CHAPTER 1

STRATEGY PROCESS

PRINCIPLE

An effective modern strategy process uses both planning scenarios and strategic business models.

STRATEGIC TECHNIQUE

1. Form top-down and bottom-up strategic-planning teams.
2. Schedule interactions between teams.
3. Construct a planning scenario and a strategic business model.
4. Formulate an intuitive, synthetic strategic vision.
5. Construct an analytical long-term strategic plan.
6. Construct short-term operational plans in the direction of the strategic plan.

CASE STUDIES

Merger of AOL and Time Warner

Rakuten

Barnes and Noble Faces Amazon.com

Hewlett-Packard's Strategy Challenges

INTRODUCTION

The world keeps changing. It always has and always will. This is the fundamental importance of strategic management, for the use of strategic planning is to make *decisions now* to guide an organization's *future directions.*

In terms of future directions, the basic problem of any company (or, for that matter, of any living thing) is *survival*. And to survive over the long term, as Lowell Steele of General Electric succinctly summarized, a company must have two strategic capabilities: the ability to *prosper* and the ability to *change* (Steele 1989).

Prosperity

The failure to prosper imperils survival because when expenses exceed income over a long enough period a company fails in bankruptcy. Moveover, prosperity now requires not only profitability but long-term growth. Modern stock markets often value long-term asset growth over short-term dividends. In these days of corporate takeovers, continual corporate growth in earnings and sales is necessary for management to retain control. Together, this combination of continuing profitability and continual growth presents a tough strategic problem because all markets eventually mature and growth in a company's business is limited by the growth of its markets. In the second half of the twentieth century, this need for continual corporate growth not only created both the driving force for corporate diversification but was also a major cause of the dissolution of large companies. Successful management of a portfolio of different businesses in the same company became a major top corporate leadership challenge.

An illustration of this was the successful growth of General Electric in the last two decades of the twentieth century. The CEO who provided strategic management for GE during that time, Jack Welch, became well known in the business world growing GE in two decades from a market value of $12 billion to $500 billion—then a rare corporate feat.

In his intended last year at GE, Welch bought more growth for GE by acquiring Honeywell:

> "It was vintage Jack Welch. At the Oct. 23 press conference announcing General Eletric Co.'s $45 billion acquisition of the aeospace and industrial conglomerate Honeywell International Inc, the GE chairman and CEO strutted around the stage, boasting of the promise of the deal . . . Welch spoke bullishly of the acquisition—'It's exciting. . . . ' "
>
> —(Barrett et al., 2000, p. 41)

In the fall of the year before Welch's intended retirement, Welch had learned that the Honeywell was agreeing to be acquired by United Technologies, and

Welsh rushed in with a higher offer ($8 billion more) to buy Honeywell. Honeywell would add 7% growth to GE's earnings. GE had revenues of $131 billion with operating profits of $19 billion. Honeywell had $25 billion revenue and $4 billion profits. Growth was important to GE to maintain a high stock value—through continuing growth.

Then Welch's business fame was so extensive that he had earlier received a $ 7.1 million advance for his projected memoirs. It was one of the highest book advances in publishing history; and the publisher, Time Warner's Doubleday, would have to sell at least 1.6 million copies in North America to make a profit:

> Executives of Doubleday had prepared a complete book jacket and marketing plan to pitch to Mr. Welch. Sitting in his shirt sleeves at a conference table, Mr. Welch preferred discussing his ideas about management over marketing details . . . At one point, the conversation turned to Lee Iacocca, the legendary chairman of Chrysler Motors whose autobiography sold 2.6 million copies in hardcover and 3.5 million in paper back in North America. Mr. Welch told them that he would consider a book like Mr. Iacocca's a failure, because it was about a personality rather than ideas. Mr. Welch said he preferred the 1964 book by Alfred P. Sloan, *My Years with General Motors* . . .
>
> —Kirkpatrick (2000)

Strategic management is about ideas. *Worth* magazine asked several successful CEOs about what they thought was important in the job of the CEO. Two of them, Koichi Nishimura of Solectron and Eric Schmidt of Novell, responded:

> *Nishimuara:* Four things, I think, are important. First, communicate a vision of where the company is and what you are doing. The second is that when you communicate, you want to be able to motivate people. Third, you want feedback. And fourth, you want to take action.
>
> *Schmidt:* I think the job breaks down into three parts. First, setting a strategic vision that is implementable. That's number one. Second is recruiting and leading great human beings. The third is worrying about shareholder value. If you follow those three rules, then everything else sort of works. . . . I think the question from an investor should be, Does the CEO have a strategy that you believe can win?
>
> —*Worth* (2000, p. 183)

Strategic vision, communicating vision, recruiting and motivating good people, obtaining feedback, and taking action that creates shareholder prosperity—these are essential elements in corporate leadership. Strategy is ideas about the long-term future.

Change

Attaining the kind of growth and prosperity Welch had achieved at GE required him to make great changes within the company. On taking office back in 1981, Welch first sold off a hundred of GE's businesses and then consolidated the rest into 14 business groups. This massive restructuring gave Welch a tough reputation:

> Neutron Jack, as he is sometimes called, is widely regarded as one of the world's most ruthless managers. The truth is more complex. Some of his actions are indeed harsh, and he antagonized people inside the company and out by fixing something they didn't think was broke. What is becoming clear only now is how those moves fit into a larger plan to strengthen the enterprise and to make its remaining employees more secure.
>
> —Sherman (1989, p.39)

Welch's success at GE was to strategically change GE from primarily manufacturing businesses into primarily financial service businesses. In 1980, manufacturing produced 70% of GE's revenues, with services contributing 30%. By 1999, manufacturing produced only 26% of revenues, with services having grown to 74%. Welch's strategy was to retain only a selective group of manufacturing businesses and grow financial services: "Chairman Welch unloaded the consumer electronics division and built financial services into a powerhouse, while keeping GE dominant in turbines and jet engines." (Teitleman, 2001, p. 31)

Periodic change in a large organization is necessary to help the firm adapt to new times, for new *times* keep on occurring. One of Jack Welch's most widely quoted strategic precepts was:

"Control your own destiny, or someone else will."

The failure to make appropriate changes at the right time, imperials survival because the company may become competitively obsolete in its products, services, and value to customers. Change requires an ability to anticipate the external dynamics of the environments in which a company operates—markets, competition, innovation, government regulation, economic conditions, globalization, and so on. Change also requires an ability to alter a company's directions (e.g., in products, production, marketing, organization, personnel, businesses, etc). Lowell Steele nicely summarized the emphasis of change as the focus of strategic thinking:

> Strategy is concerned overwhelmingly with questions of change. How much must the enterprise change in order to survive and to continue to prosper? How much change can it finance and manage? How fast can it change? These are profoundly difficult questions.
>
> —Steele, (1989, p. 178)

Strategic management is about the difficult questions of future business—whether it should go and how should it change—a particularly risky set of questions for a large business that is already successful.

In many of the older books on strategy, it was presumed that the logic of strategy should begin with a "mission and vision" statement. A mission statement is a statement of what kind of business is the organization; and a vision statement is what kind of business the organization would like to become. However, this older kind of "strategic logic" is not really useful for an ongoing organization, unless the mission changes. What is useful in vision for an organization is foresight on change to the mission. The "vision thing" is: how should the mission change to take advantage of future market opportunities and meet future competitive threats? Strategic thinking is not about the mission of the business but *changes to the mission*.

Strategic Thinking

CEOs like Jack Welch become successful and famous because of their ability to think and act strategically. And because of the fundamental importance of strategy to long-term corporate survival, this ability to think strategically became recognized as an important leadership skill for executives. For example, one can often see specifications for the ability to strategize in common recruitment advertisements for executive positions, such as the following ad, which appeared in *The New York Times* in May 2000:

> **VICE PRESIDENT—GLOBAL SOURCING**
> . . . (X) Corporation, a publicly traded manufacturer of products . . . has an excellent opportunity in its Engineered Products headquarters office. . . . The successful candidate will have hands-on experience in sourcing components. The position will report to Group VP and be responsible for purchasing in (5) divisions. . . . The individual must thrive on multitasking, have outstanding negotiating skills, be a good manager of people and projects, and be a strategic thinker. Highly competitive compensation package. For confidential consideration, forward resume and salary requirements to. . . .

This is the fundamental management skill which we address in this book. What is a strategic thinker? How can hands-on experience improve a manager's ability to think strategically? Which practical techniques facilitate effective strategic planning in a large organization? What important strategic concepts used by successful leaders such as Sloan and Welch?

Change in a company environment always forces strategic redirection. Changes in automobile technology provided the strategic ground for Sloan's successful management of General Motors, and changes in services and medical technologies provided some of the impetus for Welch's successful strategic management of General Electric.

Information Technology

By the end of the twentieth century, progress in information technology (IT) had become the strongest and most pervasive force for strategic change in businesses throughout the world. One example of IT's impact was Thomas Middelhoff's strategic exhortation to his company in *2000* (he was then chief executive of Bertelsmann with corporate headquarters in a small German city and 78,000 employees around the world):

> We have to reach every brain to explain that we have nothing less than an industrial revolution. That makes it necessary to change how we see and run our business. That means speed is king. That means we have to be decentralized on the one hand and also more corporate. We have without any question a generational change at Bertelsmann.
>
> —Carvajal, 2000, p. 1

The growth of the Internet was a rapid phenomena. For example, in the United States, 14% of the population used the Internet in 1996, jumping to 22% in 1997, 31% in 1998, 38% in 1999, and 44% in 2000 (Elliott and Rutenberg, 2000). In 2000, the average monthly hours a user spent on line was 19 hours. U.S. consumer spending online had grown from a few million in 1996 to $3 billion dollars in 1997, $7 billion in 1998, $19 billion in 1999, and $36 billion in 2000. Of the $36 billion spent in 2000, $11.0 billion was for travel, $7.7 billion for PCs, $2.4 billion for clothes, $13.4 billion for books, and $13.4 billion for other merchandise. In October 2000, advertising revenues of the Internet in the U.S. totaled $600 million (with portals receiving $150 million of this, search engines $34 million, travel $7 million and local maps $25 million, business and finance $25 million, computing and technology $23 million, Incentive $22 million, shopping and auction $21 million, and news $19 million).

In business history, the decade of the 1990s will likely be called the decade of the Internet. Its innovation and rapid impact on business made it an interesting and challenging time—that brought to everyone's immediate attention the great importance of progress in information technology upon all business strategy. The dramatic experience of that decade was nicely summarized by Joseph Nocera and Time Carvell:

> The Internet decade has seen the unscrupulous rewarded, the dimwitted suckered, the ill-qualified enriched at a pace greater than at any other time in history. The Internet has been a gift to charlatans, hypemeisters, and merchants of vapor . . . and despite all that, it still changes everything.
>
> —(Nocera and Carvell, 2000, p. 137)

The Internet was an example of a larger class of phenomena in business history called *pervasive innovations.* William Abernathy and Kim Clark even introduced

a new term to strategic management—*transilience of innovation*—to emphasize the importance of a pervasiveness of an innovation upon the operations of a firm (Abernathy and Clark, 1985). *Transilience* means the ability to pass through a system, and it emphasizes the range of business impacts that a transilient innovation may have upon the value-adding capabilities of a firm, passing through its activities to make changes in

- The kinds of products and way the firm produces products (and/or services)
- The kinds of customers and markets the business serves

Abernathy and Clark classified the types of transilient innovation impacts upon a firm by the innovation's potential to alter either product/production or market/customer competencies:

1. In product/production competency, innovations may alter
   a. Product design
   b. Production systems
   c. Technical skills and knowledge base
   d. Materials and capital equipment
2. Under market/customer competency, innovations may alter
   a. Customer bases
   b. Customer applications
   c. Channels of distribution and service
   d. Customer knowledge and modes of communication

For any of these factors the impact of innovation may range from strengthening existing competencies to making existing competencies obsolete. Accordingly, Abernathy and Clark also classified innovations:

1. A technological innovation that conserved both existing production and market competencies was called a *regular innovation*.
2. A technological innovation that conserved existing production competency but altered market competency was called a *niche-creation innovation*.
3. A technological innovation that made an existing production competency obsolete but preserved existing market competency was called a *revolutionary innovation*.
4. A technological innovation that obsoleted both existing production and market competencies was called an *architectural innovation*.

The innovation of the Internet was an architectural innovation.

Historically, many firms have usually successfully exploited regular or niche-

creation innovations, for they sustain current operations. But many large firms have perished during revolutionary or architectural innovations. For example, Clayton Christensen (2000) examined reasons why large U.S. firms historically have often failed to profit from revolutionary or architectural innovations:

1. Resource dependence in large firms, influenced by investors and current customers.
2. The emergent markets of radical innovations are early-on perceived as too small for big firm growth needs.
3. The ultimate use of radical innovations are often not known early.
4. The performance and features of radical new innovations are often not attractive to current markets.

The architectural impact information technology made on business strategy was summarized by Bill Miller (2000), who spent a long career (at Intel) and argued that IT was:

1. Altering the competitive dynamics of both products and services, leading to the new importance of dominant designs and platforms in product/service strategy
2. Flattening organizational hierarchy or even dissolving boundaries into networked forms, such as "virtual enterprises"
3. Impacting management styles through introducing (at the same time) both a "transparency" of the business model to all levels of employees and making their jobs more complex, through the increased need for teaming and direct attention to the bottom-lines of business goals.

Information technologies could strategically impact businesses in different ways:

- A business can be *in the information technology business*, providing information technology goods and services (e.g., Hewlett-Packard)
- A business can *use information technology as a core technology* in its production of goods and delivery of services (e.g., Amazon)
- A business can *use information technology as a supporting technology* in its design of products/services (e.g., Ford Motor Company);
- A business can *use information technology as a marketing tool* to attract customers to its product/services (e.g., the CNN News Web page).

In this book, we will address this new challenge of IT to strategic management, using a strategy process in which information technology integrates with business strategy.

Strategic Management

Strategy, planning, budgeting, and knowledge are the four *forward-looking activities* of management, and it is important that they be clearly distinguished.

Budgeting is the allocation of resources for the future operations of an organization. Budgeting is neither planning nor strategy. All organizations budget, but they do not necessarily plan nor strategize. Organizations annually budget in order to allocate the resources for continuing operations. Thus the managers of all organizations do formulate budgets; but not all managers plan or formulate strategy.

Planning is thinking out of tactics for the continuing operations of an organization. Planning is not strategy but the implementation of strategy. Managers plan when the tactics of operations change from year to year. Organizations that need to annually plan are those with significant changes in tactics and operations from one year to the next.

Strategy is neither planning nor budgeting. Strategy is the perspective for long term change. Many organizations do not even begin to formulate strategy until an immediate emergency requires change; but by then, it may be too late to formulate effective strategy. Effective strategy requires looking out ahead, anticipating the need for change and preparing for it. A strategy is a *change in the direction* of the objectives of the operations over a course of years (such as the acquisition of new businesses or innovation of new product lines). Few organizations do strategy when external conditions, markets, and competition all are stable. Strategy is needed when external conditions change—change in technology, change in markets, change in competitors.

Knowledge is the basis for improving and controlling the future value-adding operations of a business enterprise. Progress in information technology provides new tools for managing the development of the knowledge assets of the business. Knowledge has been and continues to be the major force in strategic changes in business.

Thus in a modern theory of strategy:

- strategy is change in direction,
- planning is future tactics,
- budgeting is allocation of resources,
- strategic knowledge is future innovation.

CASE STUDY: Merger of AOL and Time Warner

The first historical case we will examine happened just as the twenty-first century began. It is important in illustrating the rapid advance of new forms of business practice due to progress in information technology. One of the new companies in what then was called the “new economy” took over an older and

larger business in the "old economy". The case illustrates how innovation that creates rapid market growth can be exceedingly highly valued by a stock market. In this case, the market valued the new markets being created by AOL over the older markets then being served by Time Warner.

The historical setting was when the then-new electronic commerce, or e-commerce, had spawned a whole new raft of companies and media industry. The booming U.S. stock market of that decade had priced most of these new companies exceedingly high. America Online (AOL) was one of these, providing service access to the Internet to subscribers. In January, it used its very high market value to merge with an older media company, Time Warner. The business community took this merger as the first sign that e-commerce companies were beginning to mature. For example, Richard Siklow and Catherine Yang of *Business Week* wrote:

> On the surface, it looked like just another awesome megadeal . . . America Online is the acquirer. The trading symbol for the new company, tellingly, is AOL. Given the realities of the New Economy, it could hardly be otherwise. By now, the pattern is clear: the digital will prevail over the analog, new media will grow faster than old, and the leaders of the Net economy will become the 21st century Establishment.
>
> —(Siklow and Yang 2000, p. 37)

On December 10, 1999, the market capitalization of America Online was about $250 billion dollars, whereas the market capitalization of Time Warner was about $85 billion (Loomis, 2000). The difference was in the stock markets multiplication of their relative price-to-earnings (P/E) ratios. In the last 12 months, AOL had earnings of about $1 billion, so that its P/E ratio was 250/1. Time Warner's earnings were about $1.3 billion, so that its P/E ratio was about 65 to 1. Thus AOL's P/E was being valued over Time Warner's P/E at a multiple of 250/65 (so that AOL stock was 3.8 times more valuable than Time Warner's stock, based on earnings). This was the heart of the deal. AOL's vast P/E ratio gave it the leverage to take over Time Warner, and Time Warner was willing to be acquired, hoping the resulting company would have a PE ratio more like AOL's than Time Warner's.

Even comparing the evaluation on the basis of EBITDA (per-share earnings before interest, taxes, depreciation, and amortization) Time Warner was trading at a multiple of 14; whereas AOL's EBITDA was trading at 55. Time Warner had a major debt load, which AOL did not have. Moreover, AOL was in a rapidly growing new market, e-commerce, into which Time Warner had tried to enter but failed.

Yet in terms of assets—valuable products and steady, proved earnings—Time Warner had a much larger asset base. For example, Time Warner had 73 million consumer subscriptions compared to AOL's 24 million. Time Warner product brands included:

1. *Time, People, Sports Illustrated, Fortune, Money* magazines
2. The cable companies of HBO, Cinemax, CNN, TNT,
3. The movie and music production companies of Warner Bros.

In contrast, America Online had AOL, Netscape Navigator, and stakes in several companies.

Time Warner brought to the merger a powerhouse of media content-producing companies, whereas America Online principally brought success in the new electronic businesses of the time. Barry Schuler, then president of AOL Interactive Services, characterized AOL's strengths: "We (AOL) are good at aggregating eyeballs and delivering services (on the Internet)" (Nocera, 2000, p. 68).

AOL purchased Time Warner for $183 billion, but with AOL having just one-fifth Time Warner's revenue and only 15% of its employees. Time Warner, an upstart in the 1920s, had become a major media establishment company by the 1990s.

The deal was to have AOL shareholders receive one share in the new company for current AOL shares, and for Time Warner shareholders to receive 1.5 shares for each of theirs. AOL shareholders ended up with 55% of the new company, and Time Warner shareholders with 45% of the new company. At the time, the Time Warner shareholders expected a market premium of 70% for their shares.

What were the strategies of the two CEOs of AOL and Time Warner in creating the merger?

Steven Case, founder and then CEO of AOL, had two major strategies. The first was to transmute AOL's high trading multiple of the booming market stock market of 1999 into assets and revenue stream, which would survive any drop in the high-tech companies valuation of that time:

> Time Warner stood out as the only company with the content, distribution, global reach and customers. Case wants it all: The branded content from Warner Music, Turner cable networks, and Time Inc. Magazines that can be digitized and sold online. The cable pipes to speed delivery of AOL. A global promotional platform that will save AOL a fortune in ad spending. Relationships with about 73 million subscribers to Time Warner cable systems, HBO, and Time Inc. Magazines. . . . Time Warner's old-fashioned media properties deliver a stable stream of revenues, about $27.1 billion in 1999, and cash flow, about $6 billion . . . that are shielded from the vagaries of the Internet world.
>
> —(Gunther, 2000, p. 74)

From a bottom-up kind of strategic perspective (business-up to the larger world), Case's strategic perspective on the cash-flows of Time-Warner's major

publication and television empire would provide AOL a steady and major source of income over the long term.

Also from a bottom-up strategic perspective, the acquisition of Time Warner's businesses would provide a step in the direction solving AOL's bandwidth problem. AOL had been providing Internet service of connection through existing copper telephone lines of customers—slow and technically limited to 54 Kbit modem connections. The market demand for Internet connections was broadband. Time Warner owned a major cable company that could provide a much faster broadband connection to its cable customers. Through the merger Time Warner gave AOL access to a market of 20 million cable customers.

The CEO of Time Warner before the merger was Gerald Levin. His strategic perspective for Time Warner also involved kinds of top-down and bottom-up perspectives of strategy.

From the top-down—looking out on the growing importance of the Internet and electronic commerce—Levin saw the need to continue moving Time Warner into the digital world:

> Levin can empathize (with Case's vision of the Internet world), as a cable and tech guy stuck atop a content giant. . . . Before Ted Turner dreamed up CNN, Levin made his reputation by putting HBO onto a satellite in 1975. He's also been burned by technology, notably when Time Warner spent upwards of $100 million on a prototype interactive TV network in Orlando. But his biggest tech bet, on the potential of two-way cable lines, paid off handsomely . . . Time Warner's stock a so-so performer for much of the 1990s, surged . . . during the period since Levin took over in 1993.
>
> —Gunther (2000, p. 74)

From the bottom-up perspective of Time Warner's recent business capabilities, Levin saw a strategic advantage for immediately merging Time Warner into one of the biggest successful players in electronic commerce. Levin's ventures for Time Warner into the Internet world had not been strategically successful:

> But Levin's hard-won reputation as a tech-savvy executive has faded since then. He passed up the opportunity to buy a portal like Lycos or Excite, and Time Warner's own Internet hub, called Pathfinder, flopped. . . . So when Case called to offer him the chance to be CEO of AOL Time Warner—the biggest game in cyberspace and media!—why, how could Levin resist?
>
> —Gunther (2000, p. 74)

In July 2000, shareholders of both companies approved the merger, but its success was still not certain. As Gretchen Morgenson, of *The New York Times* commented:

> For months, if not years, the virtual has trounced the real in the stock market valuations of Internet concerns vastly exceed the values that investors assigned to companies unlucky enough to own tangible assets . . . Last week . . . the tables turned . . . and investors are about to experience the Great Internet Shakeout . . . A big indication that the tectonic plates of the virtual world were shifting was the bid of the high flying America Online to acquire the landlocked Time Warner . . . 'If calendar 1999 was one of discovery of the internet, 2000 is going to be characterized by much more rigorous scrutiny of the business models . . . ' "
>
> —Morgenson (2000, p. 1)

Before the stock market bubble of dot.com burst, Case had transformed equity of AOL into more equity by acquiring Time Warner.

Case Analysis

In this case, we see two important theoretical ideas about strategy. The first is the importance of information strategy to business strategy. Both AOL and Timer Warner were in the businesses of information. AOL was in the business of being an information channel provider as an Internet service provider. Time Warner was both in the business of providing information channels (television, movies, and magazines) and creating information content in these channels. Progress in information technology was bringing both firms into similar business strategies—channels and content.

The second idea about strategy is how strategy was formulated by both ÇEOs, using two kinds of perspectives on their company's future—a top-down perspective from the big picture of the Internet innovation and from a bottom-up perspective of the little picture of the companies' businesses future operations. Strategic thinking by both CEO's required two kinds of views on the future: (1) a perspective on changes in the *larger* environment of the business and (2) a perspective on future business operations about their *current* strengths and weaknesses to changes in operations for *future* strengths.

TOP-DOWN AND BOTTOM-UP PERSPECTIVE

Let us first examine the idea that there are two basic perspectives in strategic thinking—strategic views from the top of the organization and strategic views from the bottom. As illustrated in Figure 1.1, these different perspectives create different views and even different kinds of logics in stratregic thinking:

- A big-picture view with a logic of proceeding from the general to the specific changes of the future

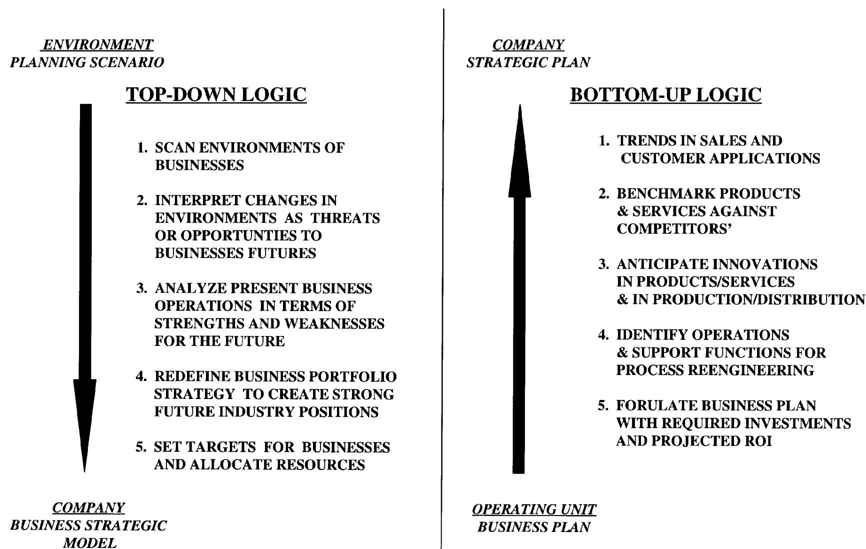

FIGURE 1.1 PERSPECTIVES ON STRATEGIC LOGIC

- An operational-reality view with a logic of proceeding from the specific to the general changes of the future

In the logic of strategic thinking, one can always look to the future by describing the big picture of everything and then deducing how changes there can impact upon the particular situation of one's own future action. For example, in this way one can see oneself as a member of a general economic class, cultural class, or generation and ask how one's particular life is impacted by trends and changes happening to these general categories of people and life. This is the deductive approach to strategy—going from the general trends to the particular descriptions of future life.

Also and conversely in the logic of strategic thinking, one can always look at changes in the particular situation of one's future and then generalize that similar changes are happening to others like oneself. For example, in this way one can generalize changes in one's own life as an exemplar of the kinds of general categories of other people and lives. This is the inductive approach to strategy—going from the particular examples to the general descriptions of future life.

At the top of an organization, information to see the big picture is more readily available there than at the bottom of an organization. Conversely, at the bottom of an organization, information to see the reality of operations is more readily available there than at the top of the organization.

A famous and bitter example of these differences in information between the

big-picture-of-the-world and the reality-of-operations was the difference in perspective between the generals and the soldiers in the First World War in Europe in the early twentieth century. From 1914 to 1918, the war stagnated into trench warfare, with the generals on both sides planning one more great battle to win the war. Each battle resulted in thousands of deaths with no substantial gain in territory or weakening of the ability of the other army to fight. The view from the general's perspective was the massing of artillery and soldiers for an attack. But the view from the soldier's perspective was that the new machine gun and artillery made every attack impossible to win, resulting only in the slaughter of the attackers. From the big picture, the view of the war was simply the massing of the attack forces. But from the reality of the trenches, the view of the war was simply devastation and destruction under the sustained and withering fire of machine guns, which would finally halt all attacks. After four years of trench war, both the German/Austrian armies and the British/French armies were too exhausted to win, and a new fresh army of Americans was brought into battle to finish the war. But throughout that war, the perspective of the generals in all armies was that the failure of their massed attacks was due to lack of spirit in their soldiers.

Not only is the experiential base of the two perspectives of top-down and bottom-up different, so too are the logics appropriate to top-down and bottom-up strategy. Figure 1.1 also summarizes the differences as deductive and inductive kinds of logic of the two perspectives.

The top-down perspective of strategy uses a deductive logic that begins with the great and goes down toward the small. In formulating strategy, top leadership should look around at the environments of the firm and its businesses to:

1. Scan the environments of a firm to identify major future trends and changes in government, the economy, territorial markets and competitors, and in the scientific and technological culture.
2. Interpret the changes as threats and opportunities to the businesses of the firm.
3. Analyze the present firm's activities in terms of strengths and weaknesses to face such threats or seize such opportunities.
4. Redefine the missions of the firm's businesses to match the future operations to future threats and opportunities.
5. Set goals and targets for businesses to meet in a proper time horizon.

In contrast, at the operating levels of businesses in a firm, managers should look to the strategic immediacy of the business's markets, competitors, operations, and knowledge:

1. Examine the trends in sales in the markets of the businesses of the firm and identify innovations that can alter these markets.

2. Benchmark a firm's products and processes against competitors' products and processes and identify changes needed to maintain or surpass any competitor's current advantages.
3. Investigate progress in information technology and in the knowledge bases of the business's product and production processes.
4. Reexamine current operations and control, and identify innovations in operations and control of operations needed to adapt to changes in market, competition, and new information and knowledge capabilities.
5. Formulate a business plan, with targets for market-share and profits along with required investments and resources needed to achieve the plan.

These different perspectives of the big-picture and trench-reality are both vital to a good strategy process. Therefore, what is critical to good strategy formulation is the *interaction of these perspectives.* Now, although the top-down and bottom-up perspectives in strategic thinking are important to formulating good strategy, coordinating them is extremely difficult to pull off in a large organization because of the hierarchy of authority.

In large organizations, these perspectives become quite different because of the hierarchical nature of authority. For example in a diversified firm, there are usually at least four levels of management hierarchy:

1. Firm level: board, CEO and firm executive team
2. Business level: president and business executive team
3. Department level: department head and staff
4. Office level: office manager and assistant

The hierarchical levels of authority in a firm usually begin at the top of the firm level with a board of directors and a chief executive officer (CEO). The CEO and his or her executive team are responsible for the strategy of the whole firm. This strategy includes what businesses are and should be within the firm and the overall financial performance of the firm. The planning scenario needed at this level should include anticipation of change in all the industries of the firm's businesses. The bottom-up input to the firm's strategy should be provided by the participation of the business's presidents to the CEO in the strategy process.

At the next organizational level, below that of the firm, is the business unit, and its president is responsible for strategy for the business as a whole. Part of the business's planning scenario is the industrial context of the firm (economy and government) as well as the territories and cultures in the markets to which the business sells. Another part of its planning scenario are goals and targets specified for it by the firm-level strategy, the strategic firm model. The outcome

of strategic planning for the business will be a strategic business model specifying changes for its future policies.

The final two levels within a company, department and office, are levels in which managers should provide bottom-up information to the business level in formulating the strategic business model. Policies of this model then provide the guidance for planning and improving operations and activities of the departments and offices.

Since it is organizationally natural for the bottom of the organization to listen more closely to the top than for the top to listen to the bottom, two kinds of misunderstandings are common in strategic thinking in large organizations:

- *The managers of operating units frequently do not think that the top executives understand the strategic problems and challenges in operations.*
- *The top executives frequently do not believe the operating units are trying hard enough to implement the strategic goals they formulate.*

This is the first challenge of strategic thinking in large organizations, to encourage real and accurate communication of strategic perspectives between the top and the bottom.

Therefore, in a good strategy process, one needs to formalize these two perspectives as two views of a firm's totalities, those of the environments of the firm and those of the operations of the firm. The top-to-down perspective looks at the big picture and formulates strategic policies for long-term direction. The bottom-to-top perspective looks at the specific nuts and bolts of the company's operations to try to carry out the desirable long-term direction.

> *The critical problem in the strategy process of any organization is to facilitate a positive, constructive, and creative interaction between the two perspectives in strategic thinking.*

Moreover, this problem is exacerbated by the periodic and noncontinuous requirements of strategic thinking. The actual process of formulating strategy is infrequent but recurrent, exploratory and interactive with the different experiential bases of the top management and of lower management levels. While the results of strategic planning may look as if created by a linear process (either linear in a top-down deductive logic or linear in a bottom-up inductive logic), the strategic process is nonlinear and recursive and interactive with different experiential bases of the company top and bottom.

For example, Arthur A. Thompson and A. J. Strickland nicely summarized the recurrent nature of the strategy process:

> The march of external and internal events guarantees that a company's vision, objectives, strategy, and implementation approaches will have to be revisited, recon-

> sidered, and eventually revised. This is why the task of evaluating performance and initiating corrective adjustments is both the end and the beginning of the strategic management *cycle.*
>
> —Thompson and Strickland (1998, p. 16)

Since the strategic management process is interactive and cyclic, the information flow must be recurrently both bottom-up and top-down between the views of the environment and the business. The cyclic nature of strategic planning is also coupled into the budget cyclic of any business, going from yearly planning to yearly planning.

Furthermore, in a multibusiness firm, there are two kinds of the top-down and bottom-up perspectives:

- firm-to-business perspectives
- businesses-to-business divisions perspectives

This makes the top-down and bottom-up communications in a multibusiness firm even more challenging than in a single business firm.

Using an interactive approach to the strategy process is important in the practice of strategic management because the principle cause of failure in the strategy of large organizations has often been due to a lack of proper internal interaction between the two strategic perspectives:

- Inadequate top-down perspective of innovative changes in environments
- Inadequate bottom-up perspectives of the need for new business models for innovative change
- Inadequate communication between executive levels and operational levels about needed strategic change

How can leadership in a large organization avoid these common kinds of mistakes in strategy processes? Good interactions between the strategic perspectives from the top and from the bottom are necessary to create a potentially profitable vision of the future—a strategic vision of the challenges, opportunities, and direction of the future business and how operations need to change to succeed in that future.

The planning process in a large organization can use two kinds of strategic techniques to assist this:

1. A strategic technique for effectively summarizing the changes in the environment's future (i.e., the "big picture") is called a "planning scenario."
2. A strategic technique for effectively summarizing the desirable changes in operations for such a future environment is called a "strategic business model."

CASE STUDY: Rakuten

We next look at a case that illustrates the importance of both an environmental scenario and a business model in strategic planning. Change in business environments has always created opportunities and threats. As noted in the case of AOL, the rise of electronic commerce in the 1990s affected many businesses, not just in the United States but all over the world. A striking example in Japan was a new retail e-commerce web site for Rakuten. This site began impacting retail business in Japan through new electronic marketing via the Internet. Oda-San Mikitani founded Rakuten in 1997 as an electronic marketplace:

> . . . www.rakuten.co.jp draws about 95 million hits a month as a gateway to about 2,800 merchants around the country selling everything from eggs to kimonos. “I want Rakuten to be the best place to sell anything,” said Mr. Kikitani. . . . “The marketplace is what we focus on, the exchange between buyers and sellers, while most others focus on being a shop or a collection of shops.”
>
> —(Strom, 2000, p. 32)

Mikitani graduated from Hitotsubashi University in Tokyo and was then employed as a banker at the Industrial Bank of Japan. In 1991, he took a leave to matriculate in the Harvard Business School for an MBA.

> “Before I went to busiess school, I thought my choices were to either work my way up Japanese style to become a director of the bank, or to go into investment banking at a Western firm and make a lot of money,” Mr. Mikitani said. But he opted for a third approach, striking out on his own to become a consultant, which led to his foray into e-commerce.
>
> —(Strom, 2000, p. 32)

At first, Mikitani thought of selling educational services or financial advisory services but saw no economies of scale in these ventures He then hit upon the idea of creating an electronic marketplace for merchants. His inspiration (and the source of the name for the site) came from a famous historical event in Japan from the 1600s. A warlord named Nobunaga Oda changed marketplaces in Japan by taking away control of the market from feudal trade associations and opening trading to all merchants for a small fee. This open market idea was so important in medieval Japan that Oda’s city became a dominant commercial center, and this policy was called “rakuichi torakuza” (free markets and free guilds).

Hiroshi Mikitani used this idea in his business model for his web site. He charged merchants about $469 dollars a month (50,000 yen) to link their web sites to Rakuten, so that visitors to Rakuten can find their way to merchant web sites. Some vendors sell their stale inventory on the Rakuten site to avoid

undercutting regular sales, and others are avoiding the several layers in a distribution system. Mikitani's strategy considered that Japan might even be a better market for e-commerce than in the United States—since the traditional Japanese retail situation had many layers in the distribution system contributing to high prices. Rakuten provides a way for merchants to avoid layers of middlemen in the traditional distribution system in Japan:

> For example, if you buy an obi, the sash worn with a kimono, at the retailer Kyoto Kimono Ichiba, it will cost 138,000 yen, or about $1,300. Buy it from Kyoto Kimono's shop on Rakuten, and it costs 13,800 yen, or an affordable $130.
>
> —(Strom, 2000, p. 32)

Rakuten also provided a venue for community dicussion, whose customers can chat online about vendors and also participate in online auctions. Mikitani had foreseen the Internet has having an extraordinary impact upon business in Japan and thought it would restructure the Japanese economic system. With Japan's relatively homogeneous population, relatively flat distribution of wealth and strong sense of community, Mikitani saw important strengths in the Internet: "Japanese people like to communicate with each other, and it's much easier to do that on the Net." (Strom 2000, p. 32)

This perception of the cultural importance of communication in Japan's use of the Internet was also shared by Jiro Kokuryo, a professor in the study of information technology and systems at Keio University's business school in Yokohama who commented that e-commerce had a great aspect of social communication in Japan (Strom, 2000, p. 32).

Mikitani had designed Rakuten to be profitable from the beginning, and in 1999, it earned $1 million (dollars) on sales of $5.5 million. This provided a 17% percent profit margin which then was extraordinary in e-commerce at the time.

Mikitani wished to avoid the investments and costs of holding product inventory and of distribution and devised his business model to let retailers sell directly, using his service. Rakutan sold the use of its site and servers to retailers, with 80% of its revenues from monthly membership fees of merchants. An additional 10% came from their advertising on Rakuten, and an additional 10% from auctions. In adding service value to Rakutan's customers, he monitors the shops using the site; and if he sees any shady business practices, he asks those retailers to leave.

It was in the year 2000 that Rakuten successfully went public and gave Mikitani fame, becoming a celebrity, who then was being consulted by government officials and politicians about e-commerce.

Case Analysis

We see in this case how a good business model is important for profitably seizing and exploiting new business opportunities when major innovations change the environments of business. Planning scenarios are a formal technique for anticipating major changes in the world; and strategic business models are ways to profitably exploit such changes.

PLANNING SCENARIOS AND STRATEGIC BUSINESS MODELS

It is always important to strategically think about the big picture of changes in the environments of business (e.g., the Internet). It is equally important to strategically think about the smaller picture of how a particular business (e.g., Rakutan) can exploit the business opportunities in that change.

For strategic thinking in a large organization, we need to consider what kinds of techniques can formally assist groups of managers reach to consensus about what is important: (1) about changes of the future and (2) their implications for future operations. To help a group to strategically think about the big picture, the technique of the planning scenario is effective. To help a group strategically think about operational realities of the future, the technique of a strategic business model is effective. These two techniques can help a large organization describe the two key totalities of strategic thinking—future environments of the company and the future company itself.

Planning Scenario

Strategic thinking needs to grasp the big picture of changes in the environments of a company. For example two of the CEOs *Worth* interviewed in 2000, Raymond Gilmartin CEO of Merck and Koichi Nishimura CEO of Solectron, commented:

> *Gilmartin:* Part of leadership is saying in touch with what's going on outside your company. . . . You need to gather information to see the patterns, to tell if you're on the wrong track, to take risks and make decisions that go against the grain.
>
> *Nishimura:* Getting it right comes from pattern recognition. You integrate information and you go "humm."
>
> —*Worth* (2000, p. 183)

Gathering information and constructing patterns of trends and changes in the environments of business is the purpose of scenario planning in the strategy pro-

cess. To systematically gather information and create insightful "humm patterns," the *strategy technique of scenario narrative* is very useful.

All strategy is based upon assumptions about the future and its business opportunities and challenges. A modern technique for exploring and expressing these pictures of the future is called a *scenario*, and when used for planning, a *planning scenario*. Scenario planning uses scenario narratives and societal models. Scenario narratives provide a method for describing and thinking about the possible impacts of the future upon a current business.

Strategic stories envision adventures of the business in the future. The future will be an adventure that will challenge business. Experience is always of the present, with memories and stories of the past. The future consists of anticipations and/or surprises and plans for the future conceived in the present. All existence is always in the present.

> *In the mind only exists intelligent perception of the past and imagination of the future.*

As we saw in the case of Rakuten, the major changes in the environments of a business are changes in structures of the society in which the business operates. To build a planning scenario that captures this kind of complexity and completeness of possible future change, one needs to use a general classification of all the societal environments of a business. In all human societies, traditional or modern, there have been general classes of social patterns that create societal structures. These include categories of territory, culture, economy, government. Planning scenarios should address issues of change in the large patterns of society, such as:

- Will there be changes in how the control of territory is decided in the future (e.g., the break-up of the country of Yugoslavia in the 1990s)?
- Will there be changes in the culture of the nation (e.g., changes in science, demographics, etc.)?
- Will there be changes in the economy of the nation, world (e.g., business cycles, innovation of new technologies, etc.)?
- Will there be changes in government of a nation (e.g., changes in taxes, government regulations, etc.)?

Strategic Business Model

Strategic thinking also needs to think about what kind of business model can meet the challenges and exploit the future opportunities in the environments of the company. So the second strategic totality to be considered in the planning process is the future of the business (or businesses) of the corporation. The strategic

technique effective for this is a model of how one's company now operates but should change in the future, a strategic business model. Strategic models of the business of a corporate summarize the future policies of the company which will prepare it to perform in the future.

The strategic importance of the concept of a 'business model' was nicely expressed by Geoffrey Colvin, commenting on the troubles Xerox was having in 2000:

> "The quote of the year for 2000 comes from Xerox CEO Paul Allaire . . . He gets the Distinguished Service Cross for extraordinary executive heroism because he told analysts in a conference call, 'We have an unsustainable business model.' In the past CEOs of big, established companies didn't say things like that. They didn't tell the people who rate their stock that the way they make money doesn't work anymore . . . The largest fact of life in business today is that virtually every company . . . has to change its business model to make it sustainable in the Internet worked, infotech-based world."
>
> —(Colvin, 2001, p 54).

A business model is an abstraction of a business identifying how that business makes money. Business models are abstracted about how inputs to an organization are transformed to value-adding outputs. As we will later review in the third chapter, all models of organizations are models of kinds of open systems (Betz, 1968). One important version of this was the now famous value-added model of Michael Porter (Porter, 1981). As a value-adding open-system model, an organization is described as taking resources from its environment and transforming them to value-added outputs sold back into its market environment. The transformation of input resources into output products/services is performed by the processes and operations of the business. The Porter model is only one of several kinds of business models, one can use in strategic planning (and which we will cover in the third chapter).

A strategic business model abstracts the basic value-adding transformation that describes how a business makes its money.

Strategic thinking about how a business now makes money and how it must change to continue making money is the 'bottom-line' for strategic management. For example, in thinking about the future capabilities of an organization, Clayton Christensen and Michael Overdorf emphasized the need to consider resources, processes, and values in an existing organization compared to the challenge of needed change (Christensen and Overdorf, 2000). The resources of a business consist of tangible resources (e.g., personnel, equipment, facilities, cash flows, location, etc.) and intangible resources (e.g., design capability, brand names, relationships to customers and suppliers, etc.). The processes of a business consist

of the activities and procedures with which a business procures resources, adds value, and produces and sells products and services. Thus dealing with change also requires determining what changes in processes and procedures are necessary to produce new kinds of value and/or address the needs of new kinds of customers. The value dimension of an organization (sometimes called "corporate values") are the standards by which management and other employees set priorities and judge the importance of activities and results. Values are standards about how resources are used and how processes are run, as Christensen and Overdorf comment:

> An organization's values [are] the standards by which employees set priorities. . . . A company's values reflect its cost structure or its business model because they define the rules its employees must follow for the company to prosper.
>
> —Christensen and Overdorf (2000, p. 69).

A strategic business model is a systematic list of the policies that will guide the future specification of inputs, outputs, processes and values of the complete operations of the business of the corporation.

The importance of conceiving of a good business model was emphasized by the experience of the many new companies (dot.coms) begun in the Internet growth years of 1996–2000. Then hundreds of these dot.coms were begun with extensive venture capital funding, and many without having a viable business model. Next in the year 2000, over 125 of these companies folded as they ran out of capital and had not yet become profitable (and found new financing difficult to achieve). The often repeated moral then was that a good business model was necessary for profitability and survival.

Strategic business models need to be constructed around strategic issues of change in markets and innovation, competition and structure, operations and control, information and knowledge, asking strategic questions such as:

- What are likely to be the changes in the *markets* that a business will serve and *innovations* that will impact these markets?
- What are likely to be changes in *competition* against which a business will compete and in the structure of the industrial sectors in which competition occurs?
- What is likely to be the progress in *information* technologies that a business can strategically exploit and how can this improve the *knowledge* assets of a business?
- What must be the changes in *operations* and *control* of business processes that the business needs to implement to be efficient and effective in its future value-adding processes?

CASE STUDY: Barnes and Noble Faces Amazon.Com

In a strategic planning process, after a planning scenario and a strategic business model have been constructed in the interactions of the top-down and bottom-up perspective, the next requirement of strategic thinking in a large organization is to create a strategic vision for the future. A strategic vision provides the *direction* for the organization to pursue *prosperity* under the conditions of *change*. A good example of this was Steve Bezos's vision of Amazon in the mid-1990s.

As we saw in the case of the rise of AOL in the time of the innovation of e-commerce in the 1990s, many entrepreneurs created new business visions from the opportunities in the big picture of the Internet and from changing the operational realities of traditional businesses. Bezos' vision was to replace traditional operations in book retail with new kinds of operations through the Internet.

Now, for strategic thinking, the importance of imaginative, creative, and correct vision cannot be overstated. Yet vision remains the most perplexing principle in strategic management. Successful new visions can blindside and totally frustrate competitors. And this was well illustrated by the impact of Amazon.com upon a then-dominant competitor, Barnes and Noble in the late 1990s.

Leonard Riggio was CEO of Barnes and Noble and had grown the nationwide book retailer as a traditional bricks-and-mortar retailer:

> December 16, 1998, was not a good day for Leonard Riggio. . . . Sitting in his cramped windowless conference room at Barnes and Noble's headquarters in lower Manhattan, Riggio just picked at his lunch . . . and shook his head in disbelief. Amazon, an upstart with sales of $600 million and losses that grow bigger every year was now worth seven times more than Barnes and Noble Inc, a chain of 1,000 bookstores with sales of $3 billion."
>
> —(Munk, 1999, p. 50)

Riggio was reacting to a stock announcement that Amazon.com stock had risen from $150 a share to $400 a share. By the end of the day 17 million shares of Amazon changed hands. When the market closed the value of Amazon.com had increased by 20 percent to $15 billion. The value of the stock held by founder of Amazon's, Jeff Bezos, was worth $5.7 billion, $914 million more than 24 hours earlier.

For thirty-five years, Reggio had been selling books (compared to the roughly five years Bezos had begun selling books through the Internet), and Reggio was disturbed: "I am sitting here, hammering away day after day, to come up with new ideas for my stores, and then, in an instant with just a single press release, Jeff Bezos is worth another $1 billion." (Munk, 1999, p. 50)

Riggio had begun selling books as a college student, while attending night

school at New York University. During the days, he worked as a clerk at the NYU bookstore. Deciding the could do a better job than the university bookstore, he dropped out of college in 1965 and started the Student Book Exchange) (SBX), near the NYU bookstore. In six years, he had expanded to five campus bookstores in New York City. Next he bought Barnes and Noble, (an unprofitable seller of textbooks on Fifth Avenue at 18th Street). Riggio was 30 years old and ready to innovate. He loaded tables in Barnes and Noble with remaindered books. He installed wood benches for people to sit on and peruse books. He gave away free copies of *The New York Times Book Review*. He adopted techniques to book selling from other mass merchants, using aggressive advertising: “If you paid full price, you didn’t get it at Barnes & Noble.”

Next, in 1986, using junk bonds for financing, he bought a chain of 37 bookstores, 142 college stores, and B. Dalton, a chain of 800 bookstores. Suddenly. Barnes and Noble was the biggest bookseller in the country. His next strategy was to put bookstores in shopping malls. He continued to expand, buying small bookstore chains, one after another (e.g., Scribner’s, Bookstop, and Doubleday Book Stores).

In the early 1990s, he changed strategy again, abandoning his mall-based strategy to build book “superstores.” Barnes and Noble’s super book stores were conceived as places to gather and spend time. They featured comfortable chairs, served Starbucks coffee, and stayed open until 11 P.M. In addition, he began building a big brand name, using celebrity authors and selling designer shopping bags, bookmarks, and advertisements with illustrations of Ernest Hemingway and Virginia Woolf. Although the idea of the superstore was not original (Borders was the first to build gigantic stores) Riggio moved faster and more nimbly.

So just a year earlier—in 1998—Lenny Riggio had been dominant. Riggio was 58, and until then he had been the most important player in the book retailing industry. In the United States, Barnes and Noble had the most bookstores and a bigger market share than any competitor, and it was profitable. In July 1998 Barnes and Nobles stock price hit $48 dollars, a 220 percent increase over the prior 18 months.

Suddenly, Riggio found he had a new competitor to battle—Jeff Bezos—just as times were again changing and new business strategies emerging. For example, Suzanne Zak, then head of a money management group called Zak Capital (and a large Barnes and Noble shareholder) attended a meeting for analysts and money managers on July 24, 1988, hosted by Amazon. “Initially, like a lot of people, we were skeptical of Amazon,” she explained. “But at that meeting, listening to Bezos a light bulb went off. I said ‘We’re going to have a problem here.’ ” (Munk, 1999, p. 51)

Zak sold all 400,000 of her Barnes and Noble shares. Others also reduced

their holdings, and Barnes and Noble's stock tumbled from $48 to the mid-20s.

The Internet had provided a strategic competitive advantage in retailing. Riggio needed to join the e-commerce strategy to try to catch up. He launched barnesandnoble.com, which in 1998 brought in just 320,000 new customers while Amazon.com added millions. In 1999, Barnes and Noble's share of the U.S. book retail market was 15 percent, while Amazon's was just 2%. Amazon.com had 8.4 million registered customers and sold 75 percent of all books ordered online, while barnesandnoble.com had only 1.7 million, selling 15 percent online. The only problem was that Amazon was not yet profitable.

Case Analysis

This case illustrates the dramatic change that the Internet began to make upon businesses in the middle of the 1990s and also illustrates the importance of strategic vision. The business model of a whole retail sector needed to be rethought in terms of the Internet. Operations had to be changed and improved to take advantage of new opportunities and to meet the challenges of competitors who leap to the challenge.

In this case, the innovation of the Internet created the challenges of change to Barnes and Noble and provided the opportunities to Amazon. Strategy is about change over the long term. When Reggio entered the book retailing business in college textbooks, he saw the opportunities, in the short term, of providing better service and lower prices than the college bookstores. He expanded by perceiving opportunities in long term change in retailing books through expansion into shopping malls and super bookstores. However, Riggio did not at first see the long-term opportunity in the Internet. Accordingly, competition in book retailing was dramatically altered by Bezos's business start-up.

Change is always possible. *Even in a well-established industry, strategic repositioning can and often does occur—over time.* Riggio saw the opportunity to provide better textbook service than the existing NYU bookstore and eventually established a chain of textbook sellers on many campuses. He next saw an opportunity in trade book retailing to discount retail prices and entered that market. There Riggio saw opportunities to build large book retailing chains and position them in shopping malls with high customer traffic. He also saw the opportunity to use the junk bond financing of the 1980s to build a national chain. Next he saw the opportunity of refashioning book retailing into superstores as places to gather and spend time.

No business strategy is forever. This case shows that even as Riggio was attaining a major success in restructuring in the book retail industry, a new business opportunity occurred in the Internet, and it was aggressively exploited by a his competitor Jeff Bezos.

New competitive advantage can occur from different sources. Riggio saw strategic opportunities in the traditional practices of book retailing, such as small inventories, large price margins, central city locations. Bezos saw strategic opportunities in new information technologies, the Internet, and retailing without the bricks-and-mortar store. Visions of change and opportunity are fundamental to strategy.

STRATEGIC VISION

In a large organization, strategic vision needs to arise from (1) strategic thinking exercises of constructing planning scenarios of the future environments of the company and (2) a strategic business model of the company's business(es). The reason this is so important in a large organization is that the experiences of being at the top and at the bottom are so different that both top and bottom perspectives are severely limited. From the top, it is really hard to see the real problems in the trenches; and from the experiences at the bottom, it is equally hard to see the pressures of control on the organization.

A good strategic vision (created from a top-down perspective and properly informed by a bottom-up perspective) is essential in strategic planning because strategic change cannot occur without top leadership's having a vision of and a commitment to change. The relationship of leadership to strategic vision and change is critical in the strategy process:

1. Strategic vision is the fundamental responsibility of leadership since only top management has the authority to make major changes in operating organizations.
2. Strategic change is only periodically necessary; but to be effective such change must be envisioned, anticipated, and planned.
3. Sources for strategic vision are either external in the environments of the organization or internal as opportunities developed within the organization.

For example, *Worth* magazine interviews with some successful CEOs in 2000 also showed their concern with the importance of providing visionary leadership, such as in comments by Koici Nishimura of Solectron and Raymond Gilmartin of Merck and by Eric Schmidt of Novell:

Nishimura: When you are leading a company, you have to figure out, conceptually, what you are trying to do. Once you have decide that, and you think it's okay, the second thing you have to figure out is: What tactics are you going to use . . . ? You continually have to ask: Are the assumptions I

made still good? My job is to continually reassess the assumptions or the foundation that the company is built on.

Gimartin: You need to have a vision that is the anchor point for what you're doing. . . . There needs to be some form of overarching statement that makes sense and on which the ECO stakes his or her job.

Schmidt: Leadership is defined about perception, not just reality. So there's always this tension in leadership to overhype. And to make promises that you can't keep and articulate things that can't happen. . . . You want to do some level of overselling, but the problem is that the people you're communicating to are smart. If they think you're a snake-oil salesman, then your whole credibility goes to zero. So leadership is also defined by credibility.

—Worth (2000, pp. 184–186)

A strategic vision summarizes the need and purposes for strategic change

Why leadership in large organizations often fails to envision and prepare for change arises from the nature of leadership in large organizations. In large organizations, leaders are usually selected as those who are committed to doing more of the same. Managers often rise to leadership because they embody a vision of the organization's past.

The vision of the past represented a tested story of success. Past leadership built organizational structures and culture that evolved into a successful company. Later when the business environment changes, the earlier structures and cultures and leadership became ineffectual in the new conditions.

Yet despite the tendency for management not to make changes, still the need for long-term change is indigenous in organizations because organizations have little control over change in their environments—and thus they may be forced by competition to change or die.

Many students of strategy and organization have argued that instability is a periodic experience for all organizations. For example, Michael Tushman and Elaine Romanelli argued that organizations experience periods of relative stability interrupted by sharp strategic reorientations (Tushman and Romanelli, 1985). They and others, (e.g., Norman, 1977; Miller and Friesen, 1984), have seen organizational change as a kind of evolution, stimulated by responding to change in business and economic structures.

Michael Tushman and Elaine Romanelli with Beverly Virany nicely summarized the connection between strategic vision, environmental (structural) change and organizational decline:

At least part of the reason for substantial organization decline in the face of environmental change lies with the executive team. A set of executives who have been

> historically successful may become complacent with existing systems and/or be less vigilant to environmental changes. Or, even if an executive team registers external threat, they may not have the energy and/or competence to effectively deal with fundamentally different competitive conditions. The importance of an effective executive team is accentuated in industries where the rate of change in underlying technologies is substantial.
>
> —(Tushman et al., 1985, p. 298)

Also students of innovation have documented that a major source of changes in the business environment and within the economic structure consists of applied knowledge discontinuities, which Tushman called "technology discontinuities" (Tushman et al., 1985) and later Clayton Christensen called "disruptive change" (Christensen, 2000). Progress in information technology has created many disruptive changes.

As an example, Tushman and his colleagues looked at the mini computer industry, focusing on fifty-nine firms started between 1967 and 1971. They compared firm records of success and failure over a subsequent 14-year period. In their analysis of the reasons some firms survived and many failed, they argued that one must understand how the *conduct* of the firm in the *context* of the changing economic structure affected the *performance* of the firm.

The conduct of firms consists of the strategic, tactical and organizational activities guided by the executive team (chief operating officer (COO) and other principal executive officers). Conduct must alter as the context of the firm changes when alterations in the economic structure affect competition. Changes can arise from:

1. Technological changes
2. Market changes
3. Resource changes
4. Regulation changes
5. Competitive changes

Successful leadership performance depends upon the executive team's ability to envision, anticipate a correct future and formulate a correct strategy and organization for the future operations of the business. Such vision, strategy and organization correctly anticipates technological opportunities for new products, market changes for new needs and applications, resource changes that affect the availability and cost of materials and energy, and changes in government regulations that affect safety, monopolies, taxes, and so on.

When industries faced changes, Tushman et al. found that those firms whose executive teams lacked vision and made no changes in strategy and organization and product failed after the change occurred. Even those firms with correct vision

but whose executives constantly made changes in strategy, organization, and product failed.

The firms that survived and prospered through a competitive discontinuity, a disruptive change, were those whose executive teams:

1. Envision and correctly anticipate the discontinuity and prepare for it with appropriate product strategy and reorganization
2. After making the appropriate strategic change, hold a steady course to produce proper products/services with quality and low costs

It is particularly difficult for a company to formulate a new product strategy when it hits a competitive discontinuity generated by new applied knowledge. The principal reasons in the difficulty of formulating a new product strategy in a competitive discontinuity are:

1. The technical uncertainties of a new applied knowledge vision
2. The differing perspectives among the different product-group managers and the technical staff about that vision

For a company to develop a new next-generation product-line strategy, the whole company must fight out different visions about the product plans in a new applied knowledge situation. To formulate a next-generation product plan for an applied-knowledge competitive-discontinuity, it is necessary for a high-level executive to envision and force the strategic issue and to organize the effort necessary to formulate and implement a new strategy for the whole company.

Competitive discontinuities are a common problem for a firm initially successful in a radically new industry because applied knowledge in the industry continues to progress for a time. The reason for the crisis is that competitive discontinuities due to rapid progress in applied knowledge force not only changes in product strategy but changes in business strategy to exploit the changing market. This is why competitive discontinuities are strategically challenging. And this is why *strategic vision* that foresees discontinuities and *strategic planning* that prepares for discontinuities are the key challenges of strategic thinking.

CASE STUDY: Hewlett-Packard's Strategy Challenges

A good example of the challenge of strategic planning occurred in Hewlett-Packard when the twenty-first century began. The Internet and growing importance of e-commerce had created competitive discontinuities to most existing businesses, including HP's businesses. The strategic challenge to business leadership of existing large firms (as also earlier seen in the case of Time Warner's merger with AOL) was reformulating strategy to survive and prosper upon the discontinuities of information technology innovations. To get

more feeling of the atmosphere of the times, even in large firms in the information technology industry, we will look at the case of how Hewlett-Packard's leadership was rethinking strategy.

Hewlett-Packard was founded in 1938 by Bill Hewlett and David Packard, then graduate students in engineering at Stanford University in Palo Alto, California. They developed an electronic measurement business that continued through the years to be a core part of HP's business. In the 1970s, HP entered the minicomputer market and grew significantly, not as a technology leader but gaining a significant market share. However, the minicomputer product become obsolete, and was replaced by personal computers, workstations, and servers. HP, continuing as a technology follower, managed to gain small percentages of the market in each of these product lines. Although HP's market share was small, the markets grew so fast and big that computers did contribute significant growth for HP through the 1980s. John Young, CEO from 1978 until 1992, presided over this growth: "Young oversaw HP's rise into a major computer company. . . . But as the 1990s began, Young's efforts to corral HP's independent units led to bureaucracy that got HP badly bogged down" (Burrows and Elstrom, 1999, p. 84).

The next CEO to preside over HP from 1992 until 1999 was Lew Platt:

> A well-liked engineer who joined HP in 1966, he was an operations expert and a devoted practitioner of the HP Way—perfect qualifications to oversee HP's growth in the mid-1990s. But when PC prices and Asian sales tanked in 1997, HP was not prepared for the next big wave: the Internet.
>
> —Burrows and Elstrom (1999, p. 84)

During the leadership period of these two CEOs, HP did have one innovation that jumped it to leadership in the personal computer printer market: the inkjet printer, introduced in 1984.

But what was the continuing strategic problem? With HP historically a strong engineering company, why had it not—except for the inkjet printer—been an innovative leader all these years?

> By late 1997, employees were crying out for stronger direction. That December, a poll of the 300 top staffers revealed that HP's workers thought the company needed an infusion of new thinking and more customer focus. . . . By last summer [1999], with revenue growth slowing to low single digits, Platt began to make dramatic changes. . . . Even more important, Platt put his own job on the line: He wanted the board to consider hiring a new CEO. The board took him up on the idea, leading to Fiorina's hiring."
>
> —Burrows and Elstrom (1999, p. 80)

In late 1999, Platt resigned and the board selected Carly Fiorina as HP's new CEO. In November 1990, at an annual computer show where she was a

keynote speaker, Fiorina was interviewed by *InfoWorld's* Editor-in-Chief Michael Vizard and News Editor Katherine Bull, who asked what she saw as the major issues facing Hewlett-Packard. She answered:

> We have to reconnect the people of HP to the fundamental spirit of invention that began with this company 60 years ago. . . . Instead of being slow, we have to be fast. Instead of being indecisive, we have to be focused. We have to lead instead of follow. We have to be bold."
>
> —Vizard and Bull (1999, p. 8)

One can see in the use of these general terms of "fast," "focused," "lead," "bold" that innovation in new products was seen as needed in HP. The reason for this was the impact of e-commerce innovations in which HP had not been a leader.

Fiorina had begun her career at AT&T in its core long-distance business but later moved to its Network Systems group, which manufactured telephone equipment. When the group was spun off from AT&T as Lucent in 1996, Fiorina was one of the new company's top executives. It was from there that she was recruited to head HP. In the *Infoworld* interview, Vizard and Bull next asked what Fiorina viewed as the best of HP, to which she responded, "We have chosen not only to embrace e-services, but to use that as a strategy to drive the entire business." (Vizard and Bull, 1999, p. 8)

Earlier under Platt's leadership, HP had begun to devise a strategy for the company's participation in the growth of the Internet. Two managers met in April 1998 to improve coordination, Ann M. Livermore (head of software and support) and William V. Russell (HP's UNIX computer chief). They began to explore a Net strategy for HP and agreed that their independent groups would cooperate to commercialize a host of Web technologies:

> "This was a big deal—like bringing two armies together," says Nicholas J. Earle, chief marketing officer for HP's Enterprise Computing Solutions Division. "The Net became the great unifier."
>
> —Burrows and Elstrom (1999, p. 82)

HP's strategy for exploiting business opportunities the Internet was making possible was summed up in their term *e-services.* HP meant this term to cover new services on the Web supported by a lot of information infrastructure.

Fiorina made strategic changes. One was to tie top manager's pay closely to the performance of the company's stock. Another was to divest HP's $8 billion test-and-measurement division as Agilent Technologies. This business was large and profitable but not an extraordinarily growing business, compared to the e-commerce businesses. By selling part of Agilent Technologies to the public, HP gained $2.07 billion and retained 84 percent of the new company.

Fiorina's strategic purpose was to change investors' view of HP as one of the new economy firms in information technology and value it as an e-commerce business:

> "The businesses that compose Agilent are basically mature but steady," says Steven Tuen, director of research at IPO Value Monitor, "Now we can value HP against competitors like Gateway."
>
> —(Gustke 2000, p. 42)

Fiorina also altered the organization of HP with a 100-person e-services unit, to provide business customers the hardware and software to use the Internet:

> With Agilent out of the way, HP's main concern is its new e-services business, a catch-all term encompassing anything to do with Internet-related hardware and software. Sun and IBM have grabbed the lead in this business, but Fiorina believes the potential size and growth rate of the market give HP a chance to catch up.
>
> —Gustke (2000, p. 42)

Hewlett-Packard was offering what they called their "e-speak" source code. Fiorina described e-speak as software that provides a building block of e-services, enabling different devices to communicate, brokering different kinds of applications. The e-speak core software provided a universal interface for software runtime that was computer-platform neutral; and e-speak software tools provide developers an ability to create appliances and components that could communicate with each other across the Web.

Even with e-speak, HP was still playing catch-up because it hadn't earlier anticipated the Internet and conducted the innovative research to lead in Internet information technologies:

> Although HP is playing catch-up in some key markets, it dominates others. "The best part of HP," says Salomon Smith Barney analyst John B. Jones Jr., "is its printers and their brand recognition. . . ." In the quarter ended October 31, 1999, total printer sales . . . accounted for abut 50 percent of HP's revenue. . . . Meanwhile HP is rolling out new products. . . . But these products represent incremental improvements rather than the sort of bold breakthroughs for which HP was once famous.
>
> —Gustke (2000, p. 42)

Having missed anticipating the coming of Internet and e-commerce, the giant company had to take the kind of risks involved in any large company's trying a catch-up strategy:

> The upside—HP boasts a crackerjack management team, shining financials, quality products and a brand name. . . . The downside—turning a successful, complacent company into a hungry, speed-driven one inevitably involves upheaval. If the process is managed badly, morale could suffer and HP could lose its focus."
>
> —(Gustke 2000, p. 44)

Case Analysis

This case illustrates the importance of strategic planning to formulate and implement new strategy and first having a vision to plan and implement change before other competitors pioneer a new technology. The lack of visionary strategic planning at HP had been part of its corporate culture for a long time. HP had been succeeding by being a technology follower rather than a technology leader. HP had been able to follow a succession of innovations in electronics, computers, and information technology to periodically improve its products.

Sixty years earlier, Hewlett-Packard had begun as a high-tech company in electronic instrumentation, but it had not managed to lead in other major inventions. It had, however, been a quick follower in minicomputers and then in personal computer printers. HP had been known as a good engineering firm with up-to-date products but not as a science firm with advanced, breakthrough products.

With the rise of the Internet, Hewlett-Packard was seeking new products to position itself in the next wave of information technology progress. In HP's case, its information/business strategies were pinned on its e-speak source code.

It is hard to prosper as a purely technology follower, for then a firm needs to find a market niche not covered well by the technology leaders (as HP did with ink-jet printers). Good strategic planning is necessary for a technology follower to jump into the prosperous position of being a technology leader.

By February 2001, Fiorina had strategically focused upon three cross-company initiatives of digital imaging, wireless services, and commercial printing. To implement these strategic initiatives across all product lines of HP, Fiorina reorganized HP into four principal units: Printers, Computers, Corporate Sale, Consumer Sales. The Printer and Computer groups were to create products sold to corporate customers and to consumer customers. This reorganization collapsed 83 HP product units into the two Printer and Computer groups:

> Not to tackle one problem at a time, Fiorina is out to transform all aspects of HP at once . . . That means strategy, structure, culture, compensation. . . . Such sweeping change is tough anywhere, and doubly so at tradition-bound HP.
>
> —(Burrows, Peter, 2001, p. 72)

PLANNING

Strategic plans need to be formulated as guided by the direction in a strategic vision. Yet the actual implementation of a strategic plan will require that it be put into action through a sequence of operational plans.

Accordingly, we next need to review the differences between strategic and operational plans:

- Strategic planning is a concern for and laying out of the directions for the long-term future.
- Operational planing is a concern for and laying out of the directions for the short-term future.

The conceptual duality of controlling both long-term and short-term events makes strategic planning *and* operational planning *complementary cognitive functions of management.*

In the case of HP, it had good operational planning capability but not good long-term strategic planning capability. The ink-jet product success was a result of good short-term product development and planning.

Stasis and Change in Operations

Operational planning is aimed at controlling the steadiness of organizational operations, or *stasis.* Stasis in management attention attends to the immediate efficiency of operations, for it is efficiency that in the short term determines profitability in a commercial organization. Efficient repetition of operations, as the production and sales of a large volume of products, creates economies of scale, and upon such economies rests profitability of operations.

In the long-term performance, management practice additionally needs to focus upon making desirable changes for future operations, strategy. Strategy focuses on the long-term, mediate effectiveness of operations—not to the short-term, immediate efficiency of operations.

Efficiency of business operations produces profits in the short term, but effectiveness of business operations creates survivability in the long term.

It is the effectiveness of business strategy in the long term that creates the right kinds of products and services for market share and dominance. It is in market share and dominance that a business survives over time.

Thus both stasis of current operations (which creates profits) and change in future operations (which creates market dominance) are essential to strategic man-

agement thinking. Stasis produces the short-term, immediate benefits of organizations, whereas change produces the long-term, benefits mediated through intervening events. Stasis and change are complementary. Few steady-state operations can go on forever without needing change because many aspects of an organization are not static—markets, technology, competition, politics, etc. Thus periodically—at the beginning of an organization, through the growth of an organization, and at subsequent critical periods of an organization—operations need to change for the organization's long-term effectiveness and survival. Planning needs both to continually optimize stasis and periodically change stasis:

- Operational planning focuses upon optimization of stasis in operations in the immediate, short-time horizon.
- Strategic planning focuses upon change in future operations for survival in the mediate, long-term horizon.

Both operational planning and strategic planning become integrated in the annual budgeting activity of organizations. But conceptually they are different. Thus in the planning and implementation procedures of strategic management, the procedures need to facilitate both short-term and long-term planning.

Implementing Operational and Strategic Plans

How is operational planning implemented? How is strategic planning implemented? To answer these questions, we need to remind ourselves of the levels of decision logic in the control of an organization's activities.

Organizations conduct repetitive activities in their operations to add value—such as manufacturing and selling products (e.g., inkjet printers, routers, automobiles) or providing and delivering services (e.g., retailing books, transporting passengers, etc.). Thus the ground logical level of any organization is its repetitive activities that directly transform inputs of resources into value-added outputs of products/services.

The scheme, or order, of how repetitive activities are to be carried out in an organization is called its "operations." Operations are the patterns of order that govern, or control, activities. For example, in automobile manufacturing operations it is the order of the assembly line, where engines are first assembled in parallel with chassis and body assemblies and then engines are mounted onto chassis and then bodies are attached.

In a large organization, precisely how these operations are to be conducted are specified as organizational "procedures." Procedures are the instructions on how to carry out an operation. For example, in automobile manufacturing, there are designs which specify the tooling for production and standards for performing operations. Procedures as designs and standards control operations (as operations control activities).

The next decision-logic level in organizations is "policies," which specify the purpose of procedures. For example, in automobile manufacturing, policies determine the types of autos to be designed, the extent of annual model change, the markets to be targeted for the auto designs, the cost targets for production, and so on. Policies control procedures (as procedures control operations).

The highest decision-logic level in organizations is "strategies," which provide the directions of change for policies. For example, in automobile manufacturing, strategies determine the product lines to be produced (e.g., family sedans, sports cars, SUVs, trucks, vans), acquisition of new brands (e.g., Ford acquiring Volvo and Jaguar), extent of vertical integration of production (e.g., GM selling off Delco), and so on. Strategies control changes in policies (as policies control procedures).

In summary, the hierarchy of decision logic in an organization consists of the following control levels:

- *Activities* that transform inputs to outputs
- *Operations* that control activities
- *Procedures* that control operations
- *Policies* that control procedures
- *Strategies* that control policies

The relationship of operational and strategic planning can now be seen in how their implementation affects differently these levels of decision-control in organizations. Operational planning is implemented by changing the lower-two levels of operations and procedures, whereas strategic planning is implemented by changing the upper two levels of policies and strategy: (1) 0perational planning specifies operations and procedures and (2) strategic planning specifies policies and strategy:

- Operational plans are implemented through targets of operations and changes of procedures.
- Strategic plans are implemented through targets of strategy and changes in polices.

Furthermore, when we look in detail at these two kinds of planning (in later chapters) we will find that their logics and processes are really very different:

- Operations planning uses the logics of known action and specific directions to specify how to achieve specific goals of repetitive types of action.
- Strategic planning uses the logics of unknown action and preparation to launch exploration into action never previously experienced.

The logic of planning is the logic of operations—knowing how to get to someplace we have gone before. The logic of strategy is the logic of exploration—preparing to go someplace we have never gone before. In the logic of an operational plan, one can clearly state the ends and means of action—goals and tactics—since we have performed this operational action before, repetitively, and we understand what it takes to do it. Thus operations plans can be summarized in bullet form, for everyone involved can fill in the story's details—been there, done that—know how to do it again. An operations plan just says how much we are going to do again.

However, in the logic of a strategic plan, one is going exploring, rather that repeating an action previously performed. The logic of strategy consists—not of spelling out the means and ends of known action—but of *refining perception, creating commitments, preparing for action*. Together—perception, commitment, and preparation—constitute the real logic of strategic exploration. (We examine all this more carefully in later chapters.)

Strategy is not planning:

- Strategy is change in long-term direction
- Strategic planning lays out the sequence of steps to implement long-term change
- Operational planning details the immediate steps of implementing long-term change and of continuing stasis

STRATEGY PROCESS

Now we can put these ideas together and depict an effective modern strategy process. We recall that strategic thinking is a process, and a strategic plan is a result of the process. The problem of a strategy process in a large organization is how to have planning procedures that:

- Focuses management thinking on *long-term* prosperity
- Anticipates *relevant* change
- Stimulates *constructive interaction* between top-down and bottom-up perspectives
- Creates *effective* strategic vision
- *Transforms* strategy into action

Strategic Planning Teams

Look at the first step in Figure 1.2, which illustrates that the first two steps in creating a strategic thinking process in an organization is to establish a planning

process that encourages the interaction of top-down and bottom-up perspectives by

1. Forming top-down and bottom-up strategic-planning teams
2. Scheduling interactions between teams

The composition of a top-down strategy team needs to consist of a firm-level planning staff and executives of the businesses or divisions that compose the company. A bottom-up strategy team should consist of managers of the businesses in the firm (or of the functional divisions within a firm). Since there are hierarchical differences in the authority positions in these teams, it is important to formally schedule interactive presentations of their planning work to one another as the planning efforts proceed to stimulate appropriate interaction of perspectives.

Planning Scenario and Strategic Business Model

Look again at Figure 1.2, which illustrates that the *next step* is to focus the strategy teams upon creating formal descriptions of the environments and the businesses as outputs of the interactions:

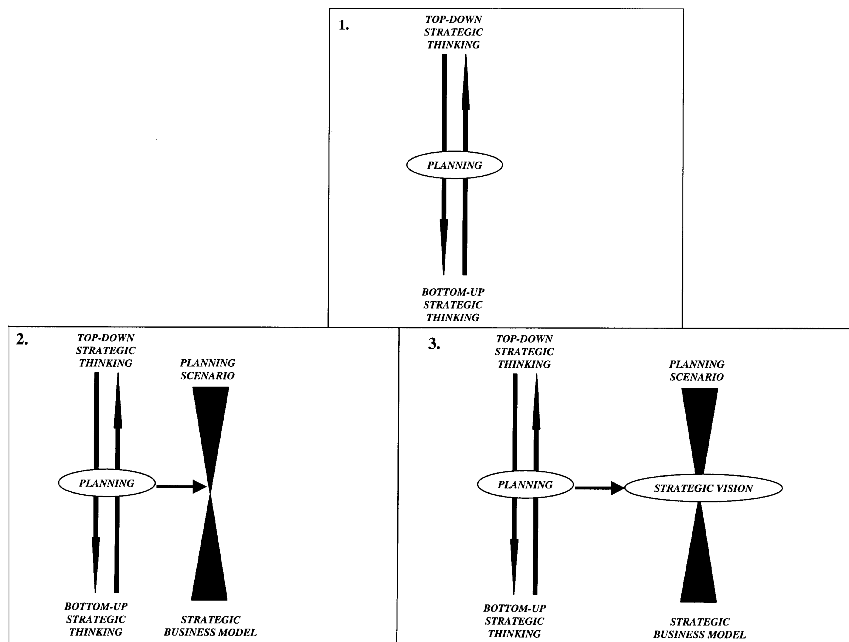

FIGURE 1.2 STRATEGY PROCESS—Frist Three Steps

3. Construct a planning scenario and strategic models.

A planning scenario anticipates from the top-down perspective the future environments of the company. Formulating such a scenario requires anticipating changes in the structures of the societies in which a company operates. In industrialized societies, four general structures exist, economic structures, governmental structures, territorial structures, and cultural structures. The technique of scenario planning provides a systematic way of examining trends and forecasts of possible and likely changes in the future in these structures.

A strategic model of a business summarizes from the bottom-up perspective the intended future policies of the business.

The kind of strategic business model one uses to depict future business policies depends upon which kind of corporate performance one wishes to optimize.

In formulating any strategic business model, important strategic issues are those of markets and innovation competition and structure, operations and control, and information and knowledge. (And these we will address in detail in later chapters.)

Strategic Vision

The procedures for creating a planning scenario and strategic business models facilitate the two perspectives on the future from the general to the particular (top-down) and from the particular to the general (bottom-up); and from this interaction the third step to add in the planning process (as sketched in Figure 1.2) is an integrative picture of the future:

4. Formulate an intuitive strategic vision.

A strategic vision is an intuitive view of the future. For example, in the merger of AOL and Time Warner, both CEOs, Case and Levin, developed a strategic vision of the future merged company, that is, altering boundaries of AOL and Time Warner to become a new firm with the boundaries of content creation and delivery. For AOL, Case's vision was to vertically integrate AOL from media service delivery back into media content creation. Acquiring the media-content creation businesses of Time Warner would change AOL's future business capabilities. For Time Warner, Levins' vision was to merge Time Warner into a major e-commerce business

Vision results from the intuitive cognitive function of the mind—vision is a synthetic view of a totality—a gestalt. How to facilitate intuition in a group setting is a difficult problem, which we will address in a later chapter. For now, the

important point is to emphasize that the procedures for strategic plan need to create a strategic vision arising from the team interactions of constructing a planning scenario and a strategic business model.

Strategic and Operational Plan

The final steps in constructing the procedures for a strategy process in a large organization is to translate the strategic vision of the future into strategic plans that can be implemented beginning as near-term operational plans, as illustrated in Figure 1.3, by adding the following procedures:

5. Construct an analytical long-term strategic plan.
6. Construct short-term operational plans in the direction of the strategic plan.

What we have sketched are the key elements in strategic thinking as an *organizational process* in Figure 1.3. The strategic planning process begins with bidirectional views on the future of the company—top-down strategic thinking about changes in the environments of the firm and bottom-up strategic thinking about changes in the businesses of the firm. The interactions (down and up, and up and down) of these two perspectives should create a *strategic vision* about the *directions* the company should go in the future; and the concrete steps to do so constitutes a *strategic plan* for the company.

The top-down view arises from the construction of a *planning scenario,* which

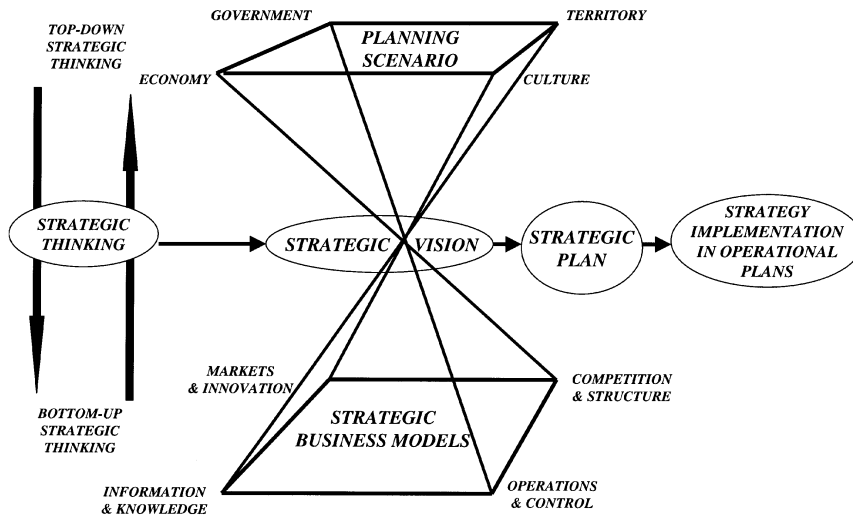

FIGURE 1.3 STRATEGY PROCESS

anticipates the kinds of changes in the environments that will be relevant to the businesses of the firm in the future. The bottom-up view arises from the construction of a *strategic business model* for each business of the firm. This model anticipates the kinds of changes desired and needed to prepare the firm and its businesses for a competitive and successful future.

Multi-Business Firm Strategy

The strategy process depicted in Figure 1.4 assumes a company is a single-business firm, yet most large corporations are multi-business firms. Strategy changes dramatically at the different levels of a multi-business corporation (i.e., the firm level and the business level). For example, Lowell Steele emphasized the perspective differences in strategy between single and multiple business companies:

> One must distinguish between single-business (or closely related business) companies and multi-business companies. Strategic planning at the corporate level for a multi-business enterprise cannot be the same for a company with a single line or closely related product lines."
>
> —Steele (1989, p. 179)

The strategic differences arise from the kinds of competition each kind of company,—single-business or diversified-businesses—faces. The single business

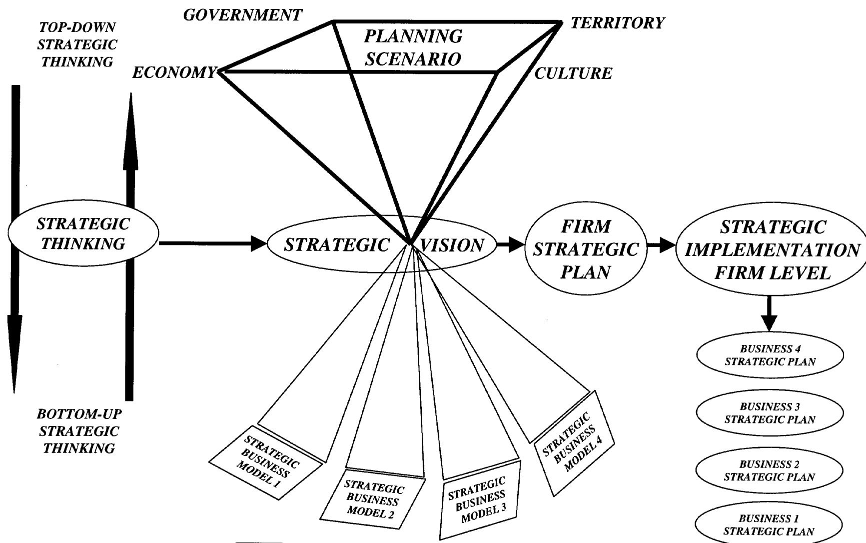

FIGURE 1.4 STRATEGY PROCESS—MULTIBUSINESS FIRM

company finds its principle competition in the marketplace—face-to-face with customers and competitors also directly in contact with customers:

> Competition for a single-business entity is in the market place, offering superior value to customers. If it does that effectively, its performance will be satisfactory—provided that its markets permit an acceptable rate of return.
>
> —Steele (1989, p. 178)

Accordingly, competitive strategy for the single business company must focus primarily upon its products and services—product, production, and marketing strategies. Strategy needs to be focused upon the variables that directly add value to customers, such as product attributes, quality, cost, safety, differentiation, distribution channels, advertising, and so on.

In contrast, the multiple-business company is primarily a financial holder of businesses, so that it performance is not in the customer market but in the financial market:

> Competition for the multi-business enterprise is in the capital markets: Does its present portfolio of businesses and mode of management produce a competitive rate of return . . . ? Multi-business strategy focuses first and foremost on portfolio optimization—what mix of sources of revenue is desired and what allocation of resources will best bring about this preferred mix.
>
> —Steele (1989, pp. 178–179)

Multi-business company strategy must focus principally upon variables that directly impact the rate-of-return of capital, such as business portfolio, position of a business in its industry, business investments, business leadership, business acquisitions and divestitures, and so on. Accordingly, the strategy process for a multi-business firm needs to be modified as shown in Figure 1.4. Therein a common planning scenario is still appropriate for the entire firm and a common strategic vision. But each separate business in the firm (Businesses 1, 2, 3, 4, etc) needs to create a strategic business model appropriate to its business. In a multi-business firm, the strategy process will result in a:

1. Firm strategic plan
2. Strategic business models and strategic plans for each business and strategic business plans and operational plans for each business

SUMMARY: USING THE TECHNIQUE OF STRATEGY PROCESS

Now we summarize the ideas in this chapter as a strategy "how-to-do-it"—how to use the strategy process as depicted in Figure 1.3 as a strategy technique to construct a formal organizational process for strategic planning.

1. Form top-down and bottom-up strategic-planning teams
    - A top-level planning team should be formed and given the task of formulating a planning scenario for the long-range strategic planning exercise.
    - Strategic business unit teams should be formed and given the tasks of constructing strategic company models for each business unit.
2. Schedule interactions between teams
    - Both sets of teams (top-down and bottom-up) should periodically meet during their tasks to present to each other and discuss preliminary versions of the planning scenarios and strategic models as they proceed.
3. Construct a planning scenario and strategic models
    - Express planning scenarios and strategic models in readable forms, emphasizing critical challenges and assumptions about the future.
4. Formulate an intuitive, synthetic strategic vision
    - From consensus in the team interactions, formulate a brief gestalt of the direction for a strategic vision that captures the conceptual totality, principal purposes, and goals and assumptions about strategic change.
5. Construct an analytical long-term strategic plan
    - The strategic vision is then used by a firm-level strategic team to construct a strategic plan for the firm and by strategic-business-unit teams to construct a strategic plan for each business unit. The strategic vision provides the strategic framework and performance measures for integrating the firm-level and business-level strategic plans.
6. Construct short-term operational plans in the direction of the strategic plan
    - Operational business plans for the next-year's budget planning can then be constructed by each business unit within the framework, assumptions, and goals of the strategic plans.

The importance of such a procedural framework for strategic planning is that it specifies the right kind and number of strategic planning teams needed for strategic planning in a diversified firm and/or in a single-business firm. Moreover, it specifies the task of each team and how these tasks are to be coordinated and integrated. Also, it specifies the kinds of outputs of the task and how they are used to create short-term business plans that have long-term strategic directions.

Essential to proper strategic thinking in an organization is a ***proper and logical clarity about the strategy process****—types and tasks of planning teams, construction of consensual top-down/bottom-up strategic vision, and guidance of short-term planning with long-term strategy.*

LOOKING AHEAD

Next we need to look at the complementary process to strategy formulation—strategy implementation. As we noted from one of the CEO's comments on strategy, "And fourth, you want to take action." After all this, we will go more deeply into the subtle ideas in strategy and strategy techniques. To use the strategy process practically, a business team needs to understand the basic techniques of *models, scenarios, vision, and planning.* We will address each of these in detail in subsequent chapters.

Also, we will briefly review the business literature on strategy. The evolution of the theory of strategy has not gone easily because while strategy is one of the deepest and most fundamental process in management, its complexity has made it the most difficult process to fully capture in the rather narrow disciplinary confines of the academic perspectives that study business. Yet we need to review all the schools of strategy in order to be certain that we have indeed captured the important lessons in the literature on the best practices and theory of strategic management.

We will look carefully at the critical strategic issues in formulating strategic models, which include *markets and innovation, competition and structure, and operations and control.* Because of the newness and importance of information and knowledge to strategic management, we will address each in separate chapters on *information strategy* and on *knowledge assets.* Finally because of the differences in strategic models for single-business companies and multi-business companies, we will examine in detail *diversification strategy* for a multi-business company.

For Reflection

Identify several firms that went public in the last ten years. Find their prospectuses, subsequent SEC filings, and trace their stock prices since going public. Have any encountered problems? What were they, and why did they occur?