



7

Choosing the Best Strategy

Learning Objectives

By the time you have completed this chapter, you should be able to do the following:

- Select criteria appropriate to the company and its purposes, and appreciate that a wide variety of criteria exists.
- Use the criteria in a criteria matrix to evaluate strategic-alternative bundles to help select the best one.
- Recognize the differences between company, partial, functional, and operational objectives, and among objectives, goals, and strategies.
- Set company-wide objectives with more confidence.
- Decide on a strategic intent for the company and major programs required to implement the strategy.
- Understand why contingency planning is necessary and how to devise meaningful triggers and contingencies.
- Appreciate why the board of directors has to be kept informed and involved throughout the strategic-decision-making process.

Chapter Outline

- 7.1 Selecting Appropriate Criteria
- 7.2 The Criteria Matrix and Choosing the Best Strategy
- 7.3 Deciding on Objectives
- 7.4 Contingency Planning
- 7.5 Keeping the Board of Directors Involved

This chapter explains how to choose the best strategy for the company from a number of viable alternatives using carefully selected criteria and how to argue persuasively for its adoption. It also shows how to arrive at the other strategic decisions and keep the board of directors involved through the process.

7.1 Selecting Appropriate Criteria

Choosing among alternatives becomes a little easier when each alternative is compared one at a time against a set of criteria. Because such an analysis is often insufficient to decide an issue, the decision may eventually turn on more subjective analysis. What kinds of criteria are appropriate? Because one of the conditions for creating a good bundle is that if implemented, it would lead to success for the company, the criteria to evaluate the bundles should together represent what “success” means to the company and, perhaps, the overall purpose of the company. Depending on the company and its particular situation, the criteria explored in this section are possible candidates that could be used to examine a company’s current standing and future outlook.



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One of the most important common criteria for choosing a strategy is revenue growth.

Shareholder value is a fairly common criterion, not only for choosing from among alternative strategies but also from among alternative investments. It requires the firm to have a model for computing shareholder value so that the computation for each strategic alternative or investment uses common values of discount rates and common assumptions about the future environment. In this way, the results become comparable. Still, many managers and companies believe that one of the principal purposes of strategic planning is to increase shareholder value. So managers should know how to compute shareholder value.

Additionally, strategic management and planning is based on an understanding of the relative contribution of brands to shareholder value (Rappaport, 1997). For example, the Coca-Cola brand accounts for 51% of the value of the Coca-Cola Company, which also includes 3,500 other brands such as Dasani, Sprite, and Schweppes (Coca Cola Company, n.d.). When managers have a solid understanding of brand value, they will use this aspect of shareholder value as a key criterion in planning.

Revenue growth is one of the most common criteria, used more often when a firm's revenue growth has been inadequate or flat, or when issues of market share and market positioning are strategically significant. A striking recent example of revenue growth is illustrated by Iluka Resources, one of 2011's best stock-market performers. Iluka posted a 53% increase in revenue between the third and fourth quarters of 2011 (Iluka grows, 2012). Such performance is often a strong predictor of takeover, a strategic decision made based on the revenue-growth criterion.

Profitability should be used when a firm has insufficient working capital or inadequate or negative cash flow, when profits in recent years have been flat or negative, or when it is highly leveraged. Leveraged buyouts (LBOs) rely on huge cash flows and profits during the first year following the LBO, so that the huge debt can be rapidly paid down. However, as a note of caution, it is relatively easy to "mortgage the future" in favor of present profits, for example, by reducing investment in R&D or new-product development, so that, as a criterion, shareholder value may be superior, taking into account as it does a 10-year future stream of earnings.

Firms vary in their propensity to take risk. They are more inclined to take risks the more that risks have paid off for them in the past and when they have sufficient capital so that they can afford to make mistakes. But degree of risk or riskiness as a criterion is more than this. A firm's culture can, for example, be risk averse, in which case it will avoid risk even when the risk has odds of success that appear to favor it. Risk can be analyzed and measured, but few have the skills to perform such analyses. Instead, they prefer to make a risky decision according to instinct, or assess risk by venturing an opinion or two (guessing), or even ignoring any underlying risk. One way in which risk can be discussed among a group of people who are not risk analysts is as follows: Because all alternative bundles except "status quo" involve doing something the company has never done before, "risk" can be used as a subjective measure of the likelihood that it can implement the bundle successfully. Some alternatives are sure to score higher or lower than others when risk is viewed this way.



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Amount of investment required is a practical criterion. If a particular strategic alternative requires an amount of capital the firm does not have or cannot secure, then it shouldn't even be considered a

When a company is looking at the amount of investment money required from investors, an appropriate criterion to consider would be return on investments and how soon the investment may be recouped.

bona fide alternative because it fails to meet the criterion of feasibility. Of course, the firm could borrow more money but must be careful not to exceed some value of debt-to-equity ratio required by its creditors or increase its debt to the point where its cash flow cannot service the debt. Obtaining equity capital may be relatively easy for a public company that has been performing well, but not so for a private company. In certain circumstances, the firm could go public and raise some equity capital; in other circumstances, that may not be possible. A firm could find a partner to share some of the risk and put up some of the capital required. But in this case, profits resulting from the strategy must also be shared. Finally, being acquired by the right company could provide the capital needed to finance a strategy, but this step is drastic and should be taken only in the best interests of the company, not just as a means of raising capital. For instance, SEOmoz software CEO and founder Rand Fishkin provided a detailed account in his blog of his experience negotiating an acquisition that ultimately didn't make sense for his company (Fishkin, 2011). In its most simplistic application, all other things being equal, it makes more sense to choose a bundle that requires less investment over another that requires more.

Even when a company can come up with the investment required by a particular alternative, an appropriate criterion might be return on investment (ROI, a profitability measure) and how soon the investment can be recouped; a breakeven point in months is desirable. Clearly an alternative with a much shorter breakeven point is more attractive to a firm with scarce resources, and one with a higher ROI is more attractive to a firm for which ROI is a critical measure of performance. It may make sense to choose a bundle that requires a higher investment if that investment can be recouped more quickly and yields a higher return, but note that these are three separate criteria and the bundles are evaluated on each one in turn.

A firm would choose an alternative that suited its existing corporate culture over one that needed a cultural change to make the strategy succeed. Just as "form follows function," so also does "culture follow strategy." This means that changing the culture to support the right strategy might be preferable to limiting a company to a strategy that fits the existing culture, or where the existing culture constrains the choice of strategy. Having said that, firms that try to change their strategy assume their culture will also change, then find the strategy almost impossible to implement because the unchanged culture is impeding it. It is well known that changing a corporate culture is exceedingly difficult and, for large organizations, takes a lot of time (recall the discussion in Sections 2.9 and 2.10). If every alternative considered required the culture to change, the alternative that matched the existing company culture the most and would therefore require the least change should, perhaps, be chosen. If a firm does not have a core competence or competitive advantage, it should certainly try to attain one, because competing without one results in below-average industry profits and a weak competitive position. Thus, the firm should look for a strategic alternative that would, in time, help it attain a core competence and competitive advantage. If the firm already possesses these attributes, then the alternative that increases the size or duration of the competitive advantage the most should be preferred.

If the industry in which a firm competes has little or no bargaining power with its buyers or suppliers, its profitability will be low or subpar and competitive conditions very difficult. Clearly in such a situation, increasing its bargaining power and giving it some leverage is highly desirable. One of the most effective ways of doing this is through differentiating. So, would any of the alternatives in question increase the firm's bargaining power with either its customers or suppliers?

There may be issues of timing to consider among the alternatives in question. Some alternatives are sensitive to when they are implemented, such as accelerating introduction of a new product or entering a particular market. If implementing an alternative now increases its likelihood of success as opposed to doing it later, this may be reason enough to choose it. Conversely, if doing it now



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If there is an opportunity in foreign markets, it is important for a company to develop a global presence, whether it is venturing into the international market for the first time or increasing market share in selected countries.

whether venturing into international markets for the first time or increasing already substantial market shares in certain countries.

Clearly, some criteria make sense for some companies in certain situations, so should be used carefully. Others, such as revenue growth, profitability, degree of risk, investment required, shareholder value, degree of cultural change required, and competitive retaliation apply to almost all corporate situations.

The criteria you ultimately use in your analysis must fit the organization you are analyzing. For example, to some organizations, profit is the primary indicator of success. Elsewhere, success may be measured by the number of jobs provided to the community, the percentage of profit donated to charitable causes, or the reduction of waste produced during the course of operations. Most of the criteria discussed in this section do not fit the circumstances of a nonprofit organization. The strategic-planning process of an academic department at a state university used the following criteria to help it choose from among several alternatives. Alternatives must accomplish the following:

- Be in the best interests of the department's faculty
- Raise the quality of education and programs
- Enhance the department's reputation with employers
- Increase the department's finances
- Make the department more competitive externally

reduces any advantage you otherwise might have, such as investing in a market push just as the economy turns down sharply or when a competitor introduces a better and cheaper product, then that may be reason enough to reject the alternative. However, using this criterion typically requires more data.

Which alternative will most help the company maintain or increase its technological lead over its competitors? Or give it the technological lead it never had? Or help it become more innovative and technologically competitive?

As more companies realize that their biggest markets lie in foreign countries, developing a global presence could become a prime factor,

Discussion Questions

1. Many candidates for possible criteria were presented in this section, and it makes sense that the criteria should be related to the company's purposes or what "success" means to the company. Yet "timing" is one that relates to neither. Which others of the criteria discussed have little or nothing to do with purposes?
2. Following on from question 1, why were such criteria included in the list of possibilities?
3. Which of the criteria discussed would be least likely to be useful in differentiating among alternative bundles?

7.2 The Criteria Matrix and Choosing the Best Strategy

One method that has been developed as a tool for evaluating strategy bundles is called the criteria matrix. It entails choosing five or six criteria most important to the firm and assigning a numerical rating as a means of identifying the best strategy. Another benefit of creating and using the criteria matrix is to use it as a worksheet in developing defensible and persuasive arguments for your preferred bundle.

Applying the Criteria

Experience has shown that using five or six criteria to evaluate the bundles makes the most sense. This range works because using too few criteria fails to capture the complexity inherent in the bundles, and using too many runs the risk of introducing conflicting criteria and would dilute the effect of each criterion on the final outcome.

Which criteria to choose is entirely up to your management team. "Playing" with several criteria can be a useful way to learn of the bundles' sensitivity to various combinations of criteria. Managers should supplement this analysis with detailed forecasts and analyses. For example, to assess which bundle might yield the most revenue growth were each one implemented, the team should conduct a more detailed sales forecast for each bundle over the planning horizon (three to five years). Similarly, profitability and shareholder-value analyses should be conducted, rather than guessing. Even though such projections are still estimates and based on assumptions, they require more reflection and thought, and so should be more valuable.



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The selection of criteria and rating bundles through the criteria matrix is an opportunity to develop the arguments you can use to defend your preferred choice.

Notice also that many of these criteria include purposes to doing strategic planning in the first place and what the firm perceives as success. It is fitting that criteria used to chart the future direction of the company be as important to an organization as its fundamental purposes and what it views as success.

The criteria matrix is used to evaluate the bundles against multiple criteria using a scoring system that enables the results of using each criterion to be added up at the end (Table 7.1). The first step is to choose a set of criteria that makes sense for the company. These may include some of those criteria described in the previous section and perhaps others relevant to the company and its present circumstances.

The next step is to assign a rating to each criterion on a 10-point scale. Some criteria are positively correlated and some negatively correlated. An example of the former is revenues: an alternative that might yield high revenue growth is good for the company, but low revenue growth is bad. The two go in the same direction so to speak (high growth = good, low growth = bad), so the criterion “revenue growth” is positively correlated. In such instances the rating would range from 0 to plus 10. A neutral alternative would be scored 0 whereas an alternative that would be strongly favorable to the company might be a 9 or a 10. An example of a negative correlation is “size of investment required”: an alternative requiring a lot of investment is “bad” for the company, but a small investment requirement is “good.” The two go in opposite directions (a lot = bad, little = good). For a negatively correlated alternative, the rating would range from 0 to minus 10. Thus, an alternative that is not risky at all would get a 0 score, one that is moderately risky a score of perhaps minus 5, and an extremely risky one perhaps minus 7 to minus 10. Table 7.2 lists examples of positively or negatively correlated criteria.

The rating scores are subjective estimates; the absolute value of the rating is not as important as spacing them according to an estimate as to how close or far apart the alternatives are. It is the *relative* ratings that are critical. The bundles are rated against each criterion independently of any other criterion. When all the ratings are done, the scores are added up to see which alternative has the higher (if evaluating two) or highest total score.

Table 7.1: Criteria matrix for evaluating alternative bundles

Criteria	Alternative A	Alternative B	Alternative C
Revenue growth (P)	8.0	8.0	9.0
Profitability (P)	7.0	7.5	8.5
Shareholder value (P)	8.0	7.0	8.0
Riskiness (N)	-8.5	-8.0	-8.5
Investment required (N)	-7.0	-9.0	-9.5
Change in culture required (N)	-6.5	-8.0	-6.0
Totals	1.0	-2.5	1.5

Table 7.2: Positively and negatively correlated criteria

Positively correlated	Negatively Correlated
Revenues or revenue growth	Capital investment required
Contribution to shareholder value	Change in culture required
Return on investment	Time to breakeven
Adverse effect on competitors	Overall riskiness
Strength of value proposition	
Gaining or extending a competitive advantage	
Increasing its bargaining power	

Table 7.3: Criteria matrix revised from Table 7.1

Criteria	Alternative A	Alternative B	Alternative C
Revenue growth (P)	7**	8	9*
Profitability (P)	7**	8	9*
Shareholder value (P)	6**	7	9*
Riskiness (N)	-7	-8	-9
Investment required (N)	-7	-9**	-8
Change in culture required (N)	-7	-9**	-6*
Totals	-1	-3	4

*Reasons to select

**Reasons to reject



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An objective is a quantitative target to be achieved within a specified time frame.

Arguing Persuasively

In Table 7.1, the alternative bundle that receives the highest total is option C. However, option A's total score is so close to C's that it makes arguing for C being the best alternative open to question. This is where other considerations come into play. If market share is particularly important to the company (revenue growth), or profitability, or if the company is averse to changing its culture a lot, then the analysis would suggest option C. But the table also shows that option C requires the most investment, and if the firm might be unable to raise

the needed capital, that could be the one reason to reject it. Recall, however, that feasibility is one of the six criteria for creating bundles, so option C should not have been qualified as a bundle if the needed capital couldn't be raised.

To avoid the situation where there are two alternatives that achieve almost equal ratings, the choice of criteria and assigned ratings are revised until there is a clear winner by at least three points. While this appears to be “fixing” the result, the process is still in “analysis” mode, which means that managers are free to try different criteria and ratings until they are satisfied they have a defensible strategic bundle. After all, defending and being comfortable with the choice of strategy is what this whole exercise is about. It is that ultimate defense before top management or the board of directors that will keep anyone from “fixing” the ratings to yield a preordained result. A preordained or poorly argued result can be spotted a mile away and will damage its proponent's credibility. So while this analysis is being done, it is important to remember to choose only that alternative that can be supported persuasively; the scoring system will help in that regard. The criteria matrix and the associated process of selecting criteria and rating bundles against them is simply an opportunity to develop arguments to defend or “sell” the preferred choice to others.

The danger with using such a quantitative yet still subjective method to choose a strategic alternative is that it invites criticism precisely because one person's criteria and ratings may not match anyone else's. The results are sensitive to the criteria chosen. Using shared or consensus ratings within a group is one way to get around this problem and to try out different combinations of criteria. The principal value of the criteria matrix, however, is to force planners to test their choice of alternatives against different criteria in case other people believe such criteria are important. In the case of disagreement, the person who has gone through this exercise will have “done their homework” and be able to discuss—and perhaps refute—another person's point of view.

Effective Presentations

In this chapter, we review a number of logical and data-based concerns you should have when presenting alternative strategic bundles to stakeholders. Undoubtedly, in order to be persuasive, you must have the data to support what you are advocating. However, how you package and present those data are critical concerns. The confidence and competence you demonstrate in proposing a strategy will impact your listeners. Communication researchers and consultants Jennifer Waldeck, Patricia Kearney, and Timothy Plax point to a rich body of research literature that examines the dynamics of persuasion and resistance. What follows is a summary of some of that research and how it applies in your strategic-planning efforts. Employ these research-based strategies to help you think through your oral or written presentation style and content:

1. Assess your stakeholders' willingness to change. Humans' inclination to resist change has been widely documented. Central to your persuasive effort is identifying your audience's present position.
 - a. When they agree at the outset, your persuasive task is to reinforce their commitment and provide them with some motivation to strengthen their commitment to a strategic change. As inconsistent with a corporate communication strategy as they may seem, emotional appeals are popular and effective ways to energize and motivate others. Finally, when dealing with stakeholders who are “with” you, you will benefit from being direct with those supportive individuals and telling them exactly what you believe needs to happen.

(continued)

- b. When dealing with a hostile or disagreeable audience, avoid direct and overt influence attempts. These will result in activation of an ego-protective defense that your listeners will use to guard what they are already invested in. In these cases, it's important to modify your expectations and ask for only small amounts of change and slight adjustments to thinking and behavior. For example, plan to move your audience from more to less disagreement in your initial discussions. Second, work to establish common ground and a sense of understanding. Acknowledge areas of agreement. Finally, be prepared to provide extensive amounts of the kinds of evidence and data discussed in this chapter to support your position.
 - c. When your audience is neutral or undecided, doesn't know much about the issues you are presenting, or is confused and overwhelmed by the facts, your first objective should be to establish relevance. By providing background information on the issue, you can make the issue professionally relevant to stakeholders and heighten their attention. Although evidence is important with these audiences, you must be cautious not to overwhelm or inundate them, since there is likely to be a learning curve involved.
2. Avoid inflammatory phrases. Steer clear of words and phrases that will make your stakeholders angry, cringe, or uncomfortable. These semantic barriers will distract your audience from listening effectively and evaluating alternatives fairly.
 3. Use a two-sided message with refutation. A speaker is most likely to influence an audience by presenting both sides of an issue and taking the time to argue against the position he/she finds undesirable. When you do this, your constituents will perceive you as well-informed, credible, and objective. Just be careful to be objective in opposing others' points of view, rather than offensive.
 4. Inoculate against counterarguments. When you know there are arguments against elements of your strategy (and there always are), it's a good idea to inoculate the audience against them. Doing so involves identifying those arguments and refuting each with solid evidence, often before they are even raised (because you have anticipated them). As a result, you will arm your audience to resist them.
 5. Minimize objections. Spending too much time inoculating against counterarguments detracts from the advantages of your proposal. So just as it's important to carefully consider the range of strategic alternatives as you are creating your bundle, you should identify only the top two or three critical objections to address in your proposal.
 6. Repeat your message using various tactics and media. Leveraging stakeholder support for a proposed strategy is rarely accomplished in a single message. In shepherding strategy change, design a message strategy that will expose your constituents to the ideas multiple times and in multiple formats (e.g., presentation, written proposal, podcast, interactive Web-based summary).

In comparing Tables 7.1 and 7.3, note that the latter uses only whole numbers; since the ratings are “educated guesses” in the absence of any data, estimating to one place of decimals belies a level of accuracy that just isn't there. Arguments involved in the selection of a bundle consist of two parts: (1) reasons why the preferred bundle was chosen, and (2) reasons why the other two were rejected. The best ratings in the table are highlighted in the winning bundle. Thus, in Table 7.3, if option A were “forming new partnerships,” option B were “developing new products,” and option C were “expanding nationally,” the argument would look like this:

The company should expand nationally because doing so would generate the most revenue growth and profitability, increase shareholder value the most, and require the least culture change. Forming new partnerships would generate the least revenue growth and profitability and increase shareholder value the least, while developing new products would require the most investment and culture change.

A final comment on the bundle analysis reflects on how well you have crafted the criteria matrix. It could be that the bundle chosen best meets all the criteria and one of the other two bundles falls short of all the criteria. This means a couple of things: (a) the winning bundle is so much better than the others and the one that falls short of all the criteria is so much worse than the others that it reflects badly on how the bundles were created in the first place (they are all supposed to be good, viable bundles); and (b) the third bundle is left with no reason to reject it, which also hurts the argument. In such a case, the criteria matrix should be reworked so that the winning bundle is still the one that would prevail, but would not be better than the other two on all criteria.

Discussion Questions

1. Are the following criteria positively or negatively correlated?
Brand reputation
Economic value added
Changing the cost structure of the firm
Cost of maintaining quality
Sales per square foot
Managerial turnover
Weighted average cost of capital (WACC)
2. The section advises that one should use 5–6 criteria in a criteria matrix. Discuss arguments of your own concerning why using fewer or a larger number of criteria would work or not work.
3. Would using more criteria produce a different result? Would it inspire more or less confidence in the result?
4. Assume you have developed a good criteria matrix and are now working on a convincing argument for your winning bundle. But what the criteria matrix reveals, in your opinion, doesn't make for a convincing argument. What do you do?
5. The overarching purpose of a criteria matrix is to choose a preferred "best" strategy and argue persuasively to others (perhaps even yourself) that it is the best one. Can you think of another method or process that would lead to the same result? Explain it.

7.3 Deciding on Objectives

The recommendations phase concludes the strategic-planning process allowing the recommendations—and the strategy—to be implemented. Recommendations include setting objectives, defining strategic intent, identifying key programs to achieve the objectives, and exploring triggers and contingencies if things do not go as planned. Creating or revising mission and vision statements is also part of this final phase if the organization's existing statements are no longer valid or if the organization has never had them before.

An objective is a quantitative target to be achieved within a specified time frame. It may seem odd to some that setting objectives comes after choosing a strategy. They may find it more logical to first set objectives and then choose a strategy to achieve them. Ideally, they should be set together, that is, iteratively until they fit with each other. But that is hard to do. Deciding on a strategy first makes sense for three reasons. First, it follows naturally from identifying the company's key strategic issues, which in turn follow logically from the situation-analysis phase. Second, by construing the selection of a strategic alternative bundle as creating a road map or direction for the company, one can then turn one's attention to deciding how far and how fast to go along that road (i.e., objectives). Last, deciding on the strategy first allows many criteria to be used, enriching the assessment and ultimately the choice of strategy.

In addition, there are two problems with setting objectives first. Where does the objective—the quantitative target—come from? Other than the case where the current strategy is being continued, setting an objective first lacks a context. For example, to meet a 20% revenue growth objective in two years may be possible by expanding internationally, but not by investing more in R&D. Yet the latter may be the better strategy in the long run. Wouldn't it make more sense to ask which of the two was capable of generating more revenues over the next several years? And where did that 20% number come from?

The second problem with setting objectives first is that, for example, revenue growth becomes the sole criterion for picking a strategy. That is, having set an objective, a strategy is chosen that will best enable the company to meet the objective. Wouldn't it make more sense to use revenue growth in this instance as one of several important criteria? Would one be as content to achieve the revenue-growth objective if the company were also losing money?

In the end, whichever one is done first—the strategy or the objectives—they must both match and be consistent with one another. The strategy determines how the company will compete and where it is going, while the objectives determine the rate of growth and how fast the company can go (what it can achieve) given its resources, capabilities, and aspirations. Great care must be taken to distinguish objectives from strategies. For example, executives often talk of “high growth,” “moderate growth,” and “low growth” strategies. Clearly, these growth “strategies” are really objectives reflecting a high, medium, or low increase in sales or revenues. The full range of possible business strategies was covered in Section 3.2.



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One of the steps in setting objectives is to decide on a small number of measures critical to the firm, such as revenues, profit, and debt structure.

Setting Objectives

While this model advocates setting objectives after deciding on a preferred strategic alternative, the two must be so well matched that an observer would imagine that they were done together. It is impossible to evaluate or judge a strategy without knowing what the objectives are, and likewise impossible to judge whether the objectives make sense without knowing how they are to be achieved (the strategy) (Collis & Rukstad, 2008).

Consider this example. A company decides to pursue an accelerated product-development strategy and at the same time, change its fairly conservative culture into an innovative one that also values quality. Is this a good strategy? It is impossible to tell unless you also know what the company is trying to achieve, that is, know its objectives. If you were now told that in three years' time the company expected sales to double and profits to increase by 50% and that it had the resources to

carry out this preferred strategy, one now has a basis for either criticizing the strategy or believing that it will work (or even criticizing the objectives). So a strategy without objectives is meaningless.

Consider a second example. A company whose sales have been flat and that has been losing money for two years wants to increase sales by 20% next year and at least break even. Are these good objectives? Again, it is impossible to tell unless you know how the company intends to achieve them, which means knowing its strategy and programs. Merely trying to increase sales, typically through a market-development strategy, may be insufficient. The company's product may be outdated and its cost structure too high. So with the competitive environment the company faces, it will take a well-thought strategy to give an observer confidence that the objectives could and would be achieved. Again, objectives without a strategy are meaningless.

Setting objectives is a three-step process.

Limit the Choices

Decide on a *small* number of measures critical to firm performance. These might typically include revenues, profit, debt structure, and the like. There is no rule as to how many objectives a firm should have. But the more it has, the more difficult it becomes to achieve them all and the greater is the likelihood that some objectives will conflict with others; that is, achieving one will result in not achieving another. About three to four company-wide objectives is typical, one of which is revenues (or market share if it can be accurately measured) and some kind of profit measure: EBIT, NIBT, NIAT, EPS, ROI, ROE, ROS, or ROA—NIAT being the most commonly used. The remaining one or two can be anything of critical importance to the company such as sales per square foot for a retailer, operating income per screen for a movie-theater chain, debt-equity ratio for a fairly leveraged company, and the like. Do not include cost-reduction objectives as one of them because any efforts to reduce costs will show up in improved profit; cost-reduction objectives are important only at an operational not a strategic level. Similarly, other operational or programmatic objectives, such as number of new products produced, percentage of international sales, number of retail outlets served, or increasing production capacity or throughput by X%, while important, should not be part of this set.



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Companies have goals because they inspire employees and external constituents to perform better.

Set Annual Objectives

Decide on annual values for these critical measures for the next three years. This is difficult to do well. Theory tells us that objectives, to be effective, should be set at a “challenging” level; set too high, they de-motivate because people consider them impossible to achieve, and set too low, they also de-motivate because they are too easily achieved. How does a company find that perfect level? The following five-step process may help.

First, extrapolate from historical data to establish *initial* values for each objective for the next three years. This is easier to do when you have at least five years of historical data available. Second,

make a list of external and internal forces or changes that might act to *decrease* these beginning values over time, such as intensifying competition, scarcity of borrowed funds, a conservative culture, rapidly accelerating technological innovation in the industry with which the firm cannot keep up, and so on. For each item, indicate, however subjectively, the strength of the negative effect on the objective (high, medium, or low). Third, make a list of external and internal forces or changes that might act to *increase* these beginning values over time such as a new strategy, company-wide training, a new CEO, a change to a more productive culture, new quality programs, strategic alliances, a new advertising campaign, and so on. For each item, indicate, however subjectively, the strength of the positive effect on the objective (high, medium, or low). Fourth, compare the two lists and decide, for each objective, whether the initial value deserves to be increased or decreased and by how much, depending on the extent to which the positive effects outweigh the negative effects or vice versa. In this way, create a “first cut” of each objective for each of the next three years.

Finally, get feedback from those who are going to be held accountable for achieving the objectives whether the “first-cut” objectives are challenging yet achievable in the circumstances. In fact, get these people involved in the other steps too. For some companies, deciding on strategic objectives cannot be done unless the whole range of operational objectives have been created, thought through, and approved, to make sure that the resources to achieve them are available and that they are feasible to achieve in the time frame specified. When they have been well designed, achieving the operational objectives should result in automatically achieving the company-wide objectives.

Match Objectives to Strategy

Check that the objectives match the preferred strategy. The preferred strategy and the set of objectives must be consistent with each other. For example, if the strategy decided upon is aggressive, the objectives set should also be aggressive. If the strategy is a turnaround, the objectives should reflect this unusual state, showing first stabilization at a lower level followed by growth consistent with the new strategy. If the strategy is designed to maintain market position in a highly competitive, mature market, the objectives should not show high growth, but reflect current conditions to a high degree. If the strategy requires a period of heavy investment before it pays off, the objectives should reflect that reality. Remember, the objectives indicate what the company considers to be successful performance over time given the changing realities of the industry, marketplace, and the company’s own strategies, resources, and commitments. Thus, not achieving these objectives (indicators) means less-than-successful performance, while meeting or exceeding them indicates intended or superlative performance in the circumstances.

Types of Objectives

The preceding discussion implicitly assumes that these are company or company-wide objectives. There are also other types of limited objectives. Partial objectives cover only part of some activity, like international sales versus total sales. Functional objectives pertain only to a particular function, like a sales and marketing department increasing the number of salesmen. Operational objectives are either subsumed by higher-order objectives (like reducing costs) or are cross-functional, for example, security or systems or plant maintenance, none of which come under any “function” (Table 7.2). All of these other types of objectives will show up during implementation of a strategy. The value of understanding the differences is that at the strategic level, we need company-wide objectives, not functional or operational objectives.

Table 7.4: Partial, functional, and operational objectives

Kind of objective	Objective	Explanation
Partial	Increase international sales by 10%/yr	Does not address domestic sales
	Increase sales from new products introduced during the past three years to 40% of total sales	Does not address sales from existing products
	Increase sales to mass merchandisers by 30%/yr	Does not address sales to other retail channels
Functional	Double the number of retail outlets	Concerns only marketing
	Increase throughput by 5%/yr	Concerns only production
	Redesign the product to reduce purchasing costs by 5%	Concerns only engineering
Operational	Reduce costs by 12%/yr	The higher-order objective of NIAT takes this into account
	Improve quality by reducing the costs of quality by 30%	Insofar as quality is measured this way, it is subsumed by NIAT
	Improve the sales “hit rate” from 2% to 6% at year-end	This is an operational objective for marketing

Typically, the most common company-wide objectives are revenues, NIAT (or other profit objective), and one or two other ratios or nonfinancial measures that the company as a whole commits to achieving. These might be volunteer hours donated by employees to the community, a lowered number of quality defects, a lowered turnover rate, or improved safety and accident rates.

Objectives vs. Goals

In many companies, what we now understand to be an objective is often referred to as a goal (and vice versa). To underscore the difference as used here, a goal is defined as a qualitative end-state a company tries for example, “to become more innovative.” Note that progress cannot be measured, and there is no specified time frame.

Why, then, do companies have goals? Because they are intended to inspire. They should sound stirring to employees and to external constituents. The following are some examples of goals:

- Become more innovative
- Make the customer #1
- Take care of the environment
- Produce better products
- Be there for our customers
- We’re going to grow
- Develop a national presence
- Become more efficient

- Become lean and mean
- Streamline our operations

At the same time, goals, precisely because they are not amenable to measurement, let management off the hook. There's no incentive to follow through. Management isn't accountable.

Objectives are written in such a fashion that organizational members will be able to answer the question "Will we know it when we see it or when it happens?" Organizational consultants and authors Beebe, Mottet, and Roach use four criteria for objectives (2003). First, accomplishment of the objective must be observable; we should be able to see the results. Second, objectives must be measurable; that is, some objective metric must yield useful data indicating that an objective has been met. Third, objectives must be specific; a clearly written objective includes precise guidelines for describing the nature of the objective and the strategies and tactics required to accomplish it. Finally, as we've made clear in our discussions so far about strategic thinking, talking, and management, objectives must be feasible and attainable. Organizations must develop objectives based on a realistic understanding of both internal and external barriers to accomplishment.

Thus, a CEO might be well advised to run a company on objectives alone. It has been said that "you can't improve what you can't measure," and there is much truth in that. Goals imply programs (for example, "produce better products" implies more R&D, engineering, better quality control, and constant customer feedback) and operational as well as company-wide objectives. Incentives for improved performance and results are tied to achieving objectives. Settling for a goal instead implies laziness and an aversion to accountability.

Discussion Questions

1. Companies, both in their public statements and in the way they are managed, make extensive use of goals and objectives. Assuming that they are defined as they are in this presentation, do you think that a company could be managed using just goals? Why or why not?
2. Imagine a company whose managers collectively set objectives at a very conservative level, knowing full well the objectives would be exceeded and all of them would get hefty bonuses as a result. How could this situation be avoided?
3. Is it possible for company-wide objectives to be set last, in effect adding up all the partial and functional objectives? If it is, might that be better or worse than setting them first?
4. At a business school, overall objectives (things like number of courses taught by full-time faculty, ratio of full-time faculty to total faculty, total funding received, etc.) are derived from annual plans of each department (finance, operations, accounting, HR, etc.); that is, the departmental objectives are combined to produce the school's overall objectives. Yet the school maintains that it does strategic planning. How would you explain to the school that it is mistaken?
5. Companies' reward and incentive systems are attached to attaining or exceeding certain objectives, assuming that profits were also achieved. But little is said or publicized about what happens when such objectives are not achieved. What kinds of penalties would you suggest for not achieving company-wide objectives and functional objectives? How would you gain everyone's agreement in the first place for a system of penalties as well as bonuses and other rewards?
6. If it didn't already exist in a company, would developing a system for penalizing failure to meet company objectives be worthwhile?
7. Recall an organization you were part of (needn't be a company). Did you have goals and objectives? What were they? Were they taken seriously?

7.4 Contingency Planning

Murphy's Law states, "If anything can go wrong, it will." An extension of this is that it always seems to happen at the worst possible time. It is a good idea to contemplate what could go potentially wrong in the future, which is termed a trigger, and what the company would do differently were that to happen, referred to as a contingency.

We therefore talk about trigger-contingency pairs, typically one or two that pertain to next year—the short term—and one or two that could occur three years from now—the long term. In reality, companies may have as many as 20 triggers and contingencies "active" at any time, assuming they do contingency planning. The planning horizon, however, can vary considerably according to the size of the company and the industry. For example, a company like Boeing views the next several years as "short-term," about 10–15 years as "medium term," and 20–30 years as "long term." Companies in the fashion business view two weeks as "short term," and a season (3–4 months) as "long term." For most companies, however, the "standard" long term of five years has now shrunk to three years because of the rapid pace of change, especially in high-technology industries.



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In contingency planning, companies tend to look at the short term, medium term, and long term. The standard range for "long term" used to be five years, but due to the rapid pace of technology, it has been reduced to three years.

differently if your sales fell below target projections by 10%, 15%, or 20%? In this way, you will monitor something you constantly measure, and so can bring into play the contingency plan at just the right moment.

Triggers also come from assumptions you make about the future that are "soft"—that is, about which you lack confidence and which are external to the company. For example, if you are engaged in strategic planning and your company is sensitive to interest rates, you might not know what is going to happen to interest rates next year. You may have tried to obtain information from various economic forecasts on this variable but, frustratingly, all of them differ in their predictions. So here is something you can do. Simply make the assumption that interest rates are not going up next year (if economic indicators make that at least plausible), and base your planning on that.

Triggers

Triggers should be external, specific, and quantitative. Absent these three qualifiers the company will not know when to invoke the contingency plan. It is no use saying, for example, "If profits decline," or "When things get tough." Decline how much? Get how tough? Even when trying to address phenomena that cannot be measured—such as a competitor infiltrating your territory, or, for the Carmike movie-theater case discussed in the previous chapter, "worse" movies being made in a certain year—try to gauge their effect on your sales. For example, if the unknown phenomena were to cause your sales to decline, would you do something

However, because the assumption is “soft,” create a trigger that admits the possibility that interest rates could go up: “If interest rates go up by more than X percentage points, then . . .” the contingency plan takes effect.

Triggers can also emerge from the timing of various imminent occurrences. For example, if new federal legislation is being created to nationalize health care, you may be unsure if this would take place next year or two to three years from now. So create your plans with your best assumption in mind—for example, no health care legislation will be enacted during the period of the planning horizon. However, because the assumption is “soft,” create a trigger, too, that specifies, “If health care legislation were enacted within the next two years, then . . .” the paired contingency will be enacted. Notice that this trigger is quantitative. You can tell exactly when it happens and can therefore invoke the contingency plan. Similarly, you may want to do something differently if two competitors merge or if quota restrictions into some foreign country are imposed or lifted.

For companies focused on increasing sales or market share, it is tempting and understandable to create triggers having to do with not meeting revenue objectives. To do this once is perfectly fine, but to have such a trigger every year gives the impression of obsessive focus in one area. Management’s role is directing and coordinating the many aspects of a company to work together seamlessly to create value, and indeed things could go wrong in many areas, not just in failing to



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Good contingency plans depend on three guidelines: not reneging on your adopted “best strategy,” not planning for something the company is already doing, and making the contingency a solution to the problem.

what a company should do differently if that trigger occurred. Later, when the strategic plan has been prepared for operational implementation, the contingency should be translated into a contingency plan complete with details as to who is responsible for it, its budget and schedule, and who must keep it relevant as conditions change.

Good contingencies should follow three guidelines:

- Do not renege on the adopted “best” strategy. For example, suppose the company chose a market-expansion strategic bundle, but there is reason to believe it would be difficult

make a revenue objective. A better approach is to make a list of all the possible things that could go wrong or where your assumptions are soft, and choose the most likely of them as your triggers. Try to choose a different trigger for the long term from what is chosen for the short term. A useful training exercise is to create one trigger-contingency pair based on what might cause a revenue shortfall and one an *NIAT* shortfall, stating one in the short term and the other in the long term, just to practice creating realistic trigger-contingency pairs.

Contingencies

Contingencies are precursors to contingency plans. They are a response to a particular trigger;

to implement and pull off. If sales were to drop more than 10% from target projections at any time, it should not set as a contingency, “Cancel the market-expansion strategy and implement a differentiation strategy.” If one does that, it is in effect saying that the strategic bundle chosen was not a good choice, and its proponents will instantly lose credibility. Besides, companies cannot—and should not—be in the habit of changing their strategies at the first sign of adversity. Strategies typically take anywhere from two to five years to implement, and the organization must give the chosen strategy a chance to succeed by not changing it until there is absolute certainty it is not working. For any new or modified strategy being implemented that does not seem to be working, it is advisable always to suspect first the execution of the strategy, not the strategy itself. That way the contingency should focus on operational changes that could be made to enable the strategy to succeed, not changing the strategy itself. The following are examples of possible operational changes:

- » Change the ad campaign or the advertising agency.
 - » Replace the VP Marketing (or any senior manager).
 - » Give the salespeople additional or more technical training.
 - » Do additional and specific market research.
 - » Broaden the distribution channels.
 - » Increase links to your customers and increase their switching costs.
 - » Seek alternative suppliers.
- Do not make something that the company is already doing the contingency. Think about it. What the company has been doing up to the time the trigger is invoked is what got the company into trouble in the first place. If sales are not meeting expectations, do not set as a contingency, “Continue advertising” or “Do more R&D.” The company is already doing those things, and, clearly, sales are still down. So think of something it can do differently, that is, an adjustment to its operations or execution, one that can be implemented quickly, say, in a couple of months.
 - Make the contingency a solution to the problem implied in the trigger. If inadequate profits are the problem, the contingency should be directed towards increasing profits, not sales. If market share is the problem, do not suggest lowering costs as the contingency, even if it is a matter of doing something different; the two are unrelated.

Because contingencies are in fact back-up plans, they have to be spelled out in great detail, and those responsible for developing them and carrying them out must know who they are and what they must do. Those details are added during the operational phase prior to implementation. Companies that go this extra mile of contingency planning will reap rewards in three ways. First, they will be better prepared for specific uncertainties than companies that have no triggers and contingencies, especially if they work to adjust the contingencies over time as conditions change to keep them current and workable. Second, they will become more adept at anticipating what might go wrong and come up with better triggers and contingencies over time. Third, they will appreciate the need to be alert to key changes in the environment and their company and, over time, create a more flexible company culture.

It is effective to express a trigger/contingency pair in the form of a three-part sentence. For example:

- The external cause of the trigger: “If competitors lowered their prices, . . .”
- The quantitative trigger: “causing revenues to lag projections by 15%, . . .”
- The contingency: “then the company should increase advertising and promotions.”

Stringing those three parts together—“If competitors lowered their prices, causing revenues to lag projections by 15%, then the company should increase advertising and promotions”—you will find that this simple sentence meets all criteria for creating a good trigger and contingency.

Discussion Questions

1. If “value” implies benefits accruing for a certain level of costs, try to articulate the true value of contingency planning to a company.
2. Contingency planning is needed precisely because certain assumptions about the changing environment might be “soft” and uncertain. Yet, because of changing conditions both inside and outside the company, contingency plans—both triggers and contingencies—rapidly go out of date. How often should a company review its contingency planning and keep things current?
3. Triggers assume that progress toward objectives is measured constantly and that actual performance can be compared to plan performance, say, every month. In your opinion, is this true of most companies? Comment specifically about NIAT performance.
4. Typically, profits are computed quarterly at most, and are done so using accounting principles. To the extent you agree with this, should profits ever be used as a trigger? Discuss.

7.5 Keeping the Board of Directors Involved

Strategic planning is a critical part of strategic management and singularly responsible for directing or keeping the company on the right path. In companies that do strategic planning, a top-management team, led by the CEO and ideally including key operational managers, is responsible for doing strategic planning and implementing the decisions made during the process.

In public companies, however, the board of directors is directly responsible to the shareholders for making strategic decisions that ultimately benefit the company and, by extension, its stockholders. So what is the role of the board in strategic planning and decision making? The role and level of involvement ranges from almost nothing at one end of the scale to taking over completely at the other, and varies from company to company.



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There are two scenarios where board involvement is nonexistent or where it “rubber stamps” executive decisions. In the first there is a high degree of trust between the board and the CEO and top management.

In the second the board members have been handpicked by the CEO and agree with all his decisions. In many such cases, the CEO is also the chairperson of the board, making the relationship even cozier. While some companies are fortunate to enjoy mutual trust, nothing is wrong with the latter technically or legally. Whether it is “right” is a matter of opinion.

In public companies, it is important to keep the board of directors involved in the process because they are directly responsible to the shareholders for making strategic decisions.

At the other end of the scale, takeover bids and acquisitions demand full board involvement, and resultant decisions are made solely by the board. Bear in mind that the CEO, CFO, and one or two other key executives are usually also members of the board.

Most companies operate somewhere in between these two extremes. Because the efficacy of the board-management relationship differs so much, it is difficult to generalize. What would be useful instead would be to summarize some things a board could and should do to be involved in the strategic-planning process:

- If at all possible, the board should nominate a strategic-planning committee whose responsibility would be to monitor the strategic decisions being made by top management and involve the whole board if circumstances warrant.
- In the absence of a strategic-planning committee, it may be advisable to have at least one board member present at all strategic-planning meetings as an observer.
- Have the director of strategic planning—or the CEO if one doesn't exist—send summaries of all reports and research done in preparation for strategic-planning meetings.
- Ask probing questions at board meetings of the CEO and CFO, especially during the strategic-planning process. If the board gets an inkling of the direction the CEO wants to take the company and it disagrees, and if each side is adamant that its direction is right, it is the CEO who gets dismissed.
- Above all, it is the board's fiduciary responsibility to ensure that the direction and strategy the company moves in is in its best interest and that of the stockholders; it has to do whatever it must to carry out that duty.

Discussion Questions

1. Somehow, the board of directors has to maintain good relationships with the top management of the company and yet stay at arm's length, so to speak, to properly perform its role of overseer. How can it best manage this tension?
2. Imagine yourself as a board member: You notice that all is not right between the CEO and the CFO and certain other board members. What would you do?
3. Also as a board member, you have a sudden insight as to what the company might do strategically in the future. What do you with this idea?
4. If the CEO and CFO are insider members of the board, is there any justification for the board appointing a strategic-planning committee?

Summary

This chapter described a useful method—the criteria matrix—for evaluating alternative bundles on a number of criteria in order to select the best one. However, choosing which criteria to use is subjective and could affect the outcome. They should be related to the purposes the company is trying to achieve and what “success” means to the company. It therefore makes sense that using such criteria would in fact result in the best bundle for the company. In addition, only five to six criteria should be used, as too few would fail to capture the complexity of a future strategic direction and too many would dilute the impact that each criterion would have on the outcome.

The criteria matrix consists of a table with the alternative bundles as columns and the criteria as rows. Putting numbers or ratings down in each cell must be done carefully. Positively correlated criteria should be rated on a scale of 0 to plus 10, 10 being best, while negatively correlated criteria should be rated on a scale of 0 to minus 10, 0 being best. The magnitude of the rating is not nearly as important as the relative ratings across bundles. Criteria for which every bundle gets the same rating should be deleted; the purpose of choosing criteria includes their ability to

differentiate the bundles. Finally, the “winning” bundle must win by at least three points or there will be difficulty arguing for it as the best bundle. If this happens, the ratings and even the criteria need to be changed until it meets that condition.

After determining the bundle with the highest score, a persuasive argument must be created to convince others of the choice. The best argument consists of two parts: why the winning bundle was selected and why the others were rejected. Reasons for selecting the winning bundle include those criteria for which it had the best rating. Reasons for rejecting any bundle include those criteria on which it had the worst rating. If the reasons are “unbalanced” (i.e., the winning bundle was best on all the criteria and another bundle was worst on all criteria), it means that the bundles were poorly formed or badly rated in the first place. If all the bundles were good to begin with and the ratings are realistic, the winning bundle should be best on a subset of criteria and the others the worst on other subsets.

Besides choosing a winning strategy and bundle, the company needs to make strategic decisions that include company-wide objectives, strategic intent, major programs, and triggers and contingencies. Company-wide objectives are targets the whole company is responsible for producing, whereas functional objectives apply only to functional departments, partial objectives are subsumed under other objectives, and operational objectives are other kinds of nonstrategic objective. The latter three types of objectives are operational, not strategic. Objectives are quantitative targets to be achieved in a specified time frame, whereas goals are simply qualitative end-states to be achieved in the future and, while they may sound inspirational, lack incentives and accountability.

Because things may go wrong despite the best planning, well-managed companies will do contingency planning. This involves, for each contingency, identifying an external assumption that might be “soft” or uncertain (what could go wrong), a quantitative trigger (when should the company do something different to correct the situation), and what the company would do if the trigger were reached. Companies who prepare themselves in this way fare better than those that don’t.

Finally, the board of directors has to be kept informed and involved throughout the strategic-decision-making process. While their involvement varies from hands-off to taking over the strategic decision making completely (as when responding to a takeover bid or making an acquisition offer), boards would do well to do some of the following: strengthen their relationship with the CEO and CFO (insider board members), appoint a strategic-planning committee, sit in on strategic-planning meetings, or receive summaries of all reports and research done in preparation for strategic-planning meetings.

Key Terms

argument The argument for selecting a preferred bundle consists of two parts: (1) reasons why the preferred bundle was chosen, and (2) reasons why the other two were rejected. The reasons are drawn from the criteria matrix.

company-wide objectives Set during the strategic-planning process that the whole company must achieve.

contingencies Back-up plans and precursors to contingency plans. They are a response to a particular trigger, what a company might do differently if that trigger occurred.

contingency planning Counteracts Murphy's Law ("If anything can go wrong, it will") by contemplating what could go wrong in the future (trigger) and what the company would do differently were that to happen (contingency).

contingency plans Differ from contingencies only in adding operational details, like who is responsible, the budget and schedule, and who must keep the plan current over time.

criteria matrix A matrix for evaluating alternative bundles using 5–6 criteria important to the firm. Uses a scoring system that enables the results of using each criterion to be added up at the end. Absolute ratings are not important, but *relative ratings* are. The winning bundle must have *at least three points* more than any other bundle, otherwise the winning bundle cannot be defended adequately.

criteria Conditions used to evaluate alternative bundles derived from purposes to doing strategic planning and what the firm perceives as "success." Must be classified as either positively or negatively correlated.

criteria, negatively correlated So labeled because a bundle having *less* of something is "good" (opposites)—like riskiness or amount of investment required. Bundles using such a criterion are rated on a scale of 0 to –10, 0 being best.

criteria, positively correlated So labeled because a bundle having *more* of something is "good" (reinforcing)—like revenue growth or profitability. Bundles using such a criterion are rated on a scale of 0 to 10, 10 being best.

functional objectives Objectives that pertain only to a particular function, like increasing the number of salespeople (marketing/sales), increasing throughput or production efficiency (production), reducing purchasing costs through redesign (engineering), or reducing the weighted average cost of capital (finance).

objective A quantitative target to be achieved within a specified time frame.

operational objectives Objectives that are either subsumed by higher-order objectives (like reducing costs) or concerning, for example, security or systems or plant maintenance, none of which come under any "function."

partial objectives Objectives that cover part of some activity, like international sales vs. total sales, sales from new products vs. all products, sales to mass merchandisers vs. all retail channels.

triggers Should be external, specific, and quantitative.

