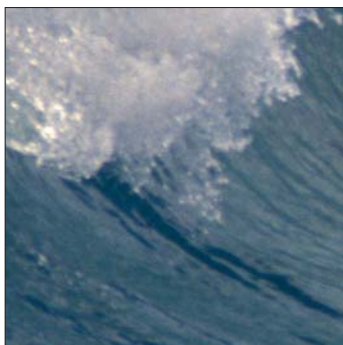




A living strategy

Senior managers spend significant amounts of time creating strategic plans only to put them away and never look at them again. In this article, *Daniel Huber, Alexander Jungmeister and Muhammad Zahid* introduce a new framework for corporate strategy development based on the use of portfolio management methods taken from the finance industry.

The new framework for corporate strategy development outlined in this article is intended to address the shortcomings of strategic planning, execution and communication. It involves setting up a series of strategic groupings, which are structured and managed as portfolios of various strategic items. They have different time horizons and are managed continuously, rather than as periodic, yearly strategy projects. Appropriate portfolio management with well-defined responsibilities and processes that develop the strategy continuously means there is permanent interaction between the responsible strategy manager and the rest of the enterprise. As a result, enterprises can react more quickly in the market, be more risk aware and have better performance and overall control in volatile markets.

Current problems in strategy making

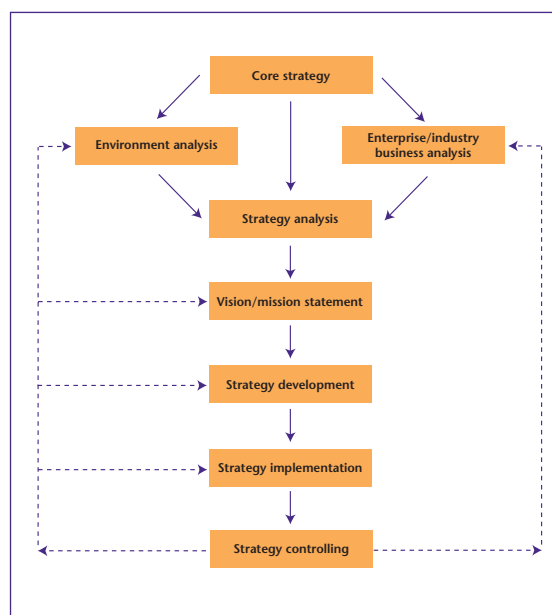
Almost half of all strategy projects struggle with implementation issues, such as the psychological assumptions of managers, the separation between planning and execution, and poor communication and organisation, as well as the nature of strategic planning itself, which is sequential and therefore often too time-consuming to keep up with today's rapidly changing environment. These defects could be called the psychology gap, the planning gap, the execution gap and the communication gap. Of these, the psychology gap is a matter of awareness and transparency and seems to be a built-in problem of human perception. A new strategy framework alone is unlikely to change human nature.

The planning gap. Current strategy frameworks generally support a sequential flow of tasks which have to be executed one after the other: analysis (customers, competition, environment and so on), positioning, implementation and control. Typically, if you discover flaws in the analysis during implementation, you will have to go through the whole process again. The procedure is inflexible, time-consuming and costly and usually results in neglect of change or inadequate

adjustments to the strategic plan. This in turn can lead to ineffective initiatives at a time when the environment and conditions of the analysis have already changed (for example, a new competitor may have emerged and changed the rules of the game).

Thus it is difficult to respond quickly to changing customer needs and market conditions. This is especially critical today as most businesses find themselves in rapidly changing environments and are inundated with confusing signals and data from competitors, customers and partners. The executive committees concerned with strategy may have little knowledge of the value creation within their companies and therefore split into factions, which base themselves on different sets of data. In the end, rather than taking the risk of following the wrong path, they pursue no path at all.

Exhibit 1: Traditional model of business strategy development



How can we find a better framework to shorten the time between planning and execution? The traditional strategy development approach is to go through a number of sequential steps, so it is this process that needs to be re-engineered.

The execution gap. Strategies can be successful only if they are implemented with great care. Yet the majority of formally formulated strategies are not implemented on time and with the intended results. Execution is obviously a key problem. The reasons for this may be found either in the nature of a company's strategy planning exercise (typically an annual internal three-day seminar) or in the gap between management functions and the rest of the organisation.

The communication gap. During strategy development there often is a lack of communication among the members of the management team and between the team and the rest of the organisation. The units then often claim that they have no directions and therefore are unable to implement the strategy properly. This may well be the cause of many strategies failing.

Many studies indicate that carefully planned strategies are very often not implemented on time or don't deliver the intended results.

Requirements for a new framework

Listening and selecting capabilities. Disruptive technologies or procedures force companies to radically change their strategies. Companies are often not capable of interpreting the signals for change in time and therefore fail in their strategic positioning and planning.

Identification and evaluation of new trends (and selecting the right skills) can help overcome these problems. Listening to weak signals from the market, from the environment in general or from a peripheral vision system should be a permanent activity, integrated carefully into a strategy development framework.

These listening and vision-building skills should include the identification of customer requirements. Customers may change or another competitor may find a better way to meet their requirements. Companies that win their customers' loyalty are the ones that can provide what they want, when they need it.

Listening has a global perspective as well. In many industries, the global market place is a reality (for example, car manufacturing, IT, banking) and modern

internet-based communication tools allow easy cross-border business. Therefore a new strategy framework must adapt flexibly to many cultures and countries.

Flexibility. This is a key requirement for effective performance, especially when operating conditions change rapidly. Flexibility means two things:

- **Adaptability.** An adaptive system is one in which managers can quickly change the direction and execution of the strategy. The strategic planning system should therefore be proactive and responsive towards the enterprise. It may even provide a basis for experimentation during planning and execution.
- **Flexible organisation structures and a co-operative culture** to allow for structural change. This includes facilities, technologies, policies and processes, talent management and labour relations, and provides adaptability to the environment. It means basically that organisational units should be kept as small and as focused as possible. This should be true for the planning as well as the execution phase.

Such a new framework should be easily extendable and adaptable to meet the individual requirements of the enterprise. If this is the case, the enterprise will be able to switch to an alternative set-up in the shortest possible time.

The core of all strategy development is finding new – and sustaining existing – profit pools.

Integration of decision making and execution. The core of all strategy development is finding new – and sustaining existing – profit pools. This essentially means maximising returns and lowering risks. The search for opportunities and risks and the quick, careful evaluation of these must therefore be integrated into the model framework:

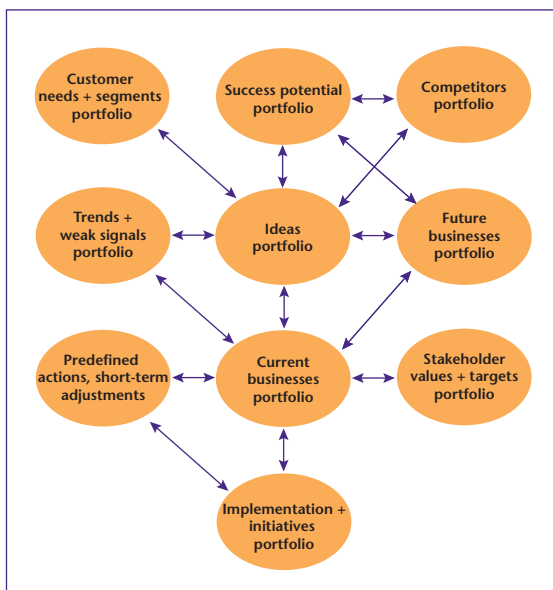
- **Risk.** For investments, modern investment theory says that you can fix the level of risk in a portfolio and then maximise the return this portfolio yields according to the preset level of risk. Conversely, you can attempt to fix a reasonable level of return and minimise the level of risk associated with achieving that rate of return. This concept of risk management might prove useful in the business strategy context as well, so risk adjustment should be part of the design of a new strategy framework. Suitable risk factors must be identified, and the adjustments should be based on the best and latest information and be understood and cleared by management. The output of such strategy development would then be risk-adjusted strategy actions. This is important, as many CEOs are unaware of the risk portfolio which goes with their strategy.

- **Speed.** Quick implementation of a new business idea is a key success factor and a new strategy framework should support it. This means building an organisation culture that will allow the removal of speed traps, resistance and other change-related problems that are barriers to execution. Communication between senior managers and the strategy division should be enhanced to enable better implementation. It is all about listening and being heard, sharing the most up-to-date research result with others to get real impact. Interactivity means communicating effectively and influencing the intellectual capital of the enterprise.
- **Predefined actions.** There might also be a need for predefined actions, which can be drawn on if a specific chance or risk arises (this will include a clear mission, dedicated people, well suited tools and appropriate resources). These predefined actions within strategy development are sometimes called 'active waiting'. They may lead to purposeful experimentation, meaning experimentation with carefully selected actions in order to test their usefulness with limited scope.

A new model of strategy development

Portfolio management techniques from the finance industry can be applied to strategy development. The various aspects of strategy are built into various corporate profiles, grouped together and related to each other. These interrelated groupings are then managed using Markowitz's portfolio theory.

Exhibit 2: An overview of a portfolio structure



The new approach to strategy allows strategy work to be undertaken not as a sequential initiative, but as a set of

tasks running continuously in parallel. However, the operational aspects remain unclear and focus mainly on the new initiative portfolio management, rather than shaping a full-blown new framework.

Taking the business re-engineering and the portfolio approaches together, the resulting new and improved model may best be described as an interlinked portfolio approach. If the various strategy development items are regarded as managed and interconnected portfolios, a complete portfolio structure may look like exhibit 2.

The new framework is made up of different portfolios:

- **Trends and weak signals.** A big problem with traditional strategy making is that it may quickly become outdated. At the time the strategy is implemented it may no longer make sense, because its assumptions are already outdated. Alternatively, the planned implementation needs to be reshaped or rescaled. Therefore at least one portfolio should deal with weak signals. Filters then evaluate them as an input for other portfolios, which have to be adapted accordingly. A portfolio manager would then constantly monitor the portfolios environment and scout the relevant trends and signals, so that data and assumptions at the time of implementation (and as well during implementation) are always up to date.
- **Customer needs and segments.** Obvious as well as hidden customer needs are the basis of current and future revenue streams. Therefore a portfolio of customers may be divided into appropriate segments and their needs and behaviour identified and followed carefully. It is important to understand why, for example, a disruptive change occurred with regard to new customer needs, values and assumptions. Within the context of customer needs, the capabilities, systems and infrastructure needed to serve those customers must be assessed.
- **Competitors.** Competitor moves shape any company's competitive position and therefore its business success. Competitor analysis therefore must be an integral part of the company's analytics. This can provide a basis for finding optimal paths to competitive advantage within the complex, fast-changing business context.
- **Ideas and future potential.** As trends, weak signals and customer needs are identified, they can lead to ideas for future potential success. It makes sense to collect ideas and future potentials in an independent portfolio and evaluate them according to the needs of the stakeholders, the assigned portfolio managers and their co-ordination committees. Ideas are semi-structured and may include a rough description of the business idea and the business model, and a rough forecast of their potential in financial terms. Organisations today rarely hire a person to collect ideas or deal with the risks and costs of their implementation.

- **Success potential.** This comes between the ideas and the future business portfolios. It deals with, shapes and weighs filtered ideas and shows future profit potentials. These are usually not shaped clearly enough to be future business units, but they indicate the size of the profit involved, which helps in selecting the right profit pools.
- **Future businesses.** Future businesses are defined and planned business units which may arise from success potentials but are not yet operative. It makes sense to deal with them in a strategy framework as they are ready to implement.
- **Current businesses.** Every company has business areas and business units which are producing and selling goods and services in the market. Their performance may also go into a portfolio, which usually records growth rate, market share, contribution margin, quality and satisfaction data. An advantage of the portfolio approach is that each existing business portfolio can periodically be stress tested with new weak signals.
- **Predefined actions and short-term adjustments.** As speed is important in realising strategic opportunities, it makes sense to predefine actions or have defined competitive responses. The idea is that those items can be activated immediately as a strategic response to outside triggers or weak signals (like competitor attacks or changed regulations). The more detailed these predefined action modules are, the quicker the company can react. They may include people, tasks, resources and processes. Sometimes change requires just little adjustments – not all weak signals will result in a large-scale change project. So it makes sense to set up next to the project or initiative portfolio a short-term action portfolio to define and track these little tasks and actions.
- **Implementation and initiatives.** Variations from past or new profit potentials often require organisational change. Change initiatives are usually handled and steered as a project portfolio, which of course should be aligned with the strategy. As execution comes more and more into focus, initiative portfolios are considered an important part of the overall portfolio structure.
- **Stakeholder values and targets.** As change ability and flexibility are part of every portfolio and indeed the whole framework, it is important that the changing and updating system does not lose direction and that the various portfolios do not move in different directions. As the company's stakeholders (typically shareholders, the public, government and others) are setting the goals, it is important that their values and needs are known and reflected in the portfolio management process. This is an ongoing task, as stakeholders' ideas and values change and new stakeholders join and old ones leave. Yet the stakeholder value portfolio can be the 'pole star' with

regard to the orientation of the whole strategy portfolio framework, and it should give direction and guidance to all other portfolios and their respective managers.

Managed portfolios often require the organisation to be updated. Once a strategic grouping, or a portfolio, is set up it needs to be managed. A portfolio manager must be appointed to define and plan enhancements, scan the environment, grow the strategic portfolio and balance its performance against targets.

For each portfolio defined, responsibilities must be designed. The resulting organisation is a networked structure with no or little hierarchy. To reduce potential organisational conflict, it is advisable to define line responsibilities according to the portfolio responsibilities, so line management reporting will include status reporting on strategic issues derived from the portfolio data.

Well-defined processes – such as intraportfolio and interportfolio management – help speed up communications and information flow.

Well-defined processes help speed up communications and information flow:

- **Intraportfolio management.** Because items are added to and removed from the portfolio, the evaluation and selection of items is one of the portfolio manager's primary tasks. As in cybernetics, the target should be set first, and then actions and metrics defined. In other words, the performance of the portfolio has to be properly adjusted. Each portfolio, however, has individual performance goals, metrics and criteria.
- **Interportfolio management** enables linking of different portfolios. Important elements are communication, system clock and speed to market, scalability and size:
 - Communication. As more portfolios are set up and monitored, there is more need for interportfolio management. Strategic ideas, new early warning signals or ideas not working in the market require discussion, valuation and feedback among the different portfolio managers (and their portfolios). If this is neglected, aspects which may influence multiple portfolios may not be recognised early enough and may cause harm later on. So communication between the portfolio managers is important. This should take place on a well-defined and regular formal basis, as well as ad hoc and informally when something unusual occurs. Notification and decision mechanisms and meetings should be set up and documented. This is quite

different from the traditional strategy approach, where after a series of exclusive workshops a strategy paper is written and frozen for a certain period of time. (This strategy document may then rust on some shelf or be left in some secret closet with the danger of being ignored.)

- System clock and speed to market. As the environment may be turbulent and the speed of change may be different in different portfolios, the triggers and the 'system clock' may vary between the portfolios. The system clock is the rhythm at which the variables of the portfolio are evaluated; for example, in a large enterprise, idea portfolios are probably evaluated more often than production portfolios (existing business). The new approach allows this to happen as each portfolio can be assigned a different clock speed in decision making (variations on the clock and timing of the decision-making sessions).
- Scalability and size. As portfolios can be set up flexibly in structure and number, a scalable strategy approach is easy. When the business grows, you add more portfolios. When it shrinks, you reduce the number of portfolios and managers. If the business is a start-up with no resources for strategy development, you can balance the most essential portfolios on a spreadsheet. If it is a multi-business-line holding in a global setting (such as General Electric), you can set up as many portfolios as you need and can handle in a clear and communicative structure and support it with a large IT system.

Special aspects and requirements

Portfolio management and systemics. Portfolio management in strategy development has a lot to do with a cybernetic cycle and with systemics. As in a cybernetic cycle, target values are set and measurements are made, actual values are compared with the target values, and actions are derived from the gap between them. In an analogous way, the variables and their interdependence need to be set up and assessed before operational measurements are made. The final goal of system thinking is always system stability – in economic terms, stable returns and profitability.

Globalisation. Many enterprises operate on a global basis, with many countries and cultures involved in their business activities. Can the portfolio approach in strategy formulation cope with this diversity and can it be accepted throughout the world? It is easy to define country- and even culture-specific portfolios. As the strategic portfolios are all interconnected, the global portfolio structure might help a company recognise culture-specific differences, potentials and risks.

Risk management and strategy development. Risk assessment is important for strategy design although it is often neglected. Because risk indicators can be defined as variables in the portfolio structure, risk management is easy to integrate and monitor. This is better than the current situation, where strategy development usually is done without defining the risk involved with actions.

Living documentation versus fixed strategy report.

One shortcoming of this new approach might be the demise of the bulky strategy report. If the strategy process is transformed from a periodic to a continuous action process, having such a report no longer makes sense. So how do you communicate your strategy to, for example, external stakeholders? As all strategic groups have a portfolio structure, an aggregated data set over many portfolios – a portfolio of portfolios – can be set up. The reporting data will reflect the strategy and its implications, and a snapshot report or slide set can be taken.

A problem might arise if different people take a portfolio snapshot at different times and then get different statements. This can be overcome with structured communication and good presentation discipline (for example, versioning). Strategy maps with live data can be useful. In many cases so-called 'war rooms' can be set up, where the important data is continuously displayed and updated on a (video) wall of a particular office: the strategy control room.

In the war room different visualisation techniques can be used, either low-tech or high-tech with computer and live data support. Strategic targets are typically shown as target figures, and real-time data is projected against its targets to show deviations. This is current practice in many complex and dynamic decision-making situations such as warfare, crisis management, call centres and software development.

As log files and reports of projected and managed situations can be stored, many of these tools allow organisations not only to set up directions and planning but also to store the decisions that have been made, thus providing hints for a learning organisation or auditing purpose as well.

Yet a portfolio of overall values and beliefs may exist over a longer period than may be communicated consistently. A side-effect of living strategy documentation is that the strategy report needs to be discussed. It is therefore ingrained in the minds of the people involved. This can form an excellent basis for strategy implementation as strategy will no longer be regarded as 'just another report on the shelf'.

Portfolio management and IT tools. The structure of strategy portfolios and the tasks of portfolio management

(with many different variables to monitor) call for IT tools. IT applications such as databases provide not only operational ease in storing and maintaining strategy data but also decision transparency, because when decisions are made the decision options are recorded together with indicator data and are documented automatically. Such records can be used for training or auditing. This can lead to organisational learning. Moreover, managing multiple portfolios from a common database assures a minimal degree of communication between the different portfolios.

Strategic alignment. Strategy portfolios may vary widely. So how can a strategy be aligned when it has to integrate all these different portfolios? It makes sense to set up a group of people to compare and evaluate the various portfolios in order to maximise overall performance and hedge the risk. This group can consist of all portfolio managers and may have regular meetings to exchange growth, profitability and vulnerability data as well as changes in the environment and upcoming opportunities. Strategic alignment takes place when the portfolios are open for input (for example, ideas or new projects) and share their results (for example, key data on their performance).

Portfolios should be positioned and connected to each other in such a way that risk and return are balanced according to the risk appetite and style of the company. For example, a weak signal from the trends portfolio may be discussed and then transferred to one or more project portfolios. The beauty of this approach is that there is leverage and speed, because one stimulus can have quick and multiple impacts on other portfolios. In traditional sequential strategy building, it is necessary not only to go through the cycle of analysis, positioning, realisation and control in sequential and time-consuming steps, but also to do so in each business unit as well as at the corporate level. This usually means long delays in implementation. With this new approach such delays can be avoided.

Benefits of the new framework

This new approach to strategy development and strategic management will close the three gaps identified earlier:

- **Planning gap** – with the active portfolio structure, the dynamics of the portfolios, including foresight portfolios and active portfolio management
- **Execution gap** – with the portfolio structure itself, active portfolio management, the portfolio metrics (target to actual performance) and interportfolio communication
- **Communication gap** – with interportfolio communication as well as portfolio transparency with war room-like active strategy communication.

The following benefits can be expected:

- **Speed and flexibility.** A seamless strategy structure which allows for continuous and parallel strategy activities throughout the year helps bring new ideas and market responses to the market more quickly. The integration between the different business units and the strategy process itself is much easier to set up and maintain than the classical sequential model. The new approach speeds up the usual cycle from analysis to implementation. This can mean real money, as in some industries (such as pharmaceuticals) each day later on the market can mean a loss of millions of dollars.
- **Risk-adjusted strategy.** As the different portfolios can easily be linked to risk management, financial data and performance measurement (or even integrated there as variables), the resulting actions can be risk-adjusted from the start. By contrast, in the sequential model risk management is usually handled separately.
- **Control.** A strategy portfolio framework might give more control in a volatile business environment and may be the only solution to cope with change in a turbulent world. In such environments, the traditional sequential approach no longer delivers useful results. Success control and backtracking are easy, as the status of the portfolios and all data can be recorded and tracked in databases. This delivers not only inputs for corporate knowledge management and decision making but also data for compliance audits.
- **Cultural awareness.** The new approach allows for different national or cultural portfolios, so internationalisation and globalisation issues can be handled better (country-specific portfolios can be set up easily and compared with each other).

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