

CHAPTER 2

CHARTING A COMPANY'S DIRECTION: VISION AND MISSION, OBJECTIVES, AND STRATEGY

The vision we have . . . determines what we do and the opportunities we see or don't see.

—Charles G. Koch

CEO of Koch Industries, the second-largest privately held company in the U.S.

A good goal is like a strenuous exercise—it makes you stretch.

—Mary Kay Ash

Founder of Mary Kay Cosmetics

If you don't know where you are going, any road will take you there.

—Cheshire Cat to Alice

Lewis Carroll, Alice in Wonderland

LEARNING OBJECTIVES

- LO 1.** Grasp why it is critical for company managers to have a clear strategic vision of where a company needs to head and why.
- LO 2.** Understand the importance of setting both strategic and financial objectives.
- LO 3.** Understand why the strategic initiatives taken at various organizational levels must be tightly coordinated to achieve companywide performance targets.
- LO 4.** Become aware of what a company must do to achieve operating excellence and to execute its strategy proficiently.
- LO 5.** Become aware of the role and responsibility of a company's board of directors in overseeing the strategic management process.

Crafting and executing strategy are the heart and soul of managing a business enterprise. But exactly what is involved in developing a strategy and executing it proficiently? What are the various components of the strategy-making, strategy-executing process and to what extent are company personnel—aside from senior management—involved in the process? In this chapter we present an overview of the ins and outs of crafting and executing company strategies. Special attention will be given to management’s direction-setting responsibilities—charting a

strategic course, setting performance targets, and choosing a strategy capable of producing the desired outcomes. We will also explain why strategy making is a task for a company’s entire management team and discuss which kinds of strategic decisions tend to be made at which levels of management. The chapter concludes with a look at the roles and responsibilities of a company’s board of directors in the strategy-making, strategy-executing process and how good corporate governance protects shareholder interests and promotes good management.

WHAT DOES THE STRATEGY-MAKING, STRATEGY-EXECUTING PROCESS ENTAIL?

The process of crafting and executing a company’s strategy consists of five interrelated managerial stages:

1. *Developing a strategic vision* of the company’s long-term direction, a *mission* that describes the company’s purpose, and a set of *values* to guide the pursuit of the vision and mission.
2. *Setting objectives* and using them as yardsticks for measuring the company’s performance and progress.
3. *Crafting a strategy* to achieve the objectives and move the company along the strategic course that management has charted.
4. *Executing the chosen strategy* efficiently and effectively.
5. *Monitoring developments, evaluating performance, and initiating corrective adjustments* in the company’s vision and mission, objectives, strategy, or execution in light of actual experience, changing conditions, new ideas, and new opportunities.

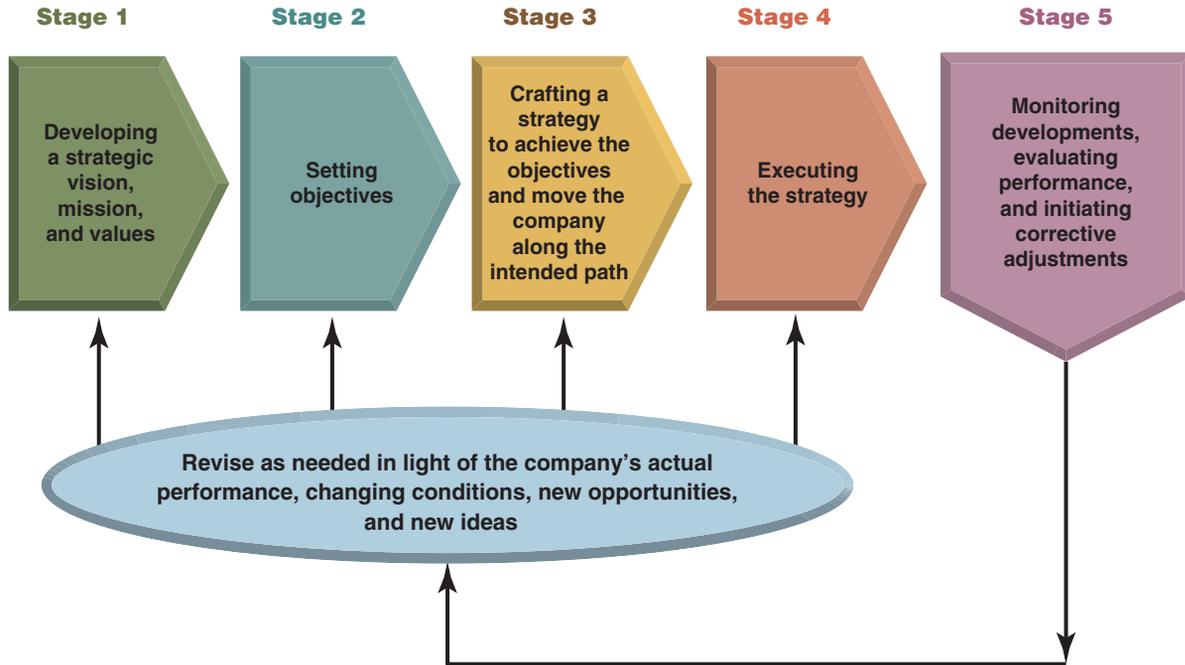
Figure 2.1 The Strategy-Making, Strategy-Executing Process

Figure 2.1 displays this five-stage process, which we examine next in some detail.

STAGE 1: DEVELOPING A STRATEGIC VISION, A MISSION, AND A SET OF CORE VALUES

LO 1

Grasp why it is critical for company managers to have a clear strategic vision of where a company needs to head and why.

Very early in the strategy-making process, a company's senior managers must wrestle with the issue of what directional path the company should take. Can the company's prospects be improved by changing its product offerings and/or the markets in which it participates and/or the customers it caters to and/or the technologies it employs? Deciding to commit the company to one path versus another pushes managers to draw some carefully reasoned conclusions about whether the company's present strategic course offers attractive opportunities for growth and profitability or whether changes of one kind or another in the company's strategy and long-term direction are needed.

Developing a Strategic Vision

Top management's views and conclusions about the company's long-term direction and what product-customer-market-technology mix seems optimal for the road ahead constitute a **strategic vision** for the company. A strategic vision delineates management's aspirations for the business, providing a panoramic view of "where we are going" and a convincing rationale for why this makes good business sense for the company. A strategic vision thus points an organization in a particular

direction, charts a strategic path for it to follow in preparing for the future, and builds commitment to the future course of action. A clearly articulated strategic vision communicates management's aspirations to stakeholders and helps steer the energies of company personnel in a common direction.

Well-conceived visions are *distinctive* and *specific* to a particular organization; they avoid generic, feel-good statements like “We will become a global leader and the first choice of customers in every market we serve”—which could apply to hundreds of organizations.¹ And they are not the product of a committee charged with coming up with an innocuous but well-meaning one-sentence vision that wins consensus approval from various stakeholders. Nicely worded vision statements with no specifics about the company's product-market-customer-technology focus fall well short of what it takes for a vision to measure up.

A sampling of vision statements currently in use shows a range from strong and clear to overly general and generic. A surprising number of the vision statements found on company Web sites and in annual reports are vague and unrevealing, saying very little about the company's future direction. Some could apply to almost any company in any industry. Many read like a public relations statement—high-sounding words that someone came up with because it is fashionable for companies to have an official vision statement.² But the real purpose of a vision statement is to serve as a management tool for giving the organization a sense of direction. Like any tool, it can be used properly or improperly, either clearly conveying a company's future strategic path or not.

For a strategic vision to function as a valuable managerial tool, it must convey what management wants the business to look like and provide managers with a reference point in making strategic decisions and preparing the company for the future. It must say something definitive about how the company's leaders intend to position the company beyond where it is today. Table 2.1 provides some dos and don'ts in composing an effectively worded vision statement. Illustration Capsule 2.1 provides a critique of the strategic visions of several prominent companies.

Communicating the Strategic Vision

Effectively communicating the strategic vision down the line to lower-level managers and employees is as important as the strategic soundness of the long-term direction top management has chosen. Company personnel can't be expected to unite behind managerial efforts to get the organization moving in the intended direction until they understand why the strategic course that management has charted is reasonable and beneficial. It is particularly important for executives to provide a compelling rationale for a dramatically *new* strategic vision and company direction. When company personnel don't understand or accept the need for redirecting organizational efforts, they are prone to resist change. Hence, reiterating the basis for the new direction, addressing employee concerns head-on, calming fears, lifting spirits, and providing updates and progress reports as events unfold all become part of the task in mobilizing support for the vision and winning commitment to needed actions.

Winning the support of organization members for the vision nearly always means putting “where we are going and why” in writing, distributing the statement organizationwide, and having executives personally explain the vision and its

CORE CONCEPT

A **strategic vision** describes management's aspirations for the future and delineates the company's strategic course and long-term direction.

An effectively communicated vision is a tool for enlisting the commitment of company personnel to actions that move the company forward in the intended direction.

Table 2.1 Wording a Vision Statement—the Dos and Don'ts

The Dos	The Don'ts
Be graphic. Paint a clear picture of where the company is headed and the market position(s) the company is striving to stake out.	Don't be vague or incomplete. Never skimp on specifics about where the company is headed or how the company intends to prepare for the future.
Be forward-looking and directional. Describe the strategic course that management has charted and the kinds of product-market-customer-technology changes that will help the company prepare for the future.	Don't dwell on the present. A vision is not about what a company once did or does now; it's about "where we are going."
Keep it focused. Be specific enough to provide managers with guidance in making decisions and allocating resources.	Don't use overly broad language. All-inclusive language that gives the company license to head in almost any direction, pursue almost any opportunity, or enter almost any business must be avoided.
Have some wiggle room. Language that allows some flexibility is good. The directional course may have to be adjusted as market-customer-technology circumstances change, and coming up with a new vision statement every one to three years signals rudderless management.	Don't state the vision in bland or uninspiring terms. The best vision statements have the power to motivate company personnel and inspire shareholder confidence about the company's direction and business outlook.
Be sure the journey is feasible. The path and direction should be within the realm of what the company can pursue and accomplish; over time, a company should be able to demonstrate measurable progress in achieving the vision.	Don't be generic. A vision statement that could apply to companies in any of several industries (or to any of several companies in the same industry) is incapable of giving a company its own unique identity.
Indicate why the directional path makes good business sense. The directional path should be in the long-term interests of stakeholders (especially shareowners, employees, and customers).	Don't rely on superlatives only. Visions that claim the company's strategic course is one of being the "best" or "the most successful" or "a recognized leader" or the "global leader" usually shortchange the essential and revealing specifics about the path the company is taking to get there.
Make it memorable. To give the organization a sense of direction and purpose, the vision needs to be easily communicated. Ideally, it should be reducible to a few choice lines or a memorable "slogan" (like Henry Ford's famous vision of "a car in every garage").	Don't run on and on. Vision statements that are overly long tend to be unfocused and meaningless. A vision statement that is not short and to-the-point will tend to lose its audience.

Sources: John P. Kotter, *Leading Change* (Boston: Harvard Business School Press, 1996), p. 72; Hugh Davidson, *The Committed Enterprise* (Oxford: Butterworth Heinemann, 2002), chap. 2; and Michel Robert, *Strategy Pure and Simple II* (New York: McGraw-Hill, 1992), chaps. 2, 3, and 6.

Strategic visions become real only when the vision statement is imprinted in the minds of organization members and then translated into hard objectives and strategies.

rationale to as many people as feasible. *A strategic vision can usually be stated adequately in one to two paragraphs, and managers should be able to explain it to company personnel and outsiders in 5 to 10 minutes.* Ideally, executives should present their vision for the company in a manner that reaches out and grabs people. An engaging and convincing strategic vision has enormous motivational value—for the same reason that a stonemason is more inspired by building a great cathedral for the ages than simply laying stones to create floors and walls. When managers articulate a vivid and compelling case for where the company is headed, organization members begin to say "This is interesting and has a lot of merit. I want to be involved and do my part to help make it happen." The more that a vision evokes positive support and excitement, the greater its impact in terms of arousing a committed organizational effort and getting company personnel to move in a common direction.³ Thus executive ability to paint a convincing and inspiring picture of a company's journey and destination is an important element of effective strategic leadership.



ILLUSTRATION CAPSULE 2.1

Examples of Strategic Visions—How Well Do They Measure Up?

Vision Statement	Effective Elements	Shortcomings
<p>Coca-Cola Our vision serves as the framework for our Roadmap and guides every aspect of our business by describing what we need to accomplish in order to continue achieving sustainable, quality growth.</p>  <ul style="list-style-type: none"> • People: Be a great place to work where people are inspired to be the best they can be. • Portfolio: Bring to the world a portfolio of quality beverage brands that anticipate and satisfy people's desires and needs. • Partners: Nurture a winning network of customers and suppliers; together we create mutual, enduring value. • Planet: Be a responsible citizen that makes a difference by helping build and support sustainable communities. <ul style="list-style-type: none"> • Profit: Maximize long-term return to shareowners while being mindful of our overall responsibilities. • Productivity: Be a highly effective, lean and fast-moving organization. 	<ul style="list-style-type: none"> • Graphic • Focused • Flexible • Makes good business sense 	<ul style="list-style-type: none"> • Long • Not forward-looking
<p>UBS We are determined to be the best global financial services company. We focus on wealth and asset management, and on investment banking and securities businesses. We continually earn recognition and trust from clients, shareholders, and staff through our ability to anticipate, learn and shape our future. We share a common ambition to succeed by delivering quality in what we do. Our purpose is to help our clients make financial decisions with confidence. We use our resources to develop effective solutions and services for our clients. We foster a distinctive, meritocratic culture of ambition, performance and learning as this attracts, retains and develops the best talent for our company. By growing both our client and our talent franchises, we add sustainable value for our shareholders.</p>	<ul style="list-style-type: none"> • Focused • Feasible • Desirable 	<ul style="list-style-type: none"> • Not forward-looking • Bland or uninspiring • Hard to communicate
<p>Walmart Saving People Money So They Can Live Better</p>	<ul style="list-style-type: none"> • Focused • Memorable • Feasible • Makes good business sense 	<ul style="list-style-type: none"> • Dwells on the present

Sources: Company documents and Web sites (accessed April 23, 2010, and June 6, 2010).

Expressing the Essence of the Vision in a Slogan The task of effectively conveying the vision to company personnel is assisted when management can capture the vision of where to head in a catchy or easily remembered slogan. A number of organizations have summed up their vision in a brief phrase:

- Levi Strauss & Company: “We will clothe the world by marketing the most appealing and widely worn casual clothing in the world.”
- Nike: “To bring innovation and inspiration to every athlete in the world.”
- Mayo Clinic: “The best care to every patient every day.”
- Scotland Yard: “To make London the safest major city in the world.”
- Greenpeace: “To halt environmental abuse and promote environmental solutions.”

Creating a short slogan to illuminate an organization’s direction and purpose helps rally organization members to hurdle whatever obstacles lie in the company’s path and maintain their focus.

The Payoffs of a Clear Vision Statement A well-conceived, forcefully communicated strategic vision pays off in several respects: (1) It crystallizes senior executives’ own views about the firm’s long-term direction; (2) it reduces the risk of rudderless decision making; (3) it is a tool for winning the support of organization members for internal changes that will help make the vision a reality; (4) it provides a beacon for lower-level managers in setting departmental objectives and crafting departmental strategies that are in sync with the company’s overall strategy; and (5) it helps an organization prepare for the future. When management is able to demonstrate significant progress in achieving these five benefits, the first step in organizational direction setting has been successfully completed.

Crafting a Mission Statement

The defining characteristic of a strategic vision is what it says about the company’s *future strategic course*—“the direction we are headed and our aspirations for the future.” In contrast, a **mission statement** describes the enterprise’s *current business and purpose*—“who we are, what we do, and why we are here.” The mission statements that one finds in company annual reports or posted on company Web sites are typically quite brief; some do a better job than others of conveying what the enterprise is all about. Consider, for example, the mission statement of Trader Joe’s (a specialty grocery chain):

The mission of Trader Joe’s is to give our customers the best food and beverage values that they can find anywhere and to provide them with the information required for informed buying decisions. We provide these with a dedication to the highest quality of customer satisfaction delivered with a sense of warmth, friendliness, fun, individual pride, and company spirit.

Note that Trader Joe’s mission statement does a good job of conveying “who we are, what we do, and why we are here,” but it says nothing about the company’s long-term direction.

Another example of a well-stated mission statement with ample specifics about what the organization does is that of the Occupational Safety and Health Administration (OSHA): “to assure the safety and health of America’s workers by setting and enforcing standards; providing training, outreach, and education; establishing partnerships; and encouraging

The distinction between a strategic vision and a mission statement is fairly clear-cut: A **strategic vision** portrays a company’s aspirations for its *future* (“where we are going”), whereas a company’s **mission** describes its *purpose* and its *present* business (“who we are, what we do, and why we are here”).

continual improvement in workplace safety and health.” Microsoft’s grandiloquent mission statement—“To help people and businesses throughout the world realize their full potential”—says so little about the customer needs it is satisfying that it could be applied to almost any firm. A well-conceived mission statement should employ language specific enough to give the company its own identity.

Ideally, a company mission statement is sufficiently descriptive to:

- Identify the company’s product or services.
- Specify the buyer needs it seeks to satisfy.
- Identify the customer groups or markets it is endeavoring to serve.
- Specify its approach to pleasing customers.
- Give the company its own identity.

Not many company mission statements fully reveal *all* these facets of the business or employ language specific enough to give the company an identity that is distinguishably different from those of other companies in much the same business or industry. A few companies have worded their mission statements so obscurely as to mask what they are all about. Occasionally, companies couch their mission in terms of making a profit. This is misguided. Profit is more correctly an *objective* and a *result* of what a company does. Moreover, earning a profit is the obvious intent of every commercial enterprise. Such companies as BMW, McDonald’s, Shell Oil, Procter & Gamble, Nintendo, and Nokia are each striving to earn a profit for shareholders; but plainly the fundamentals of their businesses are substantially different when it comes to “who we are and what we do.” It is management’s answer to “make a profit doing what and for whom?” that reveals the substance of a company’s true mission and business purpose.

Linking the Vision and Mission with Company Values

The **values** of a company (sometimes called *core values*) are the beliefs, traits, and behavioral norms that management has determined should guide the pursuit of its vision and mission. They relate to such things as fair treatment, integrity, ethical behavior, innovativeness, teamwork, top-notch quality, superior customer service, social responsibility, and community citizenship. Many companies have developed a statement of values to emphasize the expectation that the values be reflected in the conduct of company operations and the behavior of company personnel.

Most companies have identified four to eight core values. At FedEx, the six core values concern people (valuing employees and promoting diversity), service (putting customers at the heart of all it does), innovation (inventing services and technologies to improve what it does), integrity (managing with honesty, efficiency, and reliability), and loyalty (earning the respect of the FedEx people, customers, and investors every day, in everything it does). Home Depot embraces eight values—entrepreneurial spirit, excellent customer service, giving back to the community, respect for all people, doing the right thing, taking care of people, building strong relationships, and creating shareholder value—in its quest to be the world’s leading home improvement retailer.

Do companies practice what they preach when it comes to their professed values? Sometimes no, sometimes yes—it runs the gamut. At one extreme are

CORE CONCEPT

A well-conceived **mission statement** conveys a company’s *purpose* in language specific enough to give the company its own identity.

CORE CONCEPT

A company’s **values** are the beliefs, traits, and behavioral norms that company personnel are expected to display in conducting the company’s business and pursuing its strategic vision and mission.

companies with window-dressing values; the values are given lip service by top executives but have little discernible impact on either how company personnel behave or how the company operates. Such companies have value statements because they are in vogue and make the company look good. At the other extreme are companies whose executives are committed to infusing the company with the desired character, traits, and behavioral norms so that they are ingrained in the company's corporate culture—the core values thus become an integral part of the company's DNA and what makes it tick. At such value-driven companies, executives “walk the talk” and company personnel are held accountable for displaying the stated values.

At companies where the stated values are real rather than cosmetic, managers connect values to the pursuit of the strategic vision and mission in one of two ways. In companies with long-standing values that are deeply entrenched in the corporate culture, senior managers are careful to craft a vision, mission, and strategy that match established values; they also reiterate how the value-based behavioral norms contribute to the company's business success. If the company changes to a different vision or strategy, executives take care to explain how and why the core values continue to be relevant. In new companies or companies having unspecified values, top management has to consider what values, behaviors, and business conduct should characterize the company and then draft a value statement that is circulated among managers and employees for discussion and possible modification. A final value statement that incorporates the desired behaviors and traits and that connects to the vision and mission is then officially adopted. Some companies combine their vision, mission, and values into a single statement or document, circulate it to all organization members, and in many instances post the vision, mission, and value statement on the company's Web site. Illustration Capsule 2.2 describes how core values drive the company's mission at the Zappos Family of Companies, a widely known and quite successful online shoe and apparel retailer that was acquired recently by Amazon (but will continue to operate separately).

STAGE 2: SETTING OBJECTIVES

LO 2

Understand the importance of setting both strategic and financial objectives.

The managerial purpose of setting **objectives** is to convert the vision and mission into specific performance targets. Well-stated objectives are *specific, quantifiable* or *measurable*, and contain a *deadline for achievement*. As Bill Hewlett, cofounder of Hewlett-Packard, shrewdly observed, “You cannot manage what you cannot measure. . . . And what gets measured gets done.”⁴ Concrete, measurable objectives are managerially valuable for three reasons: (1) They focus efforts and align actions throughout the organization, (2) they serve as *yardsticks* for tracking a company's performance and progress, and (3) they provide motivation and inspire employees to greater levels of effort. Ideally, managers should develop challenging yet achievable objectives that *stretch* an organization to perform at its full potential.

CORE CONCEPT

Objectives are an organization's performance targets—the specific results management wants to achieve.

What Kinds of Objectives to Set

Two very distinct types of performance targets are required: those relating to financial performance and those relating to strategic performance. **Financial objectives** communicate management's targets for financial

ILLUSTRATION CAPSULE 2.2

Zappos Family Mission and Core Values



We've been asked by a lot of people how we've grown so quickly, and the answer is actually really simple. . . . We've aligned the entire organization around one mission: *to provide the best customer service possible*. Internally, we call this our **WOW** philosophy.

These are the ten core values that we live by:

Deliver Wow through Service. At the Zappos Family of Companies, anything worth doing is worth doing with WOW. WOW is such a short, simple word, but it really encompasses a lot of things. To WOW, you must differentiate yourself, which means doing something a little unconventional and innovative. You must do something that's above and beyond what's expected. And whatever you do must have an emotional impact on the receiver. We are not an average company, our service is not average, and we don't want our people to be average. We expect every employee to deliver WOW.

Embrace and Drive Change. Part of being in a growing company is that change is constant. For some people, especially those who come from bigger companies, the constant change can be somewhat unsettling at first. If you are not prepared to deal with constant change, then you probably are not a good fit for the company.

Create Fun and a Little Weirdness. At Zappos, We're Always Creating Fun and A Little Weirdness! One of the things that makes our company different from a lot of other companies is that we value being fun and being a little weird. We don't want to become one of those big companies that feels corporate and boring. We want to be able to laugh at ourselves. We look for both fun and humor in our daily work.

Be Adventurous, Creative, and Open Minded. We think it's important for people and the company as a whole to be bold and daring (but not reckless). We do not want people to be afraid to take risks and make mistakes. We believe if people aren't making mistakes, then that means they're not taking enough risks. Over time, we want everyone to develop his/her gut about business decisions. We want people to develop and improve their decision-making skills. We encourage people to make mistakes as long as they learn from them.

Pursue Growth and Learning. We think it's important for employees to grow both personally and professionally. It's important to constantly challenge and stretch yourself



and not be stuck in a job where you don't feel like you are growing or learning.

Build Open and Honest Relationships With Communication. Fundamentally, we believe that openness and honesty make for the best relationships because that leads to trust and faith. We value strong relationships in all areas: with managers, direct reports, customers (internal and external), vendors, business partners, team members, and co-workers.

Build a Positive Team and Family Spirit. At our company, we place a lot of emphasis on our culture because we are both a team and a family. We want to create an environment that is friendly, warm, and exciting. We encourage diversity in ideas, opinions, and points of view.

Do More with Less. The Zappos Family of Companies has always been about being able to do more with less. While we may be casual in our interactions with each other, we are focused and serious about the operations of our business. We believe in working hard and putting in the extra effort to get things done.

Be Passionate and Determined. Passion is the fuel that drives us and our company forward. We value passion, determination, perseverance, and the sense of urgency. We are inspired because we believe in what we are doing and where we are going. We don't take "no" or "that'll never work" for an answer because if we had, then our company would have never started in the first place.

Be Humble. While we have grown quickly in the past, we recognize that there are always challenges ahead to tackle. We believe that no matter what happens we should always be respectful of everyone.

Source: Information posted at www.zappos.com (accessed June 6, 2010). Copyright © 2011 Zappos.com, Inc.

performance. **Strategic objectives** are related to a company's marketing standing and competitive vitality. Examples of commonly used financial and strategic objectives include the following:

Financial Objectives	Strategic Objectives
<ul style="list-style-type: none"> • An x percent increase in annual revenues • Annual increases in after-tax profits of x percent • Annual increases in earnings per share of x percent • Annual dividend increases of x percent • Profit margins of x percent • An x percent return on capital employed (ROCE) or return on shareholders' equity investment (ROE) • Increased shareholder value—in the form of an upward-trending stock price • Bond and credit ratings of x • Internal cash flows of x dollars to fund new capital investment 	<ul style="list-style-type: none"> • Winning an x percent market share • Achieving lower overall costs than rivals • Overtaking key competitors on product performance or quality or customer service • Deriving x percent of revenues from the sale of new products introduced within the past five years • Having broader or deeper technological capabilities than rivals • Having a wider product line than rivals • Having a better-known or more powerful brand name than rivals • Having stronger national or global sales and distribution capabilities than rivals • Consistently getting new or improved products to market ahead of rivals

The importance of setting and achieving financial objectives is intuitive. Without adequate profitability and financial strength, a company's long-term health and ultimate survival are jeopardized. Furthermore, subpar earnings and a weak balance sheet alarm shareholders and creditors and put the jobs of senior executives at risk. However, good financial performance, by itself, is not enough.

The Balanced Scorecard: Improved Strategic Performance Fosters Better Financial Performance

A company's financial performance measures are really *lagging indicators* that reflect the results of past decisions and organizational activities.⁵ But a company's past or current financial performance is not a reliable indicator of its future prospects—poor financial performers often turn things around and do better, while good financial performers can fall upon hard times. The best and most reliable *leading indicators* of a company's future financial performance and business prospects are strategic outcomes that indicate whether the company's competitiveness and market position are stronger or weaker. The accomplishment of strategic objectives signals that the company is well positioned to sustain or improve its performance. For instance, if a company is achieving ambitious strategic objectives such that its competitive strength and market position are on the rise, then there's reason to expect that its *future* financial performance will be better than its current or past performance. If a company begins to lose competitive strength and fails to achieve important strategic objectives, then its ability to maintain its present profitability is highly suspect.

Consequently, utilizing a performance measurement system that strikes a *balance* between financial objectives and strategic objectives is optimal.⁶ Just tracking a company's financial performance overlooks the fact that what ultimately enables a company to deliver better financial

CORE CONCEPT

Financial objectives

relate to the financial performance targets management has established for the organization to achieve.

Strategic objectives

relate to target outcomes that indicate a company is strengthening its market standing, competitive vitality, and future business prospects.

results from its operations is the achievement of strategic objectives that improve its competitiveness and market strength. Indeed, *the surest path to boosting company profitability* quarter after quarter and year after year *is to relentlessly pursue strategic outcomes* that strengthen the company's market position and produce a growing competitive advantage over rivals.

The most widely used framework for balancing financial objectives with strategic objectives is known as the **Balanced Scorecard**.⁷ This is a method for linking financial performance objectives to specific strategic objectives that derive from a company's business model. It provides a company's employees with clear guidelines about how their jobs are linked to the overall objectives of the organization, so they can contribute most productively and collaboratively to the achievement of these goals. In 2008, nearly 60 percent of global companies used a balanced-scorecard approach to measuring strategic and financial performance.⁸ Examples of organizations that have adopted a balanced-scorecard approach to setting objectives and measuring performance include UPS, Ann Taylor Stores, UK Ministry of Defense, Caterpillar, Daimler AG, Hilton Hotels, Duke University Hospital, and Siemens AG.⁹ Illustration Capsule 2.3 provides selected strategic and financial objectives of four prominent companies.

CORE CONCEPT

The **Balanced Scorecard** is a tool that is widely used to help a company achieve its *financial objectives* by linking them to specific *strategic objectives* derived from the company's business model.

The Merits of Setting Stretch Objectives Ideally, managers ought to use the objective-setting exercise as a tool for *stretching an organization to perform at its full potential and deliver the best possible results*. Challenging company personnel to go all out and deliver “stretch” gains in performance pushes an enterprise to be more inventive, to exhibit more urgency in improving both its financial performance and its business position, and to be more intentional and focused in its actions. Stretch objectives spur exceptional performance and help build a firewall against contentment with modest gains in organizational performance. As Mitchell Leibovitz, former CEO of the auto parts and service retailer Pep Boys, once said, “If you want to have ho-hum results, have ho-hum objectives.” *There's no better way to avoid unimpressive results than by setting stretch objectives and using compensation incentives to motivate organization members to achieve the stretch performance targets.*

Why Both Short-Term and Long-Term Objectives Are Needed A company's set of financial and strategic objectives should include both near-term and longer-term performance targets. Short-term (quarterly or annual) objectives focus attention on delivering performance improvements in the current period and satisfy shareholder expectations for near-term progress. Longer-term targets (three to five years off) force managers to consider what to do *now* to put the company in position to perform better later. Long-term objectives are critical for achieving optimal long-term performance and stand as a barrier to a nearsighted management philosophy and an undue focus on short-term results. When trade-offs have to be made between achieving long-run objectives and achieving short-run objectives, long-run objectives should take precedence (unless the achievement of one or more short-run performance targets has unique importance).

The Need for Objectives at All Organizational Levels Objective setting should not stop with top management's establishing of company-wide performance targets. Company objectives need to be broken down into

ILLUSTRATION CAPSULE 2.3

Examples of Company Objectives



NORDSTROM

Increase same store sales by 2–4%. Expand credit revenue by \$25–\$35 million while also reducing associated expenses by \$10–\$20 million as a result of lower bad debt expenses. Continue moderate store growth by opening three new Nordstrom stores, relocating one store and opening 17 Nordstrom Racks. Find more ways to connect with customers on a multi-channel basis, including plans for an enhanced online experience, improved mobile shopping capabilities and better engagement with customers through social networking. Improve customer focus: “Most important, we continue to do everything in our power to elevate our focus on the customer. Our challenge is to keep building on this momentum. Our number one goal firmly remains improving customer service” (Blake Nordstrom, CEO).

MICROSOFT

On a broad level, deliver end-to-end experiences that connect users to information, communications, entertainment, and people in new and compelling ways across their lives at home, at work, and the broadest-possible range of mobile scenarios. Given the dramatic changes in the way people interact with technology, as touch, gestures, handwriting, and speech recognition become a normal part of how we control devices, focus on making technology more accessible and simpler to use, which will create opportunities to reach new markets and deliver new kinds of computing experiences.

More specifically, grow revenue in the PC Division slightly faster than the overall PC market fueled especially by emerging market trends.



Launch Office 2010 for the business market and promote adoption followed by a 2011 launch of the WindowsPhone 7 in the Entertainment and Devices Division. Grow annuity revenue between 4–6% in the Server and Tools Business segment. Target overall gross margin increases of 1% fueled in part by improved operational efficiency. Operating expenses are targeted at \$26.1–\$26.3 billion for the year with projected capital spending at \$2 billion.

MCDONALD'S

Reinvest \$2.4 billion in the business; 50% of this will be spent on opening 1,000 new restaurants around the world, including roughly 500 in Asia Pacific, 250 in Europe, and 150 in the U.S. The other half will be allocated toward “re-imagining” the décor and menu of over 2,000 existing locations. Re-imagining has a direct positive impact on sales as market share increases after re-imagining restaurants in the U.S., France and Australia demonstrate. Continue to expand refranchising; 80% of restaurants have been refranchised and this will be augmented by 200–300 restaurants in the next year. Focus on menu choice with a balance of familiar and popular core products as well as new items to keep products relevant.

Developed with C. David Morgan.

Sources: “Nordstrom 2009 Annual Report,” <http://phx.corporate-ir.net/phoenix.zhtml?c=93295&p=irol-irhome>, https://materials.proxyvote.com/Approved/655664/20100312/AR_57243/images/Nordstrom-AR2009.pdf (accessed April 4, 2010); “Nordstrom Fourth Quarter and Fiscal Year 2009 Earning, February 22, 2010,” <http://phx.corporate-ir.net/phoenix.zhtml?c=93295&p=irol-newsArticle&ID=1393755&highlight=> (accessed April 30, 2010); Nordstrom “4Q 2009 Financial Results,” <http://investor.nordstrom.com/phoenix.zhtml?c=93295&p=irol-audioArchives> (accessed April 30, 2010); Thompson Reuters Street Events, “JWN – Q4 2009 Nordstrom Earnings Conference Call,” www.streetevents.com, February 2010 (transcribed version of Webcast accessed April 30, 2010, through InvesText database); “Microsoft Annual Report” www.microsoft.com/msft/reports/default.aspx (accessed April 23, 2010); “Microsoft Third Quarter Earnings Call,” www.microsoft.com/msft/earnings/fy10/earn_rel_q3_10.msp (accessed April 30, 2010); Thompson Reuters Street Events, “MCD – Q4 2009 McDonald’s Corporate Earnings Conference Call,” www.streetevents.com, January 2010 (transcribed version of Webcast accessed April 30, 2010, through InvesText database).

performance targets for each of the organization's separate businesses, product lines, functional departments, and individual work units. Company performance can't reach full potential unless each organizational unit sets and pursues performance targets that contribute directly to the desired companywide outcomes and results. Objective-setting is thus a *top-down process* that must extend to the lowest organizational levels. And it means that each organizational unit must take care to set performance targets that support—rather than conflict with or negate—the achievement of companywide strategic and financial objectives.

The ideal situation is a team effort in which each organizational unit strives to produce results in its area of responsibility that contribute to the achievement of the company's performance targets and strategic vision. Such consistency signals that organizational units know their strategic role and are on board in helping the company move down the chosen strategic path and produce the desired results.

STAGE 3: CRAFTING A STRATEGY

The task of stitching a strategy together entails addressing a series of *hows*: *how* to grow the business, *how* to please customers, *how* to outcompete rivals, *how* to respond to changing market conditions, *how* to manage each functional piece of the business, *how* to develop needed capabilities, and *how* to achieve strategic and financial objectives. It also means choosing among the various strategic alternatives—proactively searching for opportunities to do new things or to do existing things in new or better ways.¹⁰ The faster a company's business environment is changing, the more critical it becomes for its managers to be good entrepreneurs in diagnosing the direction and force of the changes under way and in responding with timely adjustments in strategy. Strategy makers have to pay attention to early warnings of future change and be willing to experiment with dare-to-be-different ways to establish a market position in that future. When obstacles appear unexpectedly in a company's path, it is up to management to adapt rapidly and innovatively. *Masterful strategies come from doing things differently from competitors where it counts—out-innovating them, being more efficient, being more imaginative, adapting faster—rather than running with the herd.* Good strategy making is therefore inseparable from good business entrepreneurship. One cannot exist without the other.

Strategy Making Involves Managers at All Organizational Levels

A company's senior executives obviously have important strategy-making roles. The chief executive officer (CEO), as captain of the ship, carries the mantles of chief direction setter, chief objective setter, chief strategy maker, and chief strategy implementer for the total enterprise. Ultimate responsibility for *leading* the strategy-making, strategy-executing process rests with the CEO. In some enterprises the CEO or owner functions as strategic visionary and chief architect of strategy, personally deciding what the key elements of the company's strategy will be, although others may well assist with data gathering and analysis and the CEO may seek the advice of senior executives or board members. A CEO-centered approach

LO 3

Understand why the strategic initiatives taken at various organizational levels must be tightly coordinated to achieve companywide performance targets.

to strategy development is characteristic of small owner-managed companies and sometimes large corporations that were founded by the present CEO or that have a CEO with strong strategic leadership skills. Steve Jobs at Apple, Andrea Jung at Avon, and Howard Schultz at Starbucks are prominent examples of corporate CEOs who have wielded a heavy hand in shaping their company's strategy.

Even here, however, it is a mistake to view strategy making as a *top* management function, the exclusive province of owner-entrepreneurs, CEOs, other senior executives, and board members. The more a company's operations cut across different products, industries, and geographic areas, the more that headquarters executives have little option but to delegate considerable strategy-making authority to down-the-line managers in charge of particular subsidiaries, divisions, product lines, geographic sales offices, distribution centers, and plants. On-the-scene managers who oversee specific operating units can be reliably counted on to have more detailed command of the strategic issues and choices for the particular operating unit under their supervision—knowing the prevailing market and competitive conditions, customer requirements and expectations, and all the other relevant aspects affecting the several strategic options available. Managers with day-to-day familiarity of, and authority over, a specific operating unit thus have a big edge over headquarters executives in making wise strategic choices for their operating unit.

Take, for example, a company like General Electric, a \$183 billion global corporation with 325,000 employees, operations in some 100 countries, and businesses that include jet engines, lighting, power generation, electric transmission and distribution equipment, housewares and appliances, medical equipment, media and entertainment, locomotives, security devices, water purification, and financial services. While top-level headquarters executives may well be personally involved in shaping GE's *overall* strategy and fashioning *important* strategic moves, it doesn't follow that a few senior executives in GE's headquarters have either the expertise or a sufficiently detailed understanding of all the relevant factors to wisely craft all the strategic initiatives taken for hundreds of subsidiaries and thousands of products. They simply cannot know enough about the situation in every GE organizational unit to decide on every strategy detail and direct every strategic move made in GE's worldwide organization. Rather, it takes involvement on the part of GE's whole management team—top executives, business group heads, the heads of specific business units and product categories, and key managers in plants, sales offices, and distribution centers—to craft the thousands of strategic initiatives that end up constituting the whole of GE's strategy.

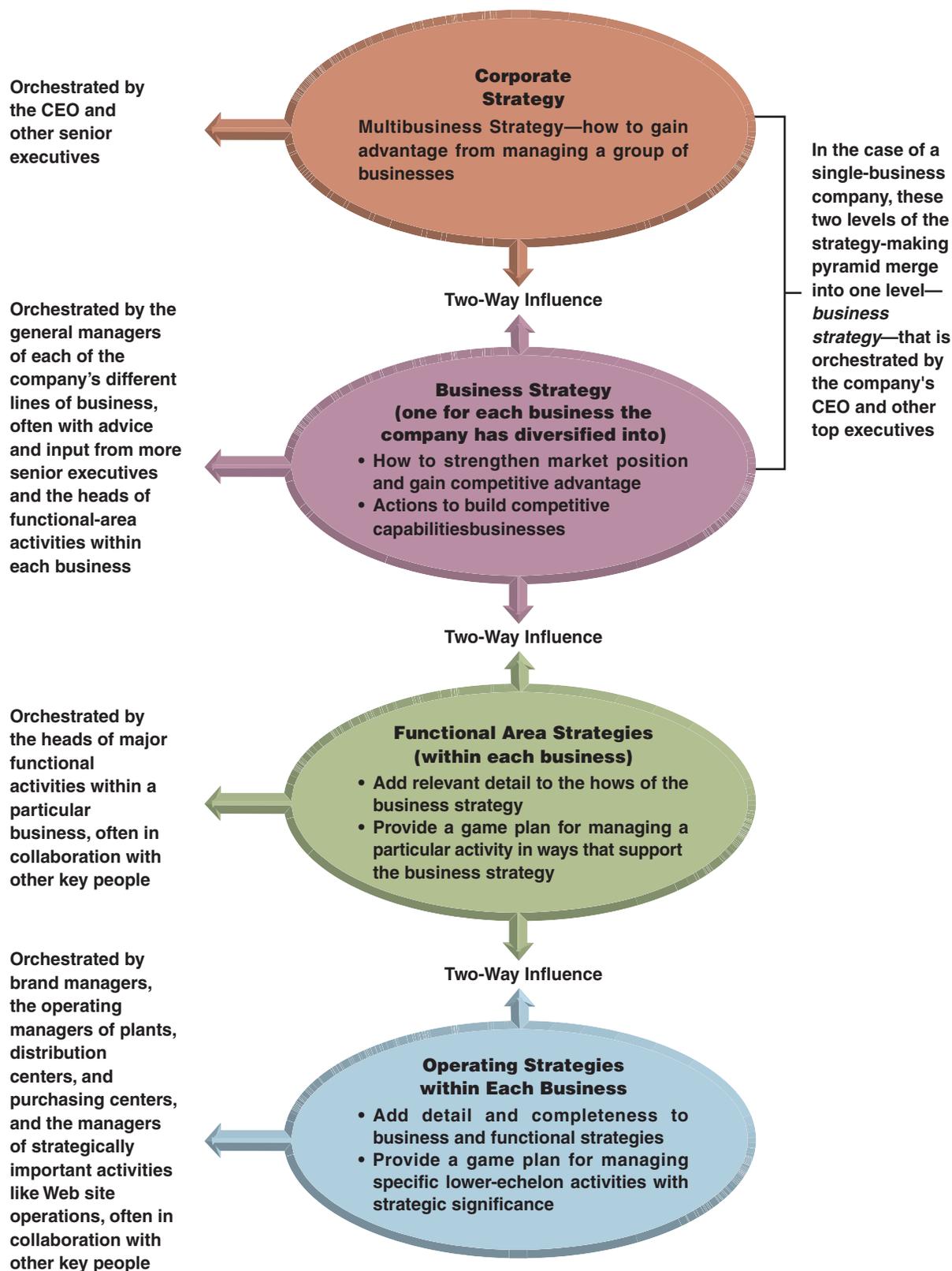
The *level* of strategy also has a bearing on who participates in crafting strategy. In diversified companies, where multiple businesses have to be managed, the strategy-making task involves four distinct levels of strategy. Each of these involves different facets of the company's overall strategy and calls for the participation of different types of managers, as shown in Figure 2.2.

1. *Corporate strategy* is strategy at the multibusiness level—how to achieve a competitive edge through a multibusiness, multimarket strategy. It concerns how to boost the combined performance of *the set of businesses* the company has diversified into and the means of capturing cross-business synergies and turning them into competitive advantage. It addresses the questions of what businesses to hold or divest, which new markets to enter, and what mode of

CORE CONCEPT

In most companies, crafting and executing strategy is a *collaborative team effort* in which every manager has a role for the area he or she heads. It is flawed thinking to view crafting and executing strategy as something only high-level managers do.

Figure 2.2 A Company's Strategy-Making Hierarchy



entry to employ (e.g., through an acquisition, strategic alliance, or franchising). It concerns the *scope* of the firm and thus includes diversification strategies, vertical integration strategies, and geographic expansion strategies. Senior corporate executives normally have lead responsibility for devising corporate strategy and for choosing among whatever recommended actions bubble up from the organization below. Key business-unit heads may also be influential regarding issues related to the businesses they head. Major strategic decisions are usually reviewed and approved by the company's board of directors. We will look deeper into crafting corporate strategy in Chapter 8.

2. *Business strategy* is strategy at the level of a single line of business—one that competes in a relatively well-defined industry or market domain. The key focus is on crafting responses to changing market circumstances and initiating actions to develop strong competitive capabilities, build competitive advantage, strengthen market position, and enhance performance. Orchestrating the development of business-level strategy is typically the responsibility of the manager in charge of the business, although corporate-level managers may be influential. The business head has at least two other strategy-related roles: (1) seeing that lower-level strategies are well conceived, consistent, and adequately matched to the overall business strategy and (2) getting major business-level strategic moves approved by corporate-level officers and keeping them informed of emerging strategic issues. In diversified companies, business-unit heads have the additional obligation of making sure business-level objectives and strategy conform to corporate-level objectives and strategy themes.
3. *Functional-area strategies* concern the actions and approaches employed in managing particular functions within a business—like R&D, production, sales and marketing, customer service, and finance. A company's marketing strategy, for example, represents the managerial game plan for running the sales and marketing part of the business. A company's product development strategy represents the game plan for keeping the company's product lineup in tune with what buyers are looking for. The primary role of functional strategies is to flesh out the details of a company's business strategy. Lead responsibility for functional strategies within a business is normally delegated to the heads of the respective functions, with the general manager of the business having final approval. Since the different functional-level strategies must be compatible with the overall business strategy and with one another to have beneficial impact, the general business manager may at times exert stronger influence on the content of the functional strategies.
4. *Operating strategies* concern the relatively narrow strategic initiatives and approaches for managing key operating units (e.g., plants, distribution centers, purchasing centers) and specific operating activities with strategic significance (e.g., quality control, materials purchasing, brand management, Internet sales). A distribution center manager of a company promising customers speedy delivery must have a strategy to ensure that finished goods are rapidly turned around and shipped out to customers once they are received from the company's manufacturing facilities. Operating strategies, while of limited scope, add further detail to functional strategies and to the overall business strategy. Lead responsibility for operating strategies is usually delegated to frontline managers, subject to review and approval by higher-ranking managers.

Even though operating strategy is at the bottom of the strategy-making hierarchy, its importance should not be downplayed. A major plant that fails in its strategy to achieve production volume, unit cost, and quality targets can damage the company's reputation for quality products and undercut the achievement of company sales and profit objectives. Frontline managers are thus an important part of an organization's strategy-making team. One cannot reliably judge the strategic importance of a given action simply by the strategy level or location within the managerial hierarchy where it is initiated.

In single-business enterprises, the corporate and business levels of strategy making merge into one level—business strategy—because the strategy for the whole company involves only one distinct line of business. Thus a single-business enterprise has three levels of strategy: business strategy for the company as a whole, functional-area strategies for each main area within the business, and operating strategies undertaken by lower-echelon managers to flesh out strategically significant aspects of the company's business and functional-area strategies. Proprietorships, partnerships, and owner-managed enterprises may have only one or two strategy-making levels since their strategy-making process can be handled by just a few key people. The larger and more diverse the operations of an enterprise, the more points of strategic initiative it has and the more levels of management that have a significant strategy-making role.

The overall point is this: Regardless of the type of enterprise and whether the strategy is primarily deliberate or primarily emergent, crafting strategy involves managers in various positions and at various organizational levels. And while managers farther down in the managerial hierarchy obviously have a narrower, more specific strategy-making role than managers closer to the top, the important understanding is that in most of today's companies *every company manager typically has a strategy-making role—ranging from minor to major—for the area he or she heads*. Hence any notion that an organization's strategists are at the top of the management hierarchy and that midlevel and frontline personnel merely carry out the strategic directives of senior managers needs to be cast aside. In companies with wide-ranging operations, it is far more accurate to view strategy making as a *collaborative team effort* involving managers (and sometimes other key employees) down through the whole organizational hierarchy. A valuable strength of collaborative strategy making is that the team of people charged with crafting the strategy include the very people who will also be charged with implementing and executing it. Giving people an influential stake in crafting the strategy they must later help execute not only builds motivation and commitment but also enhances accountability at multiple levels of management—the excuse of “It wasn't my idea to do this” won't fly.

In most companies, crafting strategy is a *collaborative team effort* that includes managers in various positions and at various organizational levels. Crafting strategy is rarely something only high-level executives do.

A Strategic Vision + Objectives + Strategy = A Strategic Plan

Developing a strategic vision and mission, setting objectives, and crafting a strategy are basic direction-setting tasks. They map out where a company is headed, its purpose, the targeted strategic and financial outcomes, the basic business model, and the competitive moves and internal action approaches to be used in achieving the desired business results. Together, they constitute a **strategic plan** for coping with industry conditions, outcompeting rivals, meeting objectives,

CORE CONCEPT

A company's **strategic plan** lays out its future direction and business purpose, performance targets, and strategy.

CORE CONCEPT

A company exhibits **strategic intent** when it relentlessly pursues an exceptionally ambitious strategic objective, committing to do whatever it takes to achieve the goals.

and making progress toward the strategic vision.¹¹ Typically, a strategic plan includes a commitment to allocate resources to the plan and specifies a time period for achieving goals (usually three to five years).

In some companies, the strategic plan is focused around achieving exceptionally bold strategic objectives—stretch goals requiring resources that are well beyond the current means of the company. This type of strategic plan is more the expression of a **strategic intent** to rally the organization through an *unshakable—often obsessive—commitment* to do whatever it takes to acquire the resources and achieve the goals. Nike's strategic intent during the 1960s was to overtake Adidas—an objective far beyond Nike's means at the time. Starbucks strategic intent is to make the Starbucks brand the world's most recognized and respected brand.

In companies that do regular strategy reviews and develop explicit strategic plans, the strategic plan usually ends up as a written document that is circulated to most managers and perhaps selected employees. Near-term performance targets are the part of the strategic plan most often spelled out explicitly and communicated to managers and employees. A number of companies summarize key elements of their strategic plans in the company's annual report to shareholders, in postings on their Web sites, or in statements provided to the business media, whereas others, perhaps for reasons of competitive sensitivity, make only vague, general statements about their strategic plans.¹² In small, privately owned companies, it is rare for strategic plans to exist in written form. Small-company strategic plans tend to reside in the thinking and directives of owners/executives, with aspects of the plan being revealed in meetings and conversations with company personnel, and in the understandings and commitments among managers and key employees about where to head, what to accomplish, and how to proceed.

STAGE 4: EXECUTING THE STRATEGY

LO 4

Become aware of what a company must do to achieve operating excellence and to execute its strategy proficiently.

Managing the implementation of a strategy is an operations-oriented, make-things-happen activity aimed at performing core business activities in a strategy-supportive manner. It is easily the most demanding and time-consuming part of the strategy management process. Converting strategic plans into actions and results tests a manager's ability to direct organizational action, motivate people, build and strengthen company competencies and competitive capabilities, create and nurture a strategy-supportive work climate, and meet or beat performance targets. Initiatives to put the strategy in place and execute it proficiently have to be launched and managed on many organizational fronts.

Management's action agenda for executing the chosen strategy emerges from assessing what the company will have to do to achieve the targeted financial and strategic performance. Each company manager has to think through the answer to "What has to be done in my area to execute my piece of the strategic plan, and what actions should I take to get the process under way?" How much internal change is needed depends on how much of the strategy is new, how far internal practices and competencies deviate from what the strategy requires, and how well the present work climate/culture supports good strategy execution. Depending

on the amount of internal change involved, full implementation and proficient execution of company strategy (or important new pieces thereof) can take several months to several years.

In most situations, managing the strategy execution process includes the following principal aspects:

- Staffing the organization with the needed skills and expertise.
- Building and strengthening strategy-supporting resources and competitive capabilities.
- Organizing the work effort along the lines of best practice.
- Allocating ample resources to the activities critical to strategic success.
- Ensuring that policies and procedures facilitate rather than impede effective strategy execution.
- Installing information and operating systems that enable company personnel to carry out their roles effectively and efficiently.
- Motivating people and tying rewards and incentives directly to the achievement of performance objectives.
- Creating a company culture and work climate conducive to successful strategy execution.
- Exerting the internal leadership needed to propel implementation forward and drive continuous improvement of the strategy execution processes.

Good strategy execution requires diligent pursuit of operating excellence. It is a job for a company's whole management team. Success hinges on the skills and cooperation of operating managers who can push for needed changes in their organizational units and consistently deliver good results. Management's handling of the strategy implementation process can be considered successful if things go smoothly enough that the company meets or beats its strategic and financial performance targets and shows good progress in achieving management's strategic vision.

STAGE 5: EVALUATING PERFORMANCE AND INITIATING CORRECTIVE ADJUSTMENTS

The fifth component of the strategy management process—monitoring new external developments, evaluating the company's progress, and making corrective adjustments—is the trigger point for deciding whether to continue or change the company's vision and mission, objectives, strategy, and/or strategy execution methods.¹³ As long as the company's strategy continues to pass the three tests of a winning strategy (good fit, competitive advantage, strong performance), company executives may well decide to stay the course. Simply fine-tuning the strategic plan and continuing with efforts to improve strategy execution are sufficient.

However, whenever a company encounters disruptive changes in its environment, questions need to be raised about the appropriateness of its direction and strategy. If a company experiences a downturn in its market position or persistent shortfalls in performance, then company managers are obligated

A company's vision and mission, objectives, strategy, and approach to strategy execution are never final; managing strategy is an ongoing process.

to ferret out the causes—do they relate to poor strategy, poor strategy execution, or both?—and take timely corrective action. A company's direction, objectives, and strategy have to be revisited anytime external or internal conditions warrant. It is to be expected that a company will modify its strategic vision, direction, objectives, and strategy over time.

Likewise, it is not unusual for a company to find that one or more aspects of its strategy execution are not going as well as intended. Proficient strategy execution is always the product of much organizational learning. It is achieved unevenly—coming quickly in some areas and proving nettlesome in others. It is both normal and desirable to periodically assess strategy execution to determine which aspects are working well and which need improving. Successful strategy execution entails vigilantly searching for ways to improve and then making corrective adjustments whenever and wherever it is useful to do so.

CORPORATE GOVERNANCE: THE ROLE OF THE BOARD OF DIRECTORS IN THE STRATEGY-CRAFTING, STRATEGY-EXECUTING PROCESS

LO 5

Become aware of the role and responsibility of a company's board of directors in overseeing the strategic management process.

Although senior managers have *lead responsibility* for crafting and executing a company's strategy, it is the duty of a company's board of directors to exercise strong oversight and see that the five tasks of strategic management are conducted in a manner that is in the best interests of shareholders and other stakeholders.¹⁴ A company's board of directors has four important obligations to fulfill:

1. *Critically appraise the company's direction, strategy, and business approaches.* Board members must ask probing questions and draw on their business acumen to make independent judgments about whether strategy proposals have been adequately analyzed and whether proposed strategic actions appear to have greater promise than alternatives. Asking incisive questions is usually sufficient to test whether the case for management's proposals is compelling and to exercise vigilant oversight. However, when the company's strategy is failing or is plagued with faulty execution, and certainly when there is a precipitous collapse in profitability, board members have a duty to be more proactive, expressing their concerns about the validity of the strategy and/or operating methods, initiating debate about the company's strategic path, having one-on-one discussions with key executives and other board members, and perhaps directly intervening as a group to alter the company's executive leadership and, ultimately, its strategy and business approaches.
2. *Evaluate the caliber of senior executives' strategic leadership skills.* The board is always responsible for determining whether the current CEO is doing a good job of strategic leadership.¹⁵ The board must also evaluate the leadership skills of other senior executives, since the board must elect a successor when the incumbent CEO steps down, either going with an insider

or deciding that an outsider is needed. Evaluation of senior executives' skills is enhanced when outside directors visit company facilities and talk with company personnel to personally evaluate whether the strategy is on track, how well the strategy is being executed, and how well issues and problems are being addressed. Independent board members at GE visit operating executives at each major business unit once a year to assess the company's talent pool and stay abreast of emerging strategic and operating issues affecting the company's divisions.

3. *Institute a compensation plan for top executives that rewards them for actions and results that serve stakeholder interests—especially those of shareholders.* A basic principle of corporate governance is that the owners of a corporation (the shareholders) delegate managerial control to a team of executives who are compensated for their efforts on behalf of the owners. In their role as an *agent* of shareholders, corporate managers have a clear and unequivocal duty to make decisions and operate the company in accord with shareholder interests. (This does not mean disregarding the interests of other stakeholders—employees, suppliers, the communities in which the company operates, and society at large.) Most boards of directors have a compensation committee, composed entirely of directors from *outside* the company, to develop a salary and incentive compensation plan that rewards senior executives for boosting the company's *long-term* performance and growing the economic value of the enterprise on behalf of shareholders; the compensation committee's recommendations are presented to the full board for approval. But during the past 10 to 15 years, many boards of directors have done a poor job of ensuring that executive salary increases, bonuses, and stock option awards are tied tightly to performance measures that are truly in the long-term interests of shareholders. Rather, compensation packages at many companies have increasingly rewarded executives for short-term performance improvements that led to undue risk taking and compensation packages that, in the view of many people, were obscenely large. This has proved damaging to long-term company performance and has worked against shareholder interests—witness the huge loss of shareholder wealth that occurred at many financial institutions in 2008–2009 because of executive risk taking in subprime loans, credit default swaps, and collateralized mortgage securities in 2006–2007. As a consequence, the need to overhaul and reform executive compensation has become a hot topic in both public circles and corporate boardrooms. Illustration Capsule 2.4 discusses how weak governance at the mortgage companies Fannie Mae and Freddie Mac allowed opportunistic senior managers to boost their compensation while making decisions that imperiled the futures of the companies they managed.
4. *Oversee the company's financial accounting and financial reporting practices.* While top executives, particularly the company's CEO and CFO (chief financial officer), are primarily responsible for seeing that the company's financial statements fairly and accurately report the results of the company's operations, board members have a fiduciary duty to protect shareholders by exercising oversight of the company's financial practices. In addition, corporate boards must ensure that generally acceptable accounting principles (GAAP) are properly used in preparing the company's financial statements

ILLUSTRATION CAPSULE 2.4

Corporate Governance Failures at Fannie Mae and Freddie Mac



Executive compensation in the financial services industry during the mid-2000s ranks high among examples of failed corporate governance. Corporate governance at the government-sponsored mortgage giants Fannie Mae and Freddie Mac was particularly weak. The politically appointed boards at both enterprises failed to understand the risks of the subprime loan strategies being employed, did not adequately monitor the decisions of the CEO, did not exercise effective oversight of the accounting principles being employed (which led to inflated earnings), and approved executive compensation systems that allowed management to manipulate earnings to receive lucrative performance bonuses. The audit and compensation committees at Fannie Mae were particularly ineffective in protecting shareholder interests, with the audit committee allowing the company's financial officers to audit reports prepared under their direction and used to determine performance bonuses. Fannie Mae's audit committee also was aware of management's use of questionable accounting practices that reduced losses and recorded one-time gains to achieve financial targets linked to bonuses. In addition, the audit committee failed to investigate formal charges of accounting improprieties filed by a manager in the Office of the Controller.

Fannie Mae's compensation committee was equally ineffective. The committee allowed the company's CEO, Franklin Raines, to select the consultant employed to design the mortgage firm's executive compensation plan and agreed to a tiered bonus plan that would permit Raines and other senior managers to receive maximum bonuses without great difficulty. The compensation plan allowed Raines to earn performance-based bonuses of \$52 million and total compensation of \$90 million between 1999 and 2004. Raines was forced to resign in December 2004 when the Office of Federal Housing Enterprise Oversight found that Fannie Mae executives had fraudulently inflated earnings to receive bonuses linked to financial performance. Securities and Exchange Commission investigators also found evidence of improper accounting at Fannie Mae and required the company to restate its earnings between 2002 and 2004 by \$6.3 billion.



Poor governance at Freddie Mac allowed its CEO and senior management to manipulate financial data to receive performance-based compensation as well. Freddie Mac CEO Richard Syron received 2007 compensation of \$19.8 million while the mortgage company's share price declined from a high of \$70 in 2005 to \$25 at year-end 2007. During Syron's tenure as CEO, the company became embroiled in a multibillion-dollar accounting scandal, and Syron personally disregarded internal reports dating to 2004 that cautioned of an impending financial crisis at the company. Forewarnings within Freddie Mac and by federal regulators and outside industry observers proved to be correct, with loan underwriting policies at Freddie Mac and Fannie Mae leading to combined losses at the two firms in 2008 of more than \$100 billion. The price of

(continued)

Freddie Mac's shares had fallen to below \$1 by the time of Syron's resignation in September 2008.

Both organizations were placed into a conservatorship under the direction of the U.S. government in September 2008 and were provided bailout funds of nearly \$60 billion by April 2009. In May 2009, Fannie Mae requested another

\$19 billion of the \$200 billion committed by the U.S. government to cover the operating losses of the two government-sponsored mortgage firms. By June 2010, the bill for bailing out the two enterprises had risen to \$145 billion, with the expectation that still more aid would be required to get them back on sound financial footing.

Sources: "Adding Up the Government's Total Bailout Tab," *New York Times Online*, February 4, 2009; Eric Dash, "Fannie Mae to Restate Results by \$6.3 Billion because of Accounting," *New York Times Online*, December 7, 2006; Annys Shin, "Fannie Mae Sets Executive Salaries," *Washington Post*, February 9, 2006, p. D4; Scott DeCarlo, Eric Weiss, Mark Jickling, James R. Cristie, *Fannie Mae and Freddie Mac: Scandal in U.S. Housing* (Nova, 2006), pp. 266–86; "Chaffetz, Conyers, Smith, Issa and Bachus Call for FOIA to Apply to Fannie-Freddie," June 17, 2010 (June 2010 Archives), <http://chaffetz.house.gov/2010/06/> (accessed June 24, 2010).

and that proper financial controls are in place to prevent fraud and misuse of funds. Virtually all boards of directors have an audit committee, always composed entirely of *outside directors* (*inside directors* hold management positions in the company and either directly or indirectly report to the CEO). The members of the audit committee have lead responsibility for overseeing the decisions of the company's financial officers and consulting with both internal and external auditors to ensure that financial reports are accurate and that adequate financial controls are in place. Faulty oversight of corporate accounting and financial reporting practices by audit committees and corporate boards during the early 2000s resulted in the federal investigation of more than 20 major corporations between 2000 and 2002. The investigations of such well-known companies as Global Crossing, Enron, Qwest Communications, and WorldCom found that upper management had employed fraudulent or unsound accounting practices to artificially inflate revenues, overstate assets, and reduce expenses. The scandals resulted in the conviction of a number of corporate executives and the passage of the Sarbanes-Oxley Act of 2002, which tightened financial reporting standards and created additional compliance requirements for public boards.

Every corporation should have a strong, independent board of directors that (1) is well informed about the company's performance, (2) guides and judges the CEO and other top executives, (3) has the courage to curb management actions the board believes are inappropriate or unduly risky, (4) certifies to shareholders that the CEO is doing what the board expects, (5) provides insight and advice to management, and (6) is intensely involved in debating the pros and cons of key decisions and actions.¹⁶ Boards of directors that lack the backbone to challenge a strong-willed or "imperial" CEO or that rubber-stamp almost anything the CEO recommends without probing inquiry and debate (perhaps because the board is stacked with the CEO's cronies) abdicate their duty to represent and protect shareholder interests.

Effective corporate governance requires the board of directors to oversee the company's strategic direction, evaluate its senior executives, handle executive compensation, and oversee financial reporting practices.

KEY POINTS

The strategic management process consists of five interrelated and integrated stages:

1. *Developing a strategic vision* of the company's future, a *mission* that defines the company's current purpose, and a set of *core values* to guide the pursuit of the vision and mission. This managerial step provides direction for the company, motivates and inspires company personnel, aligns and guides actions throughout the organization, and communicates to stakeholders management's aspirations for the company's future.
2. *Setting objectives* to convert the vision and mission into performance targets and using the targeted results as yardsticks for measuring the company's performance. Objectives need to spell out *how much* of *what kind* of performance *by when*. Two broad types of objectives are required: *financial objectives* and *strategic objectives*. A *balanced-scorecard* approach provides a popular method for linking financial objectives to specific, measurable strategic objectives.
3. *Crafting a strategy* to achieve the objectives and move the company along the strategic course that management has charted. Crafting deliberate strategy calls for strategic analysis, based on the business model. Crafting emergent strategy is a learning-by-doing process involving experimentation. Who participates in the process of crafting strategy depends on (1) whether the process is emergent or deliberate and (2) the level of strategy concerned. Deliberate strategies are mostly top-down, while emergent strategies are bottom-up, although both cases require two-way interaction between different types of managers. In large, diversified companies, there are four levels of strategy, each of which involves a corresponding level of management: corporate strategy (multibusiness strategy), business strategy (strategy for individual businesses that compete in a single industry), functional-area strategies within each business (e.g., marketing, R&D, logistics), and operating strategies (for key operating units, such as manufacturing plants). Thus, strategy making is an inclusive, collaborative activity involving not only senior company executives but also the heads of major business divisions, functional-area managers, and operating managers on the frontlines. The larger and more diverse the operations of an enterprise, the more points of strategic initiative it has and the more levels of management that play a significant strategy-making role.
4. *Executing the chosen strategy* and converting the strategic plan into action. Managing the execution of strategy is an operations-oriented, make-things-happen activity aimed at shaping the performance of core business activities in a strategy-supportive manner. Management's handling of the strategy implementation process can be considered successful if things go smoothly enough that the company meets or beats its strategic and financial performance targets and shows good progress in achieving management's strategic vision.
5. *Monitoring developments, evaluating performance, and initiating corrective adjustments* in light of actual experience, changing conditions, new ideas, and new opportunities. This stage of the strategy management process is the trigger point for deciding whether to continue or change the company's vision and mission, objectives, strategy, and/or strategy execution methods.

The sum of a company's strategic vision and mission, objectives, and strategy constitutes a *strategic plan* for coping with industry conditions, outcompeting rivals, meeting objectives, and making progress toward the strategic vision. A company whose strategic plan is based around ambitious *stretch goals* that require an unwavering commitment to do whatever it takes to achieve them is said to have *strategic intent*.

Boards of directors have a duty to shareholders to play a vigilant role in overseeing management's handling of a company's strategy-making, strategy-executing process. This entails four important obligations: (1) Critically appraise the company's direction, strategy, and strategy execution, (2) evaluate the caliber of senior executives' strategic leadership skills, (3) institute a compensation plan for top executives that rewards them for actions and results that serve stakeholder interests—*especially those of shareholders*, and (4) ensure that the company issues accurate financial reports and has adequate financial controls.

ASSURANCE OF LEARNING EXERCISES

LO 1

- Using the information in Table 2.1, critique the adequacy and merit of the following vision statements, listing effective elements and shortcomings. Rank the vision statements from best to worst once you complete your evaluation.

Vision Statement	Effective Elements	Shortcomings
<p>Wells Fargo We want to satisfy all of our customers' financial needs, help them succeed financially, be the premier provider of financial services in every one of our markets, and be known as one of America's great companies.</p>		
<p>Hilton Hotels Corporation Our vision is to be the first choice of the world's travelers. Hilton intends to build on the rich heritage and strength of our brands by:</p> <ul style="list-style-type: none"> • Consistently delighting our customers • Investing in our team members • Delivering innovative products and services • Continuously improving performance • Increasing shareholder value • Creating a culture of pride • Strengthening the loyalty of our constituents 		
<p>The Dental Products Division of 3M Corporation Become THE supplier of choice to the global dental professional markets, providing world-class quality and innovative products. [Note: All employees of the division wear badges bearing these words, and whenever a new product or business procedure is being considered, management asks "Is this representative of THE leading dental company?"]</p>		

(continued)

Vision Statement	Effective Elements	Shortcomings
<p>H. J. Heinz Company Be the world's premier food company, offering nutritious, superior tasting foods to people everywhere. Being the premier food company does not mean being the biggest but it does mean being the best in terms of consumer value, customer service, employee talent, and consistent and predictable growth.</p>		
<p>Chevron To be <i>the</i> global energy company most admired for its people, partnership and performance. Our vision means we:</p> <ul style="list-style-type: none"> • provide energy products vital to sustainable economic progress and human development throughout the world; • are people and an organization with superior capabilities and commitment; • are the partner of choice; • deliver world-class performance; • earn the admiration of all our stakeholders—investors, customers, host governments, local communities and our employees—not only for the goals we achieve but how we achieve them. 		

Source: Company Web sites and annual reports.

LO 2

2. Go to the company Web sites for Home Depot (<http://corporate.homedepot.com/wps/portal>); Avon (www.avoncompany.com/); and Yum Brands, a restaurant company that includes KFC, Pizza Hut, and Taco Bell (www.yum.com), to find some examples of strategic and financial objectives. Make a list of four objectives for each company, and indicate which of these are strategic and which are financial.

LO 5

3. Go to www.dell.com/leadership, and read the sections dedicated to Dell's board of directors and corporate governance. Is there evidence of effective governance at Dell in regard to (1) accurate financial reports and controls, (2) a critical appraisal of strategic action plans, (3) evaluation of the strategic leadership skills of the CEO, and (4) executive compensation?

EXERCISES FOR SIMULATION PARTICIPANTS

LO 1, LO 2, LO 3

1. Meet with your co-managers and prepare a strategic vision statement for your company. It should be at least one sentence long and no longer than a brief paragraph. When you are finished, check to see if your vision statement is in compliance with the dos and don'ts set forth in Table 2.1. If not, revise it accordingly. What would be a good slogan that captures the essence of your strategic vision and that could be used to help communicate the vision to company personnel, shareholders, and other stakeholders?

2. What is your company's strategic intent? Write a sentence that expresses your company's strategic intent.
3. What are your company's financial objectives?
4. What are your company's strategic objectives?
5. What are the three or four key elements of your company's strategy?

ENDNOTES

¹ For a more in-depth discussion of the challenges of developing a well-conceived vision, as well as some good examples, see Hugh Davidson, *The Committed Enterprise: How to Make Vision and Values Work* (Oxford: Butterworth Heinemann, 2002), chap. 2; W. Chan Kim and Renée Mauborgne, "Charting Your Company's Future," *Harvard Business Review* 80, no. 6 (June 2002), pp. 77–83; James C. Collins and Jerry I. Porras, "Building Your Company's Vision," *Harvard Business Review* 74, no. 5 (September–October 1996), pp. 65–77; Jim Collins and Jerry Porras, *Built to Last: Successful Habits of Visionary Companies* (New York: HarperCollins, 1994), chap. 11; Michel Robert, *Strategy Pure and Simple II: How Winning Companies Dominate Their Competitors* (New York: McGraw-Hill, 1998), chaps. 2, 3 and 6.

² Davidson, *The Committed Enterprise*, pp. 20 and 54.

³ *Ibid.*, pp. 36, 54.

⁴ As quoted in Charles H. House and Raymond L. Price, "The Return Map: Tracking Product Teams," *Harvard Business Review* 60, no. 1 (January–February 1991), p. 93.

⁵ Robert S. Kaplan and David P. Norton, *The Strategy-Focused Organization* (Boston: Harvard Business School Press, 2001), p. 3. Also see Robert S. Kaplan and David P. Norton, *The Balanced Scorecard: Translating Strategy into Action* (Boston: Harvard Business School Press, 1996), chap. 1.

⁶ Kaplan and Norton, p. 7. Also see Kevin B. Hendricks, Larry Menor, and Christine Wiedman, "The Balanced Scorecard: To Adopt or Not to Adopt," *Ivey Business Journal* 69, no. 2 (November–December 2004), pp. 1–7; Sandy Richardson, "The Key Elements of Balanced Scorecard Success," *Ivey Business Journal*

69, no. 2 (November–December 2004), pp. 7–9.

⁷ Kaplan and Norton, *The Balanced Scorecard*.

⁸ Information posted on the Web site of Bain and Company, www.bain.com (accessed May 27, 2009).

⁹ Information posted on the Web site of Balanced Scorecard Institute, <http://www.balancedscorecard.org/> (accessed May 27, 2009).

¹⁰ For a fuller discussion of strategy as an entrepreneurial process, see Henry Mintzberg, Bruce Ahlstrand, and Joseph Lampel, *Strategy Safari: A Guided Tour through the Wilds of Strategic Management* (New York: Free Press, 1998), chap. 5. Also see Bruce Barringer and Allen C. Bluedorn, "The Relationship between Corporate Entrepreneurship and Strategic Management," *Strategic Management Journal* 20 (1999), pp. 421–44; Jeffrey G. Covin and Morgan P. Miles, "Corporate Entrepreneurship and the Pursuit of Competitive Advantage," *Entrepreneurship: Theory and Practice* 23, no. 3 (Spring 1999), pp. 47–63; David A. Garvin and Lynned C. Levesque, "Meeting the Challenge of Corporate Entrepreneurship," *Harvard Business Review* 84, no. 10 (October 2006), pp. 102–12.

¹¹ For an excellent discussion of why a strategic plan needs to be more than a list of bullet points and should in fact tell an engaging, insightful, stage-setting story that lays out the industry and competitive situation as well as the vision, objectives, and strategy, see Gordon Shaw, Robert Brown, and Philip Bromiley, "Strategic Stories: How 3M Is Rewriting Business Planning," *Harvard Business Review* 76, no. 3 (May–June 1998), pp. 41–50.

¹² In many companies, there is often confusion or ambiguity about exactly what a company's strategy is; see David J. Collis and Michael G. Rukstad, "Can You Say What Your Strategy Is?" *Harvard Business Review* 86, no. 4 (April 2008), pp. 82–90.

¹³ For an excellent discussion of why effective strategic leadership on the part of senior executives involves continuous re-creation of a company's strategy, see Cynthia A. Montgomery, "Putting Leadership Back into Strategy," *Harvard Business Review* 86, no. 1 (January 2008), pp. 54–60.

¹⁴ For a timely and insightful discussion of the strategic and leadership functions of a company's board of directors, see Jay W. Lorsch and Robert C. Clark, "Leading from the Boardroom," *Harvard Business Review* 86, no. 4 (April 2008), pp. 105–11.

¹⁵ For a deeper discussion of this function, see Stephen P. Kaufman, "Evaluating the CEO," *Harvard Business Review* 86, no. 10 (October 2008), pp. 53–57.

¹⁶ For a discussion of what it takes for the corporate governance system to function properly, see David A. Nadler, "Building Better Boards," *Harvard Business Review* 82, no. 5 (May 2004), pp. 102–5; Cynthia A. Montgomery and Rhonda Kaufman, "The Board's Missing Link," *Harvard Business Review* 81, no. 3 (March 2003), pp. 86–93; John Carver, "What Continues to Be Wrong with Corporate Governance and How to Fix It," *Ivey Business Journal* 68, no. 1 (September–October 2003), pp. 1–5. See also Gordon Donaldson, "A New Tool for Boards: The Strategic Audit," *Harvard Business Review* 73, no. 4 (July–August 1995), pp. 99–107.