

The Ruthven Institute has developed 12 rules for business success. Based on 45 years of analysis of Australia's top 1000 companies, the Ruthven Institute has distilled the essence of a winning business strategy. Research undertaken by the University of Melbourne between 1998 and 2001 supported many of these rules. In this series, the RI Hub examines the literature to assess the validity and continuing relevance of these rules. In each of the following sections, the literature is summarised, the key issues for implementation highlighted, and the questions for future research identified.

"In order to survive, a business must have a very good understanding of the world outside its operation. For success, profitability and longevity, a company must now plan outside-in... adequate information is necessary to provide confidence that a long-term plan or strategy, a medium-term plan (three-year business plan) and a one-year budget can be prepared. These should be rigorous enough – with contingency 'shock absorbers' built in – to withstand the inevitable vagaries of the real world.

It pays to think outside-in when it comes to strategy... knowledge is power."
Ruthven Institute (2019) *Business Success: In Brief the 12 Golden Rules*

Understanding the external environment the firm operates in, and developing strategies in light of this environment, is a central tenet of strategic management. A range of analytical tools and frameworks have been developed over the decades to *make sense* of the key external factors shaping profitability opportunities and threats. In this Note we track the emergence of these tools and the logic behind them, and explore their underpinnings in performance data.

Rule 6 also stresses the central role of planning, information gathering, and analysis in strategy formulation and execution. In this Note, we characterise this planning mindset, and again synthesise the research that has been undertaken on the planning-performance relationship.

Understanding the Outside

As business schools were set up to train senior executives, and academics within these schools made tentative steps to systematically research the nature of such management tasks, the field of study we now know as strategic management slowly took shape. Initially this field, then known as *business policy*, was more concerned

AUTHORS

Sabutay Fatullayev & André Sammartino,
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RULE 6: PLAN FROM THE OUTSIDE IN

with the firm as an organisation (Chandler, 1962), the nature of managerial functions (Barnard, 1938; Simon, 1945), the link between managerial capabilities and competitive advantages (Penrose, 1959), and how firms behave (Cyert & March, 1963).

Somewhat slower to emerge was work that situated firms within their competitive environment, or more particularly, explored the importance of industry conditions in shaping performance possibilities. Industrial economists were the most influential voices in this domain (Bain, 1956, 1968; Caves, 1972; Mason, 1939), with Michael Porter translating this work most effectively to provide managers with clear, workable tools for understanding the drivers and constraints on industry profitability.

Mason and Bain's work is often summarised as the Structure-Conduct-Performance (S-C-P) paradigm, where the structure of a competitive environment determines the behaviour and choices firms make about how to conduct themselves in markets, with these two elements driving the performance outcomes for the firm. An extreme interpretation can be that *conduct does not matter* as structure is too powerful for a firm to change, rendering it primarily a structure-performance relationship.

Porter's contribution was to provide managers with a clear organising framework for making sense of their industry – the Five Forces model (1980, 2008). He urged managers to look beyond the drivers of competitive rivalry – such as the number of firms, their relative sizes, and their degree of similarity – to also consider the likelihood of new entrants, the threats of customers substituting with offerings from other industries, and the nature of bargaining power with buyers and suppliers. Porter provided extensive guidance on how to identify the positive and negative contributors to each Force, which in turn impact the scope of the firm to generate excess profits. Managers were being given the tools to evaluate their competitive environment and plan accordingly.

This work was somewhat less dogmatic about the inevitability of the structure-performance relationship, however. Firms were granted some agency to adjust their conduct in light of the assessments of their environment. Here, the external environment is a competitive context which the firm can shape and must respond to. This implies that firms need to scan their industry and market for insights about the advantages of their competitors and the needs of their consumers, so as to target appropriate opportunities. Firms may, through their actions and the success and

RULE 6: PLAN FROM THE OUTSIDE IN

growth of their activities within an industry, also shift the forces they and their rivals experience. The strategist's job thus becomes matching strategies with structure. Porter (1980, 1985, 1996, 2008) did insist that only a small range of viable generic strategies or market positions would prove effective – namely low cost, differentiation, either broadly or narrowly targeted – and that attempting to simultaneously pursue more than one of these positions in a market would be fruitless. Mintzberg et al. (2009: 88) critique this school of thinking – the *Positioning School* – as one where an “analyst did not *design* strategies (indeed, did not even formulate them) so much as select them... strategies were to be plucked off the tree of generic strategic opportunities”.

The proponents of the S-C-P/Positioning School were not the only scholars arguing for the importance of a firm's setting. The so-called *Environmental School* (see Mintzberg et al. 2009) was principally interested in the contingent evolution of organizations' internal structures and processes in response to their context. Early studies, for example, posited that the extent of formalization and standardization within firms was driven, in part, by the levels of stability, complexity, and hostility they encountered in their competitive settings (Blau, 1965; Child, 1972; Pugh et al., 1968).

These initial ideas were extended considerably by population ecologists who argued that industries and firms evolved in a manner that made specific modes of operating much more likely to win out as the natural form (Hannan & Freeman, 1977, 1984). Henderson (1989) evokes an evolutionary or biological analogy in that firms must also be sufficiently different from each other to coexist.¹ The implications for strategy of this perspective can, at times, be hard to interpret as actions are often presented as environmental imperatives rather than discrete choices among multiple viable options.

Other pieces of the external environment puzzle were explored through this period, including the role of Industry Life Cycles (see our Research Note for Rule 2 for a lengthy discussion thereof) and the nature of strategic groups within an industry. In the former context, there are both descriptions of likely competitive conditions during different stages of an industry's evolution and prescriptions as to the more viable strategic responses to these conditions. This is consistent, at times, with both the S-C-P approach and elements of the Environmental School. The strategic groups

¹ Henderson explicitly notes Gause's Principle from biology which observes that “no two species can coexist that make their living in the same way” (1989, p.139).

literature also bridged these two schools in a way, arguing for distinct categories of firms within markets which could be viewed as somewhat inevitable outcomes or as deliberate choices by firms (Dranove et al., 1996; McGee & Thomas, 1986). In turn, these groupings shaped the prospective decisions firms faced about how to compete (Anand et al., 2013; Mas-Ruiz & Ruiz-Moreno, 2011).²

Finally, it should be noted that the notion that firms pay heed to their positions in markets also lay at the heart of prominent consulting tools. The Boston Consulting Group's growth-share matrix was perhaps the most influential decision guide placed in the hands of senior executives in the twentieth century (Henderson, 1979). It drew specific attention to the interplay between industry growth rates and a firm's market shares as drivers of profitability, leaving strategic planning as principally a series of resource allocation decisions to the ideally positioned business units and divestments of those whose environments had taken a turn for the worse. The work of the Profit Impact of Market Strategies (PIMS) research project – which bridged corporates, academia, and consulting – shared this philosophy that a firm's environment mattered and that firms must respond to their environment through specific strategic choices (Buzzell, 2004; Buzzell & Gale, 1987). As discussed below, they produced some of the most compelling early studies on the environment-performance relationship, while also fuelling the appetite for systematic strategic planning (Schoeffler et al., 1974).

The potential impact of environmental scanning comes with one significant caveat. There is repeated recognition across the strategic management literature that decision makers face a highly complex task due to the perils of both *uncertainty* – that the future is not known with any clear probabilities (Hallberg, 2015; Rindova & Courtney, 2020) – and *bounded rationality* – that there are cognitive constraints on all decision makers that mean they cannot adequately process the volume of information they face, and thus will satisfice at best in their sensemaking (Powell et al., 2012; Simon, 1957). This renders attempts to understand one's outside inevitably incomplete, and does limit the prospects for complete plans.

Planning as a Mindset

Planning has consistently been central to the training of senior executives and the professionalisation of the administrative and managerial functions. Mintzberg et al. (2009: 50) succinctly characterise this approach as “formal procedure, formal training, formal analysis, lots of numbers”.

² The market share aspects of strategic groups are explored in our Research Note for Rule 5.

RULE 6: PLAN FROM THE OUTSIDE IN

Appropriately, the academic often cited as the *father of planning*, Igor Ansoff was a trained engineer and mathematician, who brought that technical, process-driven mindset first to the corporate arena (he was Vice-President of Planning at Lockheed Aircraft Corporation), and then to the business school classroom. His works on business and corporate strategy (1964, 1965), alongside those of Barnard (1938) and Drucker (1954, 1959, 1964), set out a clear and actionable set of structures and processes at the heart of planning. These not only reflected the emergent practices in large corporations, but also strongly influenced the installation and entrenchment of such departments into headquarters across the globe.

While the guidelines for strategic planning varied across the hundreds of books, articles, and consulting manuals that sprung up from academics, executives, and consultants, in essence they all emphasised similar processes and mindsets. Wolf and Floyd (2017: 1758) describe strategic planning as:

“a more or less formalized, periodic process that provides a structured approach to strategy formulation, implementation, and control [with the intent] to influence an organization’s strategic direction for a given period and to coordinate and integrate deliberate as well as emerging strategic decisions.”

The typical prescription is that firms, or more specifically a cadre of analysts close to the senior managers of a firm, should systematically identify threats and opportunities in the external environment, ideally those that can be readily quantified and tracked. This typically means applying the tools from the S-C-P /Positioning School outlined above.³ The external conditions may be contrasted with the firm’s strengths and weaknesses – perhaps labelled as resources, capabilities or competencies (or gaps therein) – as well as with the firm’s mission or vision. These are the inputs for an analysis that prioritises firm objectives and actions, which are then cascaded down through the organisation to inform forecasts, budgets, and allocation of resources (Ketokivi & Castãner, 2004). In firms with divisions (product and/or geographic) and business units, this is a tiered process with divisions and units *filling in* their objectives, forecasts, budgets, and actions. Performance is then measurable against these forecasts and budgets, with this performance data as another input into the planning cycle.

The mindset here is highly technocratic, as analysts gather and process more and more data, and apply increasingly complex models to try and make sense of trends

³ These may be supplemented with broader macroenvironmental analysis (i.e. beyond the industry). See Ginter and Duncan (1990). Unfortunately, rarely does this literature acknowledge the challenges of uncertainty and bounded rationality noted earlier (for an exception, see Lovallo & Kahneman (2003)).

and forces at play. Financial techniques for evaluating choices become commonplace, including break-even analysis, sensitivity analysis, and various discounted cash flow models (Grant, 1991; Johnson & Scholes, 1989; Whittington, 1993). Senior executives are expected to present highly detailed plans and business cases for Board scrutiny and approval. These may reflect simply corporate-level strategy (*what businesses should we be in*), or extend to or incorporate competitive strategy (*how will we compete*) and operational matters, special projects, and the like. The mindset can also be viewed as particularly positivist, with an implicit belief that the future is predictable, that forecasts have some degree of certainty, and that plans are unproblematically actionable.⁴

As has been documented repeatedly, the nature of such planning, its emphases, design, and position within organisational structures and processes have veered through a startling number of different phases in the decades since its emergence (Heracleous, 1998; Mintzberg, 1994; Whittington et al., 2011; Wilson, 1990, 1998). Even by the mid-1990s, Wilson (1994: 507) argued

“It has been successively a fad, an anathema, and just another management tool. It has bounced around the corporate hierarchy in search of a legitimate role and an appropriate home. Its obsession with a succession of planning methodologies has caused it to oscillate between quantitative and qualitative tools in its analyses, between external and internal emphasis in its situation assessment, between long-term and short-term focus in its goals and measurements.”

Part of the explanation for this cycle of change, and of waves of purported planning innovations, could be an ongoing disappointment with the effectiveness of planning efforts. Critics pointed to the lack of creativity inevitable in this formalisation, and the misrepresentation of forecasts as distinctive choices (Mintzberg 1981, 1993). Mintzberg argued, as did others, that formal planning gave only the *illusion of control* (Mintzberg, 1993). As Hogarth and Makridakis (1981: 127) put it, “people have a tendency to attribute success to their own efforts and failure to external factors”. They advised:

“Forecasting must therefore be used to identify sources of uncertainty in the environment. Planning should concern itself with developing policies which acknowledge the uncertainties and are on the efficient frontier. Planning cannot assume forecast accuracy” (Hogarth & Makridakis 1981: 128).

⁴ Tools and processes did emerge that took a more nuanced perspective on the challenge of envisioning the uncertain future. Perhaps most famous of these was *scenario planning*, as exemplified by Shell’s efforts to model different potential outlooks for the petroleum industry (Cornelius et al., 2005).

Mintzberg (1993) famously maintained that strategies are not solely the result of planning, but also *emerge* from the actions of actors across the firm and converge around a pattern that is subsequently labelled as strategy, and possibly incorporated into plans (Mintzberg & Waters, 1985). He pointed to example of Japanese corporate planners who, he argued, took a more learning based approach to strategy. This, coupled with a longer term perspective on organisational goals and planning, was frequently pointed to as a distinctive competitive advantage for Japanese firms during the rise through the 1970 to 1990s (see Abegglen & Stalk 1986; Aoki, 1990).

As discussed below, the evidence for the performance impact of planning is tentatively positive. However, research into strategic planning has declined significantly since the early 1980s. Over a quarter of the articles (26.7 percent) in the four most prominent academic strategy journals in 1980-1985 looked at planning issues. By 2001-2005 this percentage has dropped to 3.2 (Furrer et al., 2008). This does not necessarily reflect a decline in the significance of planning as an activity, but perhaps more that planning is often *taken for granted* as something that happens in organisations (Wolf & Floyd, 2017).

The Performance Effects of the External Environment

The S-C-P/Positioning school's arguments for the significant impact of industry conditions on firm performance was always grounded in empirical evidence. Bain (1951) presented profit data from 340 US industries from 1936 to 1940 to show that higher firm concentration correlates with higher profit levels. Porter's case for industry analysis rested on data showing substantial and consistent differences in returns on invested capital between US industries over several decades (1985, 2008). The bases for his Five Forces tool were the data from across industrial economics, such as Bain's work, which point to the various effects of firm scale, industry concentration, buyer and seller concentration on profitability levels.

Similarly, the PIMS project provided extensive empirical evidence, based on a broad sample of primarily manufacturers from the US, Canada, and Europe, to demonstrate, like Porter, that some industries were clearly more profitable on average, over time, than other industries, that Industry Life Cycles did appear to explain some of this variation, and that supplier and buyer concentration and the scale of these relationships impact profitability (Buzzell & Gale, 1987).

RULE 6: PLAN FROM THE OUTSIDE IN

The strategic management field has continued to investigate and debate the impact of industry effects. It has proven a challenging task, as researchers have wrestled with untangling the effects of industry versus a firm's endowment of resources and capabilities. This is made more complex by firms often operating across multiple industries, leading to these projects often looking at business unit-level data.

Schmalensee (1985) utilised US Federal Trade Commission (FTC) cross-sectional data on business unit performance to explore how much of the performance variance could be explained by which industry they were in.⁵ Industry effects were found to explain just over 19 percent of performance variance (and 75 percent of the variance in average rates of return between industries), while firm-level effects were found to be insignificant. Rumelt (1991) revisited the FTC using longitudinal data and arrived at very different conclusions, finding the business unit effects to be six times more important than industry effects, with corporate (i.e. whole of firm) effects negligible. This turnaround is partially attributed to Schmalensee's single year of data capturing a lot of transient variation between industries. This led Rumelt (1991: 168) to conclude that "the most important impediments to the equilibration of long-term rates of return are not associated with industry, but with the unique endowments, positions and strategies of individual businesses". Roquebert et al. (1996), using a larger and more recent longitudinal Compustat dataset of US corporations over seven years, reconciled these two results somewhat, with industry effects explaining around 12.5 percent of profitability versus firm effects of around 55 percent. McGahan and Porter (1997) extended the Compustat data out to 14 years, and included a wider range of firms, found industry effects to explain almost 19 percent, and firm effects 36 percent.⁶

Researchers continued to explore this topic, applying ever more sophisticated statistical methods to try and tease out the different performance effects. Brush et al. (1999) used two-stage least-squares regressions and similar Compustat data to McGahan and Porter, and found firm effects were around double the size of industry effects. Hawawini et al. (2003) used different performance measures (economic profit and total market value per capital employed) and a bespoke dataset of US listed firms. They too found firm effects explained around one-third of the variance in firm performance (varying between 27 and 36 percent depending on the performance measure), while industry effects accounted for between 7 and 11 percent. When they removed the highest and lowest performing pairs of firms from

5 Unless explicitly noted, these studies use Return on Assets as the performance measure.

6 Roquebert et al.'s firm effects broke down into 37.1 percent business unit and 17.9 percent corporate effect. For McGahan and Porter the split was 31.7 percent and 4.3 percent, respectively.

RULE 6: PLAN FROM THE OUTSIDE IN

each industry, they found the gap between industry and firm effects closed, or even disappeared depending on the performance variable. Short et al. (2007) added strategic groups into the mix. Using hierarchical linear modelling, longitudinal Compustat data on US firms, and different performance measures (ROA, Tobin's Q, and Altman's Z), they found firm effects to be at least double the effect of industry, with strategic groups effects comparable to industry effects for some performance measures.

In one of the relatively few studies of non-US data, Galbreath and Galvin (2008) surveyed executives of Australian firms on their perceptions of firm performance, their industry setting (i.e. the Five Forces they were experiencing), and their firms' resource endowments. Resource endowments were found to explain just over twice as much of the performance variation between firms in their sample than industry structure factors. This finding only held for service firms when the sample was broken down further, however, with opposite results for manufacturing firms (i.e. industry structure was more influential than resources). There was relatively weak support for the specific impacts of each of Porter's Five Forces on performance levels. The only highly significant finding was that threat of substitutes had a strong negative effect on the performance of manufacturing firms.

Most recently, Bamiatzi et al. (2016) utilised a 20-country data set of publicly listed firms to ascertain the relative impact of firm, industry, and country effects on performance. They too found firm effects to be the most powerful explanation of performance differences, with industry effects being stronger than country effects. This finding was robust across emerging and developed economies, and during both expansionary and recessionary periods.

In sum, the findings in this extensive empirical literature are consistent. The context in which a firm operates – namely its industry – does impact firm performance. There are consistent differences in average performance levels between industries, which indicate each industry's structural and dynamic elements warrant ongoing scrutiny by firms' decision makers. At the same time, the stronger explanation of differences in performance levels rests on firm-level variables. This is still consistent with our expectations here, as most of these firm-level attributes can also be interpreted as outcomes of choices firms have made about how to compete and the resources they need in light of their interrogation of their competitive environment.

Strategic Planning Mindsets and Firm Performance

The parallel question is whether engaging in strategic planning has positive performance effects.

Powell (1992: 552) noted more than 40 planning-performance studies over the preceding two decades, and a collective frustration that the overall findings were “confusing, contradictory, and impossible to reconcile”. While the majority of studies did find a positive planning-to-performance relationship, it was also observed that the greater the level of methodological rigour, the weaker or non-existent this relationship became. In a meta-analysis of 26 studies during this same period, Miller and Cardinal (1994) did find planning to have positive performance effects, with some substantive contingencies. Most of these contingencies also pertained to the research methods – that findings were more robust and positive when the studies collected primary data on planning processes from key informants (e.g., the c-suite), had a holistic definition of planning (e.g., beyond simply looking for formalisation or standardisation), and recognised the timeframes in which a relationship would occur (e.g., looked at planning in an earlier period than the performance). On the actual planning side, Miller and Cardinal (1994) found the positive performance effects of planning to be stronger in more turbulent industries (i.e., in more volatile and uncertain settings).

As noted earlier, the academic planning literature dropped off considerably around the mid-1990s. Wolf and Floyd (2017: 1756) attribute this partially to the Miller and Cardinal study, which “may not have entirely settled the matter, [but] it did seem to reduce the motivation for further work.” One study of note during this fallow period provides an excellent example of how planning is often measured. Rudd et al. (2008), in a study of 366 UK manufacturers, adapted a survey from Boyd and Reuning-Elliott (1998) that gauged the extent to which firms: had a mission statement; analysed competitor, supplier, and market trends; engaged in internal analysis; analyse contingencies; engaged in on-going evaluation and control; and formulated long-term corporate-level strategies, medium-term business-level strategies, and short-term business-level strategies. They tested a model that reflects the shift in this literature, in that planning is theorised as positively impacting a firm’s operational, financial, structural, and technological flexibility, with these four flexibility dimensions the pathways to positive performance effects. Their model is supported by the empirical evidence.

Dibrell et al. (2014) extended this model, finding that firms’ processes of (a) formal

RULE 6: PLAN FROM THE OUTSIDE IN

strategic planning and (b) retained planning flexibility (i.e., being responsive to various opportunities and changes in the competitive environment) are positively associated. These two elements were then positively related to firm innovativeness, and this innovativeness was positively associated with firm performance.⁷ This approach reflects what Wolf and Floyd (2017) present as the overarching framework that summarises the current state of play in strategic planning research. Planning with all its different elements – practices, routines, rituals, participants, tools, attitudes, and roles – is typically modelled as positively affecting a wide range of proximate outcomes such as decision quality, coordination, communication, legitimation, and shared understandings. These *proximate* outcomes are the pathways to *distal* outcomes such as strategic change, organisational learning, and performance outcomes such as profitability.

Conclusions and Future Research Opportunities

Rule 6 argues for the primacy of a firm's competitive context in shaping its strategic opportunities and likely performance. Senior decision-makers are urged to constantly monitor and assess the threats and opportunities at play in their macro-environment. Systematic analysis of the *outside* is viewed as a key input into a layered strategic planning process that cascades from a long-term road-map, to a medium-term plan, and annual budgeting and forecasting.

The rule is certainly consistent with both the central frameworks of strategic management and the empirical evidence. A firm's context does matter. Industries have been consistently shown to vary in average profitability, and these variances are often persistent over the medium term, as they often reflect enduring structural differences. Firms do have agency to both affect their environment and to adapt their strategic choices to best fit their settings. An extensive literature points to industry effects that are significant pointers to firm performance. Having said that, these typically are less substantive than firm-level effects. As argued above, this does not discount the role of understanding and adapting to the external environment. The firm-level effects can also be interpreted as evidence that some firms do a much better job of such strategic decision-making, and have built the most appropriate resources and capabilities for their competitive setting and optimised their position within their industry.

This last point is also a key element in the role of planning. Firms have a wide range

⁷ This positive relationship between innovativeness and performance is also consistent with Rule 4 – See the Research Note.

RULE 6: PLAN FROM THE OUTSIDE IN

of analytical tools, and ever-increasing data, at their disposal to *make sense* of their environment. While planning has ebbed and flowed in terms of popularity and tone over the decades, there is no evidence suggesting firms should NOT plan. The current thinking in the academic literature is very aligned with Rule 6, as evidence points to the importance of balancing some formal procedures of analysis, matching of internal capabilities with external opportunities and threats, envisioning, goal-setting, and monitoring, with more flexible processes that allow for frequent adjustments in light of new information from the external environment. Adopting such a planning approach has been shown to have a range of positive direct effects which then flow through to firm performance. It appears such effects are likely to be stronger in more turbulent environments. Such contexts are those where decision makers are most exposed to the challenges of high uncertainty and bounded rationality. A thorough, structured, but flexible, planning process does appear to best assist the navigation of such complexity.

One other takeaway from our survey of the empirical literature on planning is that it is challenging to observe and quantify the planning efforts of firms, as there is such a wide range of processes they may engage in, and questions as to the competence of a specific firm in planning itself. Best practice from a research perspective is to observe as much of the processes and as closely as possible, or at least to gather data from multiple informants within the company over time. This is not easy, but there may be merit in textual analysis of firms' statements in public documents as to, for example, their time horizons, mission, scanning of the environment and the like.

Innovations continue in the planning space. The potential of big data analytics, machine learning, and artificial intelligence are increasingly trumpeted as the next stage in strategic planning, and as a potential source of competitive advantage (Barton & Court, 2012; Davenport & Harris, 2007; Kiron et al., 2014; Mulligan et al., 2021). Gathering and analysing large volumes of data on the external environment in close to real time, and drawing inferences as to the strategic opportunities therein, is an exciting prospect for building advantages, and also for overcoming bounded rationality. Blockchain technology is perhaps the starkest example of how extra-firm innovations can structurally change the way firms think about and implement their essential activities (Lacity & Van Hoek, 2021). This cutting-edge technology is extremely promising in not only finance, but also logistics and supply-chain planning. There are certainly research opportunities in assessing the impact of such planning advances.

RULE 6: PLAN FROM THE OUTSIDE IN

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RULE 6: PLAN FROM THE OUTSIDE IN

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