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# How to Design a Strategic Planning System

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Every business carries on strategic planning, although the formality of that process varies greatly from one company to the next. Conceptually, the process is simple: managers at every level of a hierarchy must ultimately agree on a detailed, integrated plan of action for the coming year; they arrive at agreement through a series of steps starting with the delineation of corporate objectives and concluding with the preparation of a one- or two-year profit plan. However, the *design* of that process—deciding who

does what, when—can be complex, and it is vital to the success of the planning effort.

A strategic planning system is nothing more than a structured (that is, designed) process that organizes and coordinates the activities of the managers who do the planning. No universal, off-the-shelf planning system exists for the simple and obvious reason that companies differ in size, diversity of operations, the way they are organized, and managers' style and philosophy. An effective planning system requires "situational design"; it must take into account the particular company's situation, especially along the dimensions of size and diversity.

While providing in this article some guidelines for designing strategic planning systems, we caution the reader to recognize that, for the reasons just stated, such generalizations can be treacherous. We do not aspire to prescribe a planning system for your organization; you must do the tailoring.

But some useful generalizations are possible, particularly in distinguishing between large companies and small ones and between highly diversified companies and less diversified ones. Size and diversity of operations generally go hand-in-hand, although exceptions to that rule are common. Several of the large airlines, for example, are in one business, and a number of mini-conglomerates with sales of less than \$100 million have divisions in disparate industries. For convenience here, we shall talk about companies as

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*In this sequel to their well-received earlier collaboration for HBR, "Strategic Planning in Diversified Companies" (January–February 1975), Peter Lorange and Richard F. Vancil take the reader through the steps necessary to implement and carry forward a formal strategic planning effort. They identify six issues that top management has to deal with along the way: communication of corporate goals, the goal-setting process, environmental scanning, the subordinate managers' focus, the corporate planner's role, and the linkage of planning and budgeting. The authors take up these problems separately, in each case analyzing how they can be met in both small companies and large—the principal distinguishing factor being whether the enterprise does business in one industry or more than one.*

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“small” or “large,” defining those labels in terms of the typical characteristics shown in *Exhibit I*.

While your company may not neatly match either set of characteristics, an understanding of why an effective strategic planning system is different in these two types of companies may enable you to design a system that fits your situation. We should note that the characteristics of small companies also describe a “typical” division in a large, diversified business. Therefore, division managers in such companies can follow our discussion at two levels simultaneously: (1) in their role as a part of the corporate planning process, and (2) in their strategic planning role for their own “small” businesses.

There are six issues on which a choice must be made while designing a strategic planning system. With each issue the proper choice for large companies will be different in most cases from the one for small companies. The issues are: communication of corporate performance goals, the goal-setting process, environmental scanning, subordinate managers’ focus, the corporate planner’s role, and the linkage of planning and budgeting. We shall describe each of these issues in turn and briefly discuss why the design choice differs in the two corporate settings.

## Communication of Corporate Goals

A common roadblock in designing a formal planning system occurs when second-level managers ask headquarters for guidelines to focus the preparation of their strategic plans. These managers, uncertain how to tackle the assignment, may ask, implicitly or explicitly, “Tell us where you want us to go and the performance you expect from us, and we’ll give you a plan of how to achieve it.” These questions are not unreasonable, but acceding to them may violate the very purpose for undertaking strategic planning. To determine how goals should be communicated and

how specific they should be is an important matter in planning system design.

When the president of a *small company* (or the general manager of a division of a diversified company) initiates the strategic planning process, he shares with his functional subordinates his thoughts about the objectives and strategy of the business. In most situations, however, he does not make explicit his performance goals. Instead, he asks his functional managers to devise a set of action programs that will implement the strategy of the business in a manner consistent with its objectives. In a pharmaceutical company that we observed, the R&D, manufacturing, and marketing functions jointly proposed a series of possible programs for developing various new drugs and modifying existing ones. But often, of course, this “programming” process involves only a single department.

Usually, the managers concerned realize that there is no need to anticipate the results of their planning efforts by trying to establish goals before establishment and evaluation of the programs. This would be time-consuming and burdensome and might also create false expectations among the functional managers.

The programming process is oriented much more toward analysis of alternative actions than toward establishment of corporate goals, primarily because the functional managers involved in programming tend (properly) to have a parochial point of view. They have a somewhat shorter time horizon than the president and focus their attention on their own areas of the business. The president is the one who selects the action programs for achieving the goals he has set for the business. Functional managers do not need to know the president’s performance goals, only that he wants the managers to recommend the best set of programs.

Because of its action orientation, the programming process usually lacks continuity from one year to the next. The objectives and strategy of the business may remain the same, but each year it is necessary

**Exhibit I Characteristics of “Small” and “Large” Companies**

	“Small” companies	“Large” companies
Annual sales	Less than \$100 million	More than \$100 million
Diversity of operations	In a single industry	In two or more different industries
Organization structure	Functional departments	Product divisions
Top executives’ expertise in industries in which company operates	Greater than that of functional subordinates	Less than that of divisional subordinates

to reexamine all existing programs and try to devise new ones. As a consequence, even though the programming activity commonly uses a three- to five-year time horizon, management pays little attention to the tentative goals established in the preceding year. Instead, the focus is on the current situation, the best set of action programs now, and the development of an achievable goal for the forthcoming year.

The diversity of the portfolio of businesses in *large companies* is often so great that it limits top management's capacity for in-depth perception and familiarity with each business. Consequently, management has to rely on the relatively unconstrained inputs from the divisions.

Division managers do heed corporate guidance in the form of broad objectives, but as a rule top management should delay development of a statement of performance goals for the corporation. Usually, a division manager is in a better position to assess the potential of his own business if he is unbiased by corporate expectations. Delay also permits the top executives to change their approach to the task. In the absence of a formal strategic planning process, top management may have developed explicit goals for itself; but it cannot be sure of the appropriateness of the goals when viewed in the context of a set of independently arrived-at divisional goals. Divisional recommendations stimulate a better job of corporate goal setting.

## Goal-Setting Process

From the division manager's viewpoint, should he or corporate management set the division's goals? This issue is sometimes cast as a choice between "top-down" and "bottom-up" goal setting. Actually, of course, management at both levels must agree on divisional goals. An important issue, however, remains: Which level in the hierarchy should initiate the process? In a homogeneous company, the same issue arises concerning the general manager and functional managers. The design of the planning system can strongly influence how this issue is resolved.

The goals that emerge from the programming process in a *small company* are tied to an approved set of action programs. Until the president has decided on the programs, no functional manager can set goals for his sphere of activity. Selection of a set of action programs, therefore, more or less automatically determines the performance goals for each functional unit. In many small companies—such as the pharmaceutical concern we spoke of—a "package" of action programs spells out the functional goals for every

department, because of the interdependence of all the departments.

In a sense then, functional goal setting is a top-down process. The functional managers propose action programs, but the president with his business-wide perspective determines the programs and goals for his functional subordinates.

In a *large company* with a relatively diversified group of businesses, "capacity limitations" at the corporate level dictate a more or less bottom-up approach. The divisions initiate much of the goal setting, since it requires intimate knowledge of the industry-specific set of business conditions.

Establishing an effective corporate-divisional goal-setting climate in a large company is not easy. For the first year or two of a formal planning effort, the best approach in most situations is to allow the initiative for recommending divisional goals to rest with the division manager. This approach gives him support in running his business and encourages strategic thinking at the divisional level.

Later, after the corporate and divisional managers have gained experience in hammering out a mutually agreeable set of divisional goals, the division manager's annual proposal for divisional goals will become more constrained than in the early years. In a divisionalized, consumer goods manufacturer we know of, the first years of carrying on the planning process were viewed frankly as a learning experience for division managers in making plans operational as well as for top management in learning to appreciate the strategic problems of each business of the company.

The cumulative experience of negotiating the goal setting over the years improves the effectiveness of the process. Corporate management can help nurture this development by creating a system that maintains a proper top-down/bottom-up balance. One way to achieve this balance is by withholding an explicit statement of corporate goals for the first year or two, while requiring the division manager to recommend goals for his division.

## Environmental Scanning

A strategic planning system has two major functions: to develop an integrated, coordinated, and consistent long-term plan of action, and to facilitate adaptation of the corporation to environmental change. When introducing and developing such a system, companies commonly concentrate on its integrative aspects. The design of the system, however, must also include the function of environmental scanning to make sure that the planning effort also fulfills its adaptive mission.

Corporate management, of course, provides subordinates with a set of forecasts and assumptions about the future business environment. Since each manager, initially at least, draws the strategic plans for his sphere of responsibility more or less independently of his counterparts, all managers must have access to the same set of economic and other environmental forecasts.

Environmental scanning in *small companies* is a strategically oriented task that can go far beyond the mere collection of data about markets, competitors, and technological changes. A company that, for example, enjoys a large share of the market for a product used by middle- and upper-income teenagers and young adults may devote considerable effort in analyzing demographic trends and changes in per capita income. A fairly accurate forecast of market size five years hence is possible to make and would be useful in appraising the potential for the company's growth.

The task of monitoring detailed environmental changes in *large companies* is too difficult to be performed by top management alone. Division management, therefore, is expected to study the external environment that may be relevant to their particular businesses. In these circumstances, headquarters typically provides only a few environmental assumptions—mainly economic forecasts.

Environmental scanning may play another important role in large companies that are interested in diversification through acquisitions. In one diversified electronics and high-technology company that set out to decrease its dependence on defense contracts, the vice president in charge of planning spent most of his time searching for acquisition opportunities. After establishing close ties with the investment community and certain consultants, he spread word of his company's intentions.

## Subordinate Managers' Focus

In a strategic planning effort, where should the second-level managers direct their attention? What roles do the division manager, functional manager, and top management play? We shall consider these questions in terms of whether plans should be more quantitative or more qualitative, more concerned with financial detail or with strategic analysis.

Preparation of a functionally coordinated set of action programs for a *small company* may require a great deal of cross-functional communication. Much of this interchange is most efficiently expressed in dollar or other quantitative terms, such as numbers of employees, units of product, and square feet of plant space. Use of financial or quantitative data is

appropriate for two reasons: (1) it helps each functional manager understand the dimensions of a proposed program and forces him to think through the implications of executing it; (2) it permits the president to select more confidently the set of programs to be implemented. The pharmaceutical company previously referred to, for instance, focuses on the funds flows that might be expected from the various strategic programs suggested by the functional departments.

In practice, the financial and quantitative aspects of functional planning become progressively detailed as the programming process continues, culminating in very specific plans that constitute the operating budget.

In a diversified *larger company*, top management wants each division to adopt a timely strategic outlook and division management to focus primarily on achieving that outlook. Particularly during the early years of the planning program, division managers should be permitted to develop as much financial detail in support of their proposals as they think desirable. As a result, they may generate more financial detail than necessary for strategic business planning. After a year or two, therefore, the corporate requirements for financial detail to support division proposals should be made explicit—and should be explicitly minimal.

Division managers should be asked to shift the focus of their efforts to identification and analysis of strategic alternatives, using their expertise to estimate quickly the financial implications. This focus has been a goal from the beginning, of course, but it is difficult to achieve at the outset. Failing to shift the focus is an even greater danger; the planning activity becomes a "numbers game" and never achieves its purpose.

Considering that the division manager may never have seen, much less prepared, long-range financial projections for his business, drawing them up should be a useful activity. Such projections help him lengthen the time horizon of his thinking; they oblige him to make his intuitive economic model of the business more explicit, which in turn enables him to forecast changes in financial performance. As a result, a division manager's initial planning efforts tend to be financially oriented and, in many respects, analogous to long-range budgeting. Corporate management should design the requirements of the system to mitigate the pressures that initiation of formal planning poses for a division manager.

One important caveat for the chief executive of a large company: he should never allow himself to get so involved in the development of business plans that he assumes the division managers' planning job. A situation that we investigated concerned the

newly appointed president of a multinational company in the consumer products business, whose experience was mainly in marketing. He could not resist "helping" one of his divisions develop a detailed, more aggressive marketing plan. Such interference often inhibits the division from coming up with a realistic plan to which it can commit itself. In this case, quiet resistance effectively shelved the president's ideas.

## Corporate Planner's Role

A major issue in the design of the planning system is where the corporate planner fits. Strategic planning is a line management function; a sure route to disaster is to have plans produced by staff planners and then issued to line managers. Strategic planning is essentially a people-interactive process, and the planner is only one in the cast of characters involved. If the process is to function effectively, he must clearly understand his proper role. The corporate planner's function in small and large companies is quite different.

In a *small company* (or a product division of a large company), the planner performs the function of staff planning assistant to the president (or the general manager). While coordinating the planning activities of the functional managers, he concerns himself with the president's problem of selecting the best set of action programs. Only the president—and his planning assistant—has a business-wide perspective of the choices, and the assistant must do the bulk of the analysis.

Cast in this role, the planner may become a very influential member of the president's (or the general manager's) executive team. If he uses his power sensitively, he need not lose effectiveness with his peers running the functional departments. They can appreciate the necessity for cross-functional analysis of program alternatives. Managing the planning process is an almost incidental role for the assistant, since he merely formalizes the analysis that leads to a coordinated set of action programs.

In a *large company*, the corporate planners organizational status can have significant symbolic value in conveying to division managers the importance of formal strategic planning and the difference between it and conventional budgeting. The planner's role initially is that of a catalyst, encouraging line managers to adopt a strategic orientation. He helps corporate management do a better job of resource allocation among the divisions, partly by assisting the division managers in strategic planning for their businesses. But he must not succumb to the tempta-

tion to become more involved in formulating the plans, or he may lose his effectiveness.

System maintenance and coordination is the planner's primary function as the planning effort matures; he monitors its evolution and maintains consistency. His tasks differ greatly from the mainly analytical role of the planner in the small company.

## Linkage of Planning and Budgeting

The steps in a typical planning system represent an orderly, gradual process of commitment to certain strategic alternatives. Each step is, theoretically at least, linked to those preceding. In financial terms, this linkage may be quite explicit; for instance, a division's profit forecast prepared in the first planning cycle may become the profit commitment for next year's operating budget. Although few companies expect to achieve this financial linkage in narrowing the choices, all the parties involved in the process should understand the intended relationship between the cycles.

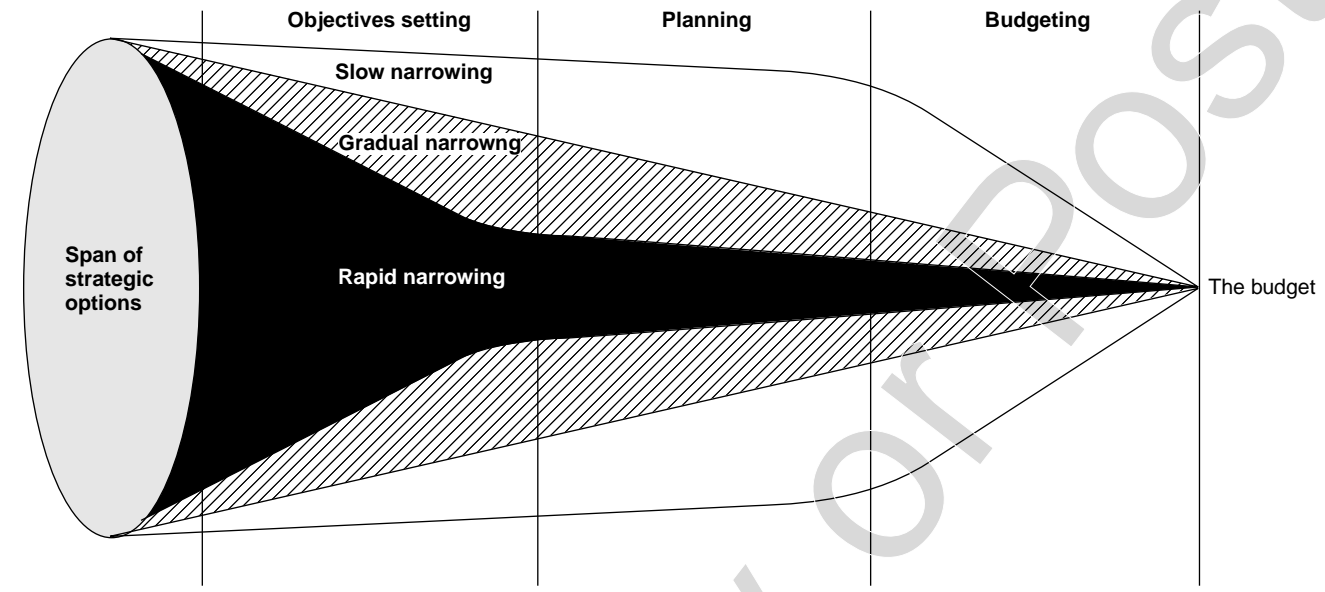
How fast this narrowing should be is a situational design question that depends on the particular corporate setting. A tight linkage between planning and budgeting indicates that more strategic commitments have been made at an earlier stage. A loose linkage, on the other hand, implies that the narrowing process is slower and will occur mainly late, in the budgeting stage of the process.

*Exhibit II* shows examples of slow versus rapid narrowing profiles. Notice that a company that does little narrowing in the early stages faces the task of considering a large number of strategic issues in the budgeting stage. This implies that either the company is equipped with an adequate organization to process an immense and "peaky" budgeting workload, or it will neglect some choices altogether, with the likely result that the quality of its allocation decisions suffers.

A *small company* with little diversity in its operations may wish to adopt an early or rapid narrowing process, since the functional and corporate executives involved are thoroughly familiar with the strategy of the few businesses in question. Then functional managers can proceed directly to the development of action programs to continue implementation of that strategy. Quantitative financial linkage between the selected programs and the resulting budgets is feasible, and "tight" linkage of this type is common practice.

In a *large company*, linkage is usually looser and the narrowing process more gradual. During the start-up phase top management should give division

## Exhibit II Slow Versus Rapid Narrowing Profiles in the Planning Process



managers plenty of time to devote to strategic thinking about their businesses—but the lower-level executives must remember to differentiate that activity from long-range budgeting, with its related requirement of divisional performance fulfillment.

As the system matures, however, management can gradually accelerate the narrowing process without jeopardizing the creative aspect of planning. A natural result of this progress is a more precise definition of the linkage between the planning cycle and the budgeting cycle. A large producer of heavy equipment we know of, for instance, has “tightened up” the linkage between planning and budgeting. The top executives believe that this development is a

natural consequence of their increasingly cohesive strategic points of view.

### Evolving Systems

In sum, significant differences exist between the planning procedures used in the two types of companies we have examined. The issues that management must address, and our attempt to delineate what is good practice in small and large companies, are summarized in *Exhibit III*.

In companies that are not very diversified and are

## Exhibit III Approaches to Planning System Design Issues

Issues	Situational settings		
	“Small” companies	“Large” companies	
		New planning system	Mature planning system
Communication of corporate goals	Not explicit	Not explicit	Explicit
Goal-setting process	Top-down	Bottom-up	“Negotiated”
Corporate-level environmental scanning	Strategic	Statistical	Statistical
Subordinate managers’ focus	Financial	Financial	Strategic
Corporate planner’s role	Analyst	Catalyst	Coordinator
Linkage of planning and budgeting	Tight	Loose	Tight

functionally organized—as well as product units of diversified corporations—top management carries on the strategic thinking about the future of the business. In such companies, a formal process to help organize that reflective activity is frequently unnecessary, in view of the few managers involved. Instead, formal strategic planning focuses on the development and review of innovative action programs to implement the strategy. The planning system reflects that focus: goal setting is top-down, linkage to the budget is tight, and the staff planning officer plays a major role as cross-functional program analyst and environmental scanner.

In companies that operate in several industrial sectors and are organized into product divisions, initiating a formal strategic planning process is a major task. The first year or two of such an effort must

be viewed as an investment in fostering a planning competence among division managers; the payoff in better decisions at the corporate level must wait until the system matures.

If the planning system is to survive as more than an exercise in pushing numbers into the blank spaces on neatly designed forms, it must evolve rapidly along several dimensions. A mature system, however, can be invaluable, helping both corporate and divisional executives make better and better-coordinated strategic decisions.

Any company—indeed, any organization—is a dynamically evolving entity whose situational setting is subject to change. Accordingly, to remain effective, the design of the planning process is a continuous task requiring vigilance and insight on the part of management.