that planning processes failed to track the execution of strategic initiatives. All this suggests that putting in place a system to measure and monitor their progress can greatly enhance the impact of the planning process.

Most companies believe that their existing control systems and performance-management processes (including budgets and operating reviews) are the sole way to monitor progress on strategy. As a result, managers attempt to translate the decisions made during the planning process into budget targets or other financial goals. Although this practice is sensible and necessary, it is not enough. We estimate that a significant portion of the strategic decisions we recommend to companies can't be tracked solely through financial targets. A company undertaking a major strategic initiative to enhance its innovation and product-development capabilities, for example, should measure a variety of input metrics, such as the quality of available talent and the number of ideas and projects at each stage in development, in addition to pure output metrics such as revenues from new-product sales. One information technology company, for instance, carefully tracks the number and skill levels of people posted to important strategic projects.

Strategic-performance-management systems, which should assign accountability for initiatives and make their progress more transparent, can take many forms. One industrial corporation tracks major strategic initiatives that will have the greatest impact, across a portfolio of a dozen businesses, on its financial and strategic goals. Transparency is achieved through regular reviews and the use of financial as well as nonfinancial metrics. The corporate-strategy team assumes responsibility for reviews (chaired by the CEO and involving the relevant business-unit leaders) that use an array of milestones and metrics to assess the top ten initiatives. One to expand operations in China and India, for example, would entail regular reviews of interim metrics such as the quality and number of local employees recruited and the pace at which alliances are formed with channel partners or suppliers. Each business unit, in turn, is accountable for adopting the same performance-management approach for its own, lower-tier top-ten list of initiatives.

More on strategic planning

In a *Quarterly* interview, Richard Rumelt, a professor at UCLA's Anderson School of Management, discusses the misperceptions some executives have about strategic planning:

"Most corporate 'strategic plans' have little to do with strategy. They are simply three-year or five-year rolling resource budgets and some sort of market share projection. Calling it 'strategic planning' creates false expectations that the exercise will somehow produce a coherent strategy."

Read the full interview on mckinseyquarterly.com.

When designed well, strategic-performance-management systems can give an early warning of problems with strategic initiatives, whereas financial targets alone at best provide lagging indicators. An effective system enables management to step in and correct, redirect, or even abandon an initiative that is failing to perform as expected. The strategy of a pharmaceutical company that embarked on a major expansion of its sales force to drive revenue growth, for example, presupposed that rapid growth in the number of sales representatives would lead to a corresponding increase in revenues. The company also recognized, however, that expansion was in turn contingent on several factors, including the ability to recruit and train the right people. It therefore put in place a regular review of the key strategic metrics against its actual performance to alert managers to any emerging problems.

Integrate human-resources systems into the strategic plan

Simply monitoring the execution of strategic initiatives is not sufficient: their successful implementation also depends on how managers are evaluated and compensated. Yet only 36 percent of the executives we surveyed said that their companies' strategic-planning processes were integrated with HR processes. One way to create a more valuable strategic-planning process would be to tie the evaluation and compensation of managers to the progress of new initiatives.

Although the development of strategy is ostensibly a long-term endeavor, companies traditionally emphasize short-term, purely financial targets—such as annual revenue growth or improved margins—as the sole metrics to gauge the performance of managers and employees. This approach is gradually changing. Deferred-compensation models for boards, CEOs, and some senior managers are now widely used. What's more, several companies have added longer-term performance targets to complement the short-term ones. A major pharmaceutical company, for example, recently revamped its managerial-compensation structure to include a basket of short-term financial and operating targets as well as longer-term, innovation-based growth targets.

Although these changes help persuade managers to adopt both short- and long-term approaches to the development of strategy, they don't address the need to link evaluation and compensation to specific strategic initiatives. One way of doing so is to craft a mix of performance targets that more appropriately reflect a company's strategy. For example, one North American services business that launched strategic initiatives to improve its customer retention and increase sales also adjusted the evaluation and compensation targets for its managers. Rather than measuring senior managers only by revenue and margin targets, as it had done before, it tied 20 percent of their compensation to achieving its retention and cross-selling goals. By introducing metrics for these specific initiatives and linking their success closely to bonus packages, the company motivated managers to make the strategy succeed.

An advantage of this approach is that it motivates managers to flag any problems early in the implementation of a strategic initiative (which determines the size of bonuses) so that the company can solve them. Otherwise, managers all too often sweep the debris of a failing strategy under the operating rug until the spring-cleaning ritual of next year's annual planning process.

Some business leaders have found ways to give strategic planning a more valuable role in the formulation as well as the execution of strategy. Companies that emulate their methods might find satisfaction instead of frustration at the end of the annual process. Q

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