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Creating a Strategic Control System

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Strategic controls can be considered to be non-financial performance measures and they are of particular value in a diversified company in controlling, monitoring and guiding the development of operating units. The development of a strategic control process is described and its implementation.

Why have Strategic Controls?[1]

Businesses need a balance between managing for short-term profits and for long-term strategic position (i.e. future profits).[2] But, on the principle that what you cannot measure, you cannot manage, it is very difficult to manage for long-term position without some measurements of it. Companies need some specific measures of the progress of their long-term strategies to build into their control systems, for what a company chooses to control explicitly is what its people will focus their attention on. A strategic control system ensures that the immense effort often put into preparing lengthy and detailed strategic plans is in fact translated into action, and the learning process is consolidated.

Strategic controls are of particular value to those at the centre of a diversified company with responsibility for controlling, monitoring and guiding the development of operating units. For example:

☆ They are a means of clarifying what good performance is. Everybody wants to know three things: 'Where are we going?', 'What do you want from me?' and 'How am I doing?' The control system can give answers to all of those questions, for it secures commitment to objectives which are tangible and complement financial ratios.

☆ They confer an ability to make explicit trade-offs between profit and investment/growth. Without them, when the going gets tough, budgetary pressures will tend to derail strategic goals, and in the same way, a strong short-term financial performance can make it hard to uncover underlying problems.

☆ They can be a way of introducing strategic 'stretch' as well as financial stretch. Most people are motivated by targets which are difficult but just achievable, and it is often only by being set tough targets that they realize what they can achieve. Setting a competitive goal raises the sights of the business and gives it something worth striving for.

☆ They allow management in the business unit and at the centre to take action in a more timely way if the situation of a business is deteriorating. The alternative is to rely on gut feelings that something is wrong or wait until the bottom line proves the point. The right controls can not only give an early warning of impending problems but can suggest a diagnosis which enables management to take appropriate corrective action.

What are Strategic Controls?

The measures actually adopted as strategic controls vary greatly, and are dependent on the nature of the business. In general, strategic controls can be considered to be non-financial performance measures or milestones. For example, for a company like Nestlé in a fast-moving consumer goods business, market share relative to other leading competitors is a vital measure, whereas for a research intensive business like ICI Pharmaceuticals, some measure of the quality of the R & D pipeline of new drugs is critical. Whatever measures are chosen should focus on objectives that are essential for achieving long-term competitive advantage in the business.

Strategic controls can be open to quantification, but

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sometimes their very nature mitigates against this. An interesting example of the use of both quantitative and qualitative strategic controls is offered by Honda. Honda places great emphasis on the measurement of non-financial controls at all levels. At corporate level, although the centre believes in exercising as little direct control as possible over operations, it monitors customer satisfaction ratings very closely. Honda supplements industry surveys with the company's own research which focuses on ascertaining the causes of problems. An overriding goal of Honda's senior management is to come top of these ratings.

In contrast to the formal way in which the customer satisfaction ratings are monitored, Honda pursue their second major goal in a more informal way, as it is not quantified. This goal, which they take as seriously as the customer ratings, is to have high levels of 'employee excitement' in all departments. 'Employee excitement' is monitored by senior managers who are expected to visit their departments and report on it on a regular basis.

In addition to these two strategic controls, a host of operational factors (such as utilization, machine break-down rates, cycle times, waste levels, etc.) are measured at each Honda plant. They too are non-financial performance measures, but they have a different status from the two strategic controls, which are regarded as fundamental. Achieving top scores in customer satisfaction ratings is the company's overriding goal; 'employee excitement' is a leading indicator of the company's ability to fulfil the goal, for doing so depends on continuous improvement, which Honda believe will only come about if employees remain highly motivated. Their controls complement each other and open the company up to enable it to learn rapidly: both learning what customers' needs are and encouraging employees to learn how to satisfy those needs better next time.

The choice of strategic objectives therefore needs to be based on a thorough assessment of what a company needs to do to achieve competitive advantage in its business. But once chosen, they are only effective when used in a control process through which monitoring and learning can take place. While the choice of objectives should be driven by the nature of the business, the development of an appropriate control process should be determined by the circumstances of the company and its management.

Developing a Strategic Control Process

Most major companies now have a strategic planning system which they use to help them manage their long-term position. Most multi-divisional organizations have adopted a 'Strategic Planning' or 'Strategic Control' style[3] in which the centre shares some degree of responsibility for strategy development with the business units. It is in the context of the strategic planning process that strategic controls have their place.

A strategic planning process can only add value if the dialogue between the centre and the operating units is of high quality. In order to achieve high quality dialogue, it is necessary for both the centre and the operating companies to invest in a period of building the requisite skills. Both must understand the sources of competitive advantage in the business, both must talk a common language, and most fundamentally, both must trust each other.

The effectiveness of the process is therefore as dependent on management skills, knowledge and attitudes as it is on the focus of strategy. Controls can be particularly valuable in helping to develop these skills, which is an inherently slow process. Use of them can focus attention on the key success factors, keep discussion at the level of strategy, not operations, and facilitate the building of trust, by forcing both parties to be explicit about what they are collectively seeking to achieve. Instead of one party judging what the other is proposing, common ownership of the strategy is ensured. It follows that the planning process of which controls are an element should itself evolve with the skills of those engaged in it. A well-known but clear example of how the process can develop is offered by the case of GE.[4]

GE introduced its famous SBU structure in the late 1960s and at about the same time began a major effort to improve the quality of strategic thinking in the businesses. Training was provided at internal strategy seminars and by 1980 some 200 senior planning posts had been created. As the 1970s progressed, the planning process began to work well, with every SBU producing sophisticated plans. As Jack Welch put it:

> 'We had the best financial controls in the world at General Electric. We did not have an outstanding planning process. We put one in. So you put good thinking across good numbers; there's nothing like thinking to go with good numbers. The first years of the planning process were sensational.'

But as time passed, the books got thicker, the printing more sophisticated and the amount of thinking steadily declined. As meetings grew larger, and planning tended to be delegated by line managers to planning specialists, so the quality of the dialogue also began to sink. It was time to change, and accordingly in the early 1980s, the planning process was simplified at the same time as the number of SBU's was reduced and management layers thinned out. Dialogue about strategy took place in more frequent, less formal meetings. The goals were still clear, but not formalized and written

down, reflecting a new emphasis on speed, responsiveness and insight. For example, one business stated in a strategy review that the key to its future was to reduce delivery cycle times. This was noted, but not made explicitly into a control measure. Likewise, GE's celebrated goal, stated in their 1988 annual report, of being number one or two in their chosen markets, is not rigidly interpreted, but articulates a shared understanding of what GE is trying to achieve. This in no way diminishes its importance: it has been the driving principle behind the divestments and closures of recent years, including the sale of the GE/RCA television business to Thomson of France.

This simplified process could only be run successfully because of what went before it. Mike Carpenter, Head of Planning at GE from 1982 to 1986 has said:

> 'Our ability to move in this direction is heavily dependent on:
>
> ☆ our historical commitment to a strategic planning process, and the strong foundation that gives us in terms of having a very high proportion of businesses with well-defined, successful strategies and a group of general managers with good strategy skills;
>
> ☆ the extensive knowledge of our businesses on the part of the Chief Executive's Office;
>
> ☆ having a Chief Executive's Office which consists of individuals who are powerful strategic thinkers in their own right;
>
> ☆ having an environment where open and honest dialogue on strategic issues, however difficult and unresolved, is at a premium and where covering up problems is the kiss of death.'

The view taken within GE is that without the historic disciplines the simplified, less formal approach to strategic planning and control would have simply been loose and ineffective. Given what preceded it, it seems to work well.

The experience of GE points to a general conclusion about the development of a strategic control system. It shows how the skills of the people involved in the process can be built up by starting with a formal system and progressively relaxing it as the disciplines it inculcates become second nature and the participants have got to know each other's thinking. It also illustrates that the process takes years rather than months, and requires major investments in training.

Stages in the Development of a Strategic Control Process

It is thus possible to think about the development of an effective strategic control process in terms of a number of broad phases which tend to merge into each other. Firstly, the process presupposes the decentralization of responsibility for setting strategy into business units which are capable of operating with some degree of autonomy. Only when a suitable organizational structure is in place can proper planning systems be developed. The next phase is the development of a formal planning process to create strategic planning skills in the business units, and establish a common basis for dialogue with the centre. This should begin by focusing on competitive analysis and then move on to the definition of objectives and controls as part of the skill-building process. As the planning process evolves, it tends to grow in sophistication and it carries within itelf the danger of stultification into a formal routine. The third phase, therefore, which is as yet less common in practice, is to reduce the formality of the plans and shift the emphasis onto the controls. But the effectiveness of this stage will be greatly improved by the learning resulting from the previous ones, for it presupposes a high level of knowledge and understanding on the part of all those involved. Let us review each of these stages in more depth.

(1) *Aligning Appropriate Structures*
The establishment of an organization structure with business units capable of being treated as separate strategic entities is a move which many companies have made during the 1980s. At ICI, for example, it is widely felt that effective business strategies could only be developed after the company was reorganized in the early 1980s. Most of the operating units took on international, rather than U.K. responsibility, and units with significant overlaps, such as Petrochemicals and Plastics, were amalgamated. This organizational change was also a necessary precursor of ICI's introduction, in the mid-1980s, of strategic milestones as control mechanisms.[5]

The question in the 1990s is now, however, much more often whether the delegation of authority and the lack of cross-links between operating units has gone too far. The problems which can arise are well expressed by this comment from Digital:

> 'We had a structure based on product-market businesses and accountabilities. But there were lots of difficulties and problems. Because of separate accountability it was difficult to provide an integrated approach to large accounts. There were lots of boundary disputes. Instead of being strategists, the product people were being policemen, accountants and lawyers. Now we are trying to encourage people to work together in a more flexible fashion.'

Being organized into autonomous units is good for the development of business-specific competences, but can prevent the transfer of intra-business capabilities across the whole organization. One of the roles the centre will increasingly have to adopt is therefore to act as guardian and developer of the company's capabilities. An important mechanism

for doing this is the choice of controls. Strategic controls can be used to monitor the extent of cross-business interaction, to develop sensitivity to market changes that cut across business units and to avoid a blinkered concentation by each business unit exclusively on its own bottom line.

(2) *Building Skills*
Once the appropriate structure is in place, a formal (though not necessarily extensive) planning system can be introduced, in which line management has responsibility for the plans and the analysis which goes into them. The initial focus should be on the analysis of the businesses themselves and of competitors to isolate the key success factors and articulate what, if any, change in direction is needed. Established beliefs should be tested and thinking forced beyond the platitudinous.

Line managers can only be expected to accept planning responsibility and perform well if they are given adequate support. They will need training and explicit help in improving the clarity and cogency of their thinking, the focus of their plans and their communications skills.

The centre's role is to ask questions which prompt reflection on what matters most and to draw out an articulate account of what makes each business tick. The operational leaders should be prompted by questioning to discover issues for themselves and to think through the options they have in addressing them. In this way, as the line learns to think strategically, the centre learns about the business. Both are necessary if the control process is to work effectively. Insight is more important than precision and rigorous thought more important than pages of numbers.

BCG have developed a simple tool, dubbed a 'Strategy Statement', for helping companies to create strategic plans which can double as control documents (see Figure 1). In every business, each of the six topics is summarized on just one page, with the whole document containing the essentials of the strategy, its rationale and the control mechanisms. Figure 2 provides illustrative sections from a strategy statement for an international airline. Particularly in a company with a diverse portfolio, it helps to focus data gathering and analytical effort on what is important. The main role is played by line management, with central staff or consultants providing the necessary support (see Figure 3). The conciseness of the document greatly facilitates its use as a control device, and producing it imposes valuable discipline: it really does make it necessary to concentrate on what matters most. Page five consists of milestones (such as 'close depot A',

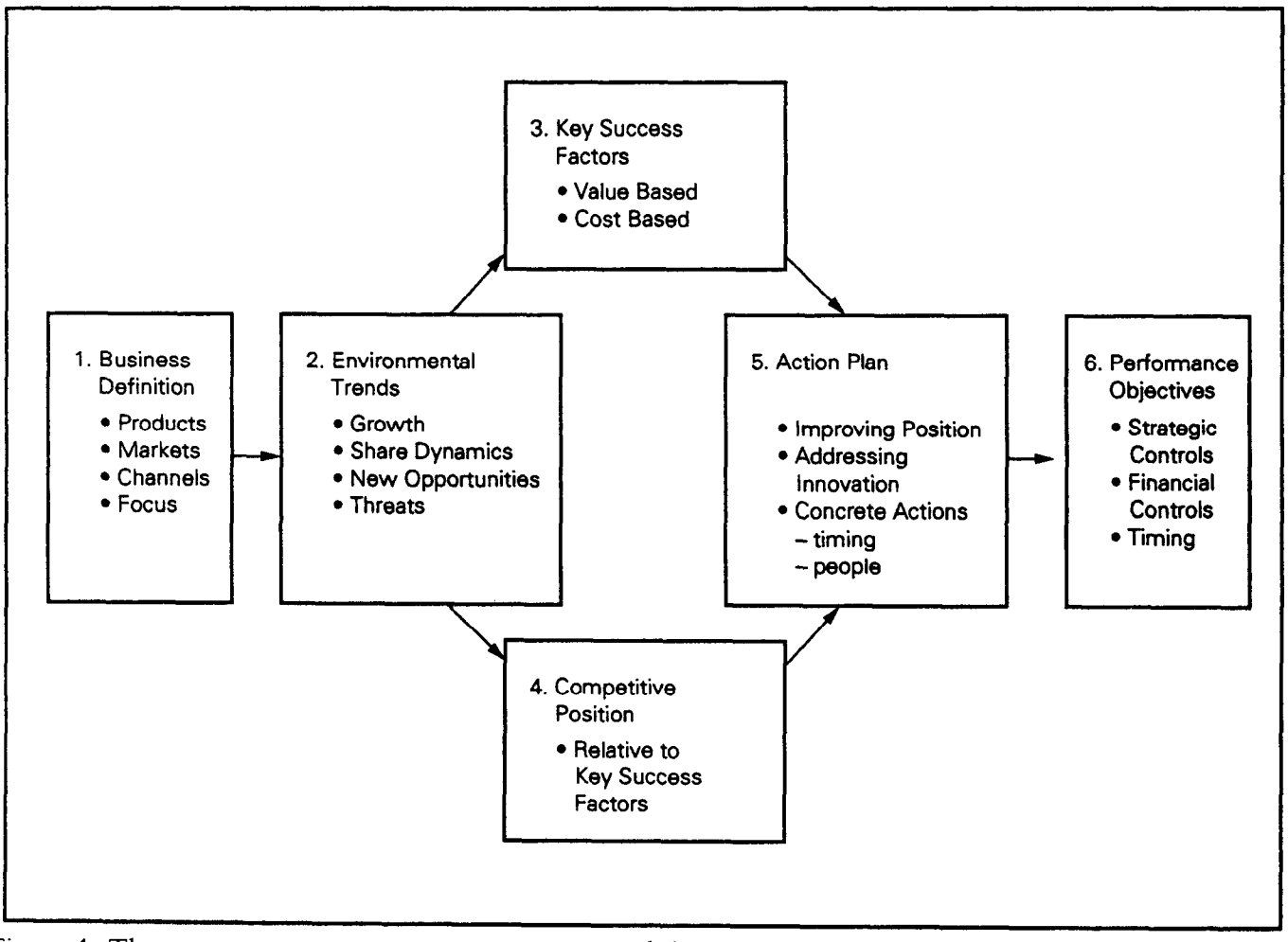
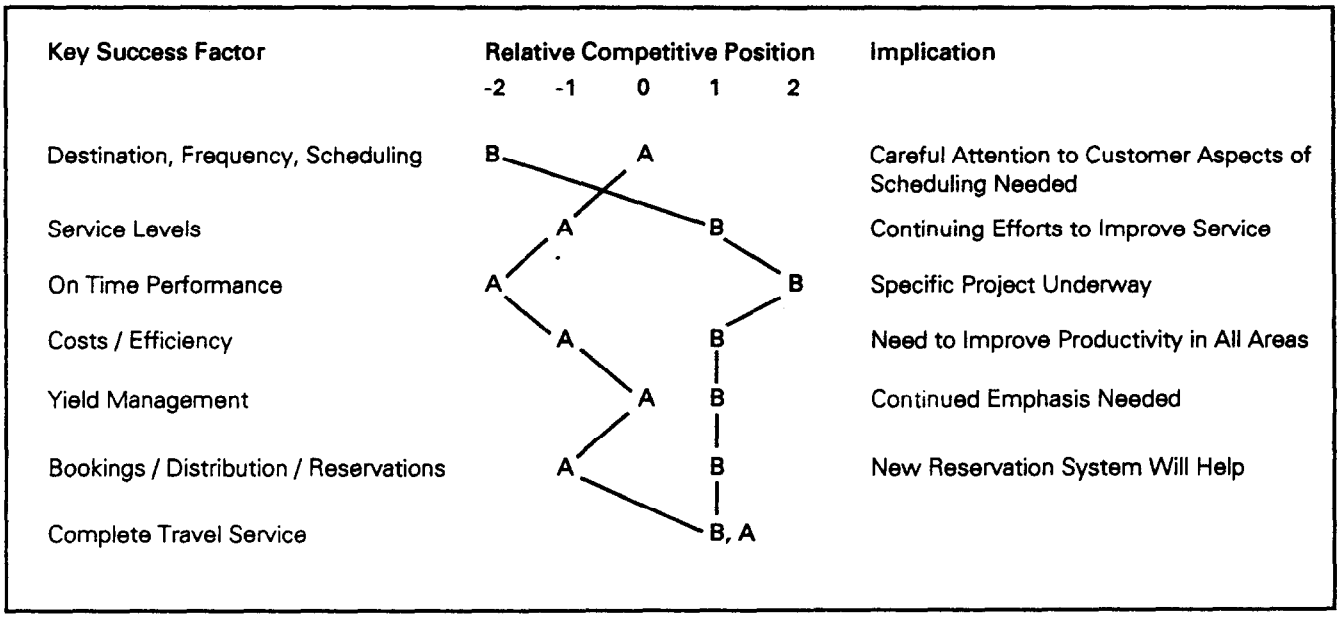


Figure 1. The strategy statement can serve as a control document

Key Success Factors	Value Based	Cost Based
1. Destinations, Frequency, Scheduling	x	
2. Appropriate Service Levels • On Time Performance	x	
3. Yield Management		x
4. Cost / Efficiency • Labour / Overheads • Capacity Management • Aircraft Utilization		x
5. Efficient Marketing Distribution / Reservation System	x	
6. Complete Travel Service	x	

Key Success Factors



Competitive Position

Figure 2. Strategy statement: international airline*

'centralize order entry', 'eliminate service X'), and page six of further strategic controls (such as relative market share targets, manning level targets, new product introduction rates and cycle times) as well as financial ones. Conciseness has even more point here—too many controls will be confusing and ineffective, and we generally find that only three or four at a maximum are what is required. The Strategy Statement has been used successfully to develop strategy in diversified businesses and to give the centre an economical means of ensuring that strategy implementation takes place, and monitoring the progress of the resulting changes in direction.

Once a strategic planning process of this sort has been introduced, it may well be some years before the necessary skills are developed for it to work well. As the first sets of plans will be relatively unsophisticated, they are unlikely to be pushed through to clear, specific targets or milestones, and control will probably be informal. The value of planning is as much in the learning effect of the process as the result, deepening the understanding of the business and competitors and creating a language understood by both the centre and the line.

(3) *Setting Control Targets*

Targets should be set and agreed in formal discussions between the board member responsible for the operating company and the operating executive. The planning document should be ready in good time for the discussion and should contain suggestions for appropriate controls, the reasons why they are the key measures of success and what means

*These sections are illustrative only.

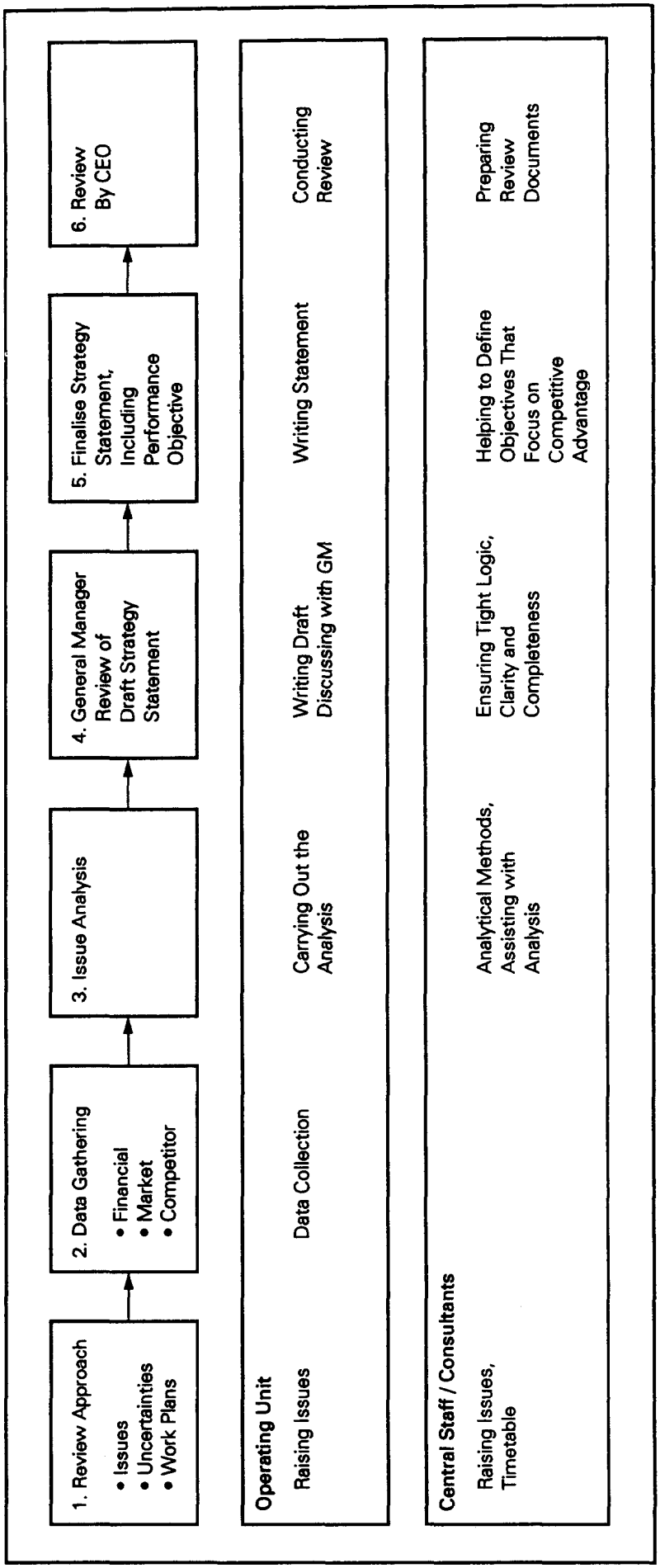


Figure 3. Stages in writing a control document

could be adopted to measure them. This discussion can be quite detailed, covering, for example, how market share should be defined and how the necessary data can be collected.

Proper preparation is essential to enable a sensible discussion to take place, and central staff can help to define questions and structure the agenda. Once the targets are agreed, tracking systems need to be put in place which will often involve IT investments to produce the requisite data on the MIS. Without this investment, however, the exercise will often be futile.

The establishment of the right control objectives can be vital in implementing a change in the way a business is run. A simple illustration of this is offered by some of the changes recently introduced in one of the major U.K. insurance companies. In common with most of the industry, it had traditionally regarded claims costs as an unmanageable given, and put all its emphasis on keeping staff costs low. However, the view developed that claims could to some extent be managed and in the light of the fact that claims are an enormously more significant cost element than staff expenses, it clearly made sense to invest in the extra staff necessary to do so. One step decided upon was to introduce a claims investigation field-force for household claims. This field-force would call on customers making claims on their home buildings and contents policies to discuss and assess the claim and agree a settlement value. Previously, on the infrequent occasions on which such visits were made, they had been carried out by outside loss-adjusters. The field-force would not only deal with the immediate claims, but also check sums insured and advise on measures to lessen the risk of future losses.

The introduction of the field-force was anchored in a change in the control system. Previous controls penalized managers for high staff numbers, but did not reward them for low claims, increased sums insured or higher customer satisfaction. In the new system, managers had claims investigation targets, and were also required to report on the results. The field-force had the effect of reducing fraud, producing more realistic settlements, increasing sums insured and improving the customers' image of the company, which was monitored in a follow-up survey. One important effect of the control system was to keep the field-force doing what it was supposed to be doing and not being side-tracked into helping out on routine work. Managers would be tempted to use these experienced claims staff on internal processing during the periods of claims peaks, such as was experienced after the great storms in southern England. With investigation targets to meet, they kept the field-force doing what it was intended to do, despite the pressures elsewhere. The use of quantified, non-financial targets got the strategy implemented and kept it on the road.

To make strategic controls effective, it is vital to integrate the strategic control process into budgeting. If it is not, and particularly if the two processes are controlled by different corporate departments, strategic goals will tend to be hijacked by short-term budgetary pressures, no matter how explicit they are. In particular, management priorities may change, and attention may shift from the long-term goals established in the strategic planning process to short-term financial targets which emerge from the budget.

(4) *Dismantling the Bureaucracy*
When the strategic planning process is well established and strategic controls are routinely agreed, the process can move into its final stage. Plans can begin to be less elaborate, formal requirements can be relaxed, and the discussions between the operating companies and the centre can focus much more on the controls themselves. The bureaucracy can be reduced now that everyone has mastered it, and, as time goes on, the meetings can also become less formal. Plans themselves, as opposed to controls, can be reviewed on a 3- or 5-year cycle, rather than annually, or restricted to a consideration of major ventures (such as potential acquisitions) or changes in the competitive or market environment. The formal apparatus built up in order to introduce the process and build skills should be dismantled once this has been accomplished. This is the lesson learned from GE.

How to Make Strategic Controls Work

The main problems companies encounter in building a strategic control system are the cost of setting up the planning system in the first place, which is mainly management time; the cost of defining key success factors in some businesses, which may mean an intensive one-off study; overcoming the initial hostility of line managers who will tend to regard the process as a waste of time until they find that they learn from it; and the time required to educate all those involved, which is usually years not months. None of these problems can be totally avoided, but they can be anticipated. The most important factor in achieving success is therefore to create realistic expectations on all sides and to give due allowance for the time and resources necessary. The process should itself be carefully planned, or the problems will quickly seem to outweigh the benefits and morale will suffer.

There are a few important lessons about how to make strategic control work successfully. It is necessary to:

☆ invest in the training necessary and adopt an appropriate style in reviewing plans, especially in the early stages;

- ☆ invest in careful preparation before review sessions, as good questions are vital;
- ☆ set stretching targets, but only a limited number;
- ☆ follow through, take it seriously and make actions and words consistent;
- ☆ create an explicit link with financial targets and budgets, integrating the two processes (or none of it will be taken seriously at all);
- ☆ show that the operating company benefits from the process (e.g. through the business becoming easier to manage) and give strong support for success (so that another real benefit becomes the approval of senior management or a better relationship with the centre).

Strategic control processes are still relatively rare, though a number of companies have made a start in parts of their operations. We believe that, over the next decade, their use will increase as more and more organizations discover the benefits of not just planning for the long-term, but building long-term thinking into day-to-day operations.

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(1) This article draws on research into the strategic control process carried out by the Ashridge Strategic Management Centre and sponsored by the Boston Consulting Group. For a fuller account see Michael Goold with John J. Quinn, *Strategic Control: Milestones for Long Term Performance*, The Economist/Hutchinson Business Books (1990).

(2) See K. R. Andrews, *The Concept of Corporate Strategy*, Richard D. Irwin, Homewood, Ill. (1980) (original 1971); Robert H. Anthony, *The Management Control Function*, Harvard Business School Press, Boston (1988); J. Dearden, The case against ROI control, *Harvard Business Review*, pp. 124–135, May/June (1969); P. Lorange, *Corporate Planning: An Executive Viewpoint*, Prentice-Hall, Englewood Cliffs, NJ (1980); P. Lorange, M. F. Scott Morton and S. Ghoshal, *Strategic Control*, West Publishing Company, St. Paul, Minn. (1986); Kenneth A. Merchant, *Rewarding Results: Effectively Motivating Profit Center Managers*, Harvard Business School Press, Boston (1989); M. D. Richards, *Organisational Goal Structures*, West Publishing Company, St. Paul, Minn. (1978); C. H. Roush and B. C. Ball, Controlling the implementation of strategy, *Managerial Planning*, **29** (4), 3–12, November/December (1980); B. Yavitz and W. H. Newman, *Strategy in Action*, The Free Press (1982). The Financial Control Research Institute, a gathering of senior managers from the planning and control functions in British industry, has made similar points in *Control Systems for Strategy Enforcement* (1986).

(3) See Michael Goold and Andrew Campbell, *Strategies and Styles*, Blackwell (1987)

(4) The case is well documented. See, for example, General Electric Company: Background Note on Management Systems: 1981, in R. F. Vancil, *Implementing Strategy: The Role of Top Management*, Harvard Business School Press, Boston (1982); Michael A. Carpenter, Planning vs strategy—which will win?, *Long Range Planning*, 50–53 (1986); Christopher Lorenz, Life under Jack Welch: opportunistic and tough, *Financial Times*, 16 May (1988); Christopher Lorenz, Why strategy has been put in the hands of line managers, *Financial Times*, 18 May (1988); Speed, simplicity and self-confidence; An interview with Jack Welch, *Harvard Business Review*, September/October (1989).

(5) The non-financial milestones used were deliberately kept diverse and have included: volume or capacity achievements in selected product areas; energy usage; capacity utilization; timetabled achievement of specific key success factors; market share in specified regions; new product or new process introduction dates; technical achievements and timetables; product quality levels; safety standards; plant closure dates; acquisition, joint venture or collaboration agreement timetables, and other objectives concerning people and organizational issues, though these have proved to be harder to specify.