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Strategic Planning for Regulated Companies

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SUMMARY

The need for strategic planning by firms to achieve an alignment with their environment is widely recognized. Various studies have analysed the structures and strategic processes utilized by firms in their attempts to establish domains and attain goals. Yet the problems faced by firms in regulated environments by and large have been ignored.

This paper examines the critical differences found in regulated environments that affect strategic planning. Propositions which can serve as the basis of future empirical research are offered and a theoretical framework in which to view the regulated industry situation is developed.

INTRODUCTION

The purpose of this paper is to describe and analyse certain strategic and structural differences that need to be taken into account when planning for regulated companies. Our exposition is toward the development of theory applicable for firms operating in administered markets and environments.

Despite an extensive and growing body of literature on strategic planning, the bulk of theoretical work and the majority of practical guides to date reveal several gaps in our knowledge. For example, such standard works as Rothschild (1976), Lorange and Vancil (1977), and Steiner (1977) pay little or no explicit attention to strategic planning for firms operating in regulated environments. Consequently, practising managers in those kinds of companies have limited resources to which they can turn for useful insights.

This dearth of strategic planning literature for regulated companies is particularly puzzling, for despite all the current rhetoric about deregulation, there is considerable evidence to suggest that in many instances, outside influences, including regulation, are increasing, not decreasing.[1] Dill (1976), addressing the problems of strategic management in a 'kibitzer's world', argues that there are growing pressures for strategic intervention, born partly out of a new consciousness among 'external' stakeholders. Ironically, the firms themselves have encouraged and contributed to the increased stakes of external constituencies. As a consequence, managers are going to have to invest more time, money, and effort in working outside the organization to develop

[1] For an illustration of an agency expanding its regulatory impact, see Robert R. Dince's 'The bank regulators have a new point of view', *Fortune*, October 8, 1979, pp. 166–8; and, as an example of the mounting concern about *over-regulation*, see Tom Alexander's 'Its roundup time for the runaway regulators', *Fortune*, December 3, 1979, pp. 126–32.

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more sympathetic audiences, attuned more closely to corporate goals and priorities. In sum, the firm must prepare itself to cope with an active, intrusive environment.[2]

Although Dill stresses that interference from the outside need not necessarily manifest itself as 'regulation', much recent experience indicates that increasing government regulation persists as a prevalent issue for many companies and industries. As more and more firms are involved in some form of regulation, the nature and scope of strategic planning will have to adapt to these changing circumstances. The question is, how?

Environmental analysis

It is well recognized that organizations have to adapt to their environments in order to survive. Accordingly, the heart of most approaches to strategic planning consists of an analysis of the firm and its environment so an appropriate alignment between the two can be achieved. This interface between organizations and their environments has represented an area of common interest to researchers in both the strategic management and organizational behaviour areas. In strategic management, researchers such as Hofer and Schendel (1978), MacMillan (1978), Miles and Snow (1978), and Steiner (1969) have discussed the significance of environmental factors in formulating and implementing corporate strategies. In organizational behaviour, the works of Thompson (1967), Lawrence and Lorsch (1967), Galbraith (1973), and others have focused on the relationships among organizational purposes, structures, and environmental circumstances. Drawing on the literature of both fields, Pfeffer and Salancik (1978) theorize that since corporate actions are ultimately dependent on external resources, corporations are in fact constrained and even controlled by their environments. There are, they note, certain strategies and tactics that can be employed to moderate or lessen that control.

Clearly, environmental analysis is critical to effective strategic planning. How is it uniquely different for regulated companies, though? It is to this topic that we now turn our attention.

REGULATED ENVIRONMENTS

Arguably, all firms today are regulated to a greater or lesser degree, but we are interested here in those companies and/or industries which are overseen by one or more industry-specific regulatory agency or commission (such as the Federal Reserve for national banks and the Civil Aeronautics Board for commercial airlines). As a result, we are addressing regulated industries such as banking, insurance, utilities, and airlines.

We have chosen this focus for two reasons. First, industry-specific regulation has had a long history in the United States and second, this is an area currently subject to broadening deregulation efforts (airlines, trucking, banking). As such, an awareness of the differences in strategic planning in regulated environments is critical during a transition to non-regulated environments. The regulatory actions of OSHA, EPA,

[2] Despite Dill's use of the term 'kibitzer', this is not a trivial issue. In some cases active intrusion may result in the termination of the firm. See A. E. Ehrbar's 'The needless death of Federal Glass', *Fortune*, July 2 1979, pp. 58–63.

EEOC, and CPSC, while important, are not the subject of inquiry here. This latter type of regulation, which we have labelled 'social' regulation, is fundamentally different in character than industry-specific regulation (see Mahon and Murray, 1980).

Of importance to any organization according to Thompson (1967), are the concepts of domain and task environment. Domain delineates those areas in which the organization is dependent on inputs from the environment while task environment denotes those parts of the environment which are relevant to goal setting and attainment. For a domain to be operational, however, the organization's claim to that domain must be recognized and implicitly agreed to by those who can provide the necessary support. According to Thompson, there must exist a consensus regarding domain:

> Domain consensus defines a set of expectations both for members of an organization and for others with whom they interact, about what the organization will and will not do. It provides, although imperfectly, an image of the organization's role in a larger system, which in turn serves as a guide for ordering action in certain directions and not in others (1967:27).

In a non-regulated environment, the domain and task environment involve a large number of actors. It is entirely possible for the organization to balance off these various parties against one another. This would have two beneficial effects for the corporation. First, the larger the network of actors involved in this relationship, the greater the ambiguity in expectations about corporate actions by those external to the firm. In effect this would allow the firm to be less strictly accountable to any one external entity. Second, the larger the network of relationships, the less the influence or impact of any one external actor on the organization. These two points illustrate the relatively great flexibility that an organization has in its response options with respect to external forces in a non-regulated situation.

In a regulated environment, the organization's domain and task environment are much more clearly delineated and the number of external actors involved tends to be more limited. This restricts the organization's ability to face off external actors, one against the other. The dependencies among actors in a regulated environment are much more explicit. This clarity of relationships eliminates some of the alternative plans of action that are available to firms in non-regulated situations. Pfeffer and Salancik (1978) argue that a firm could avoid dependencies in the environment by termination or withdrawal from the relationship. In a regulated environment, the relationship is mandated by law and termination/withdrawal is not an available response option.[3]

Strategies for Regulated Companies

Out of necessity, strategies for organizations in such regulated situations come to be negotiated (Murray and Isenman, 1978). In essence, actors in a regulated environment are stuck with one another and they must learn to get along. Moreover, mutual accommodation under these circumstances involves both a strategic *process* and a strategic *product*. The strategic process is the management of ongoing, dynamic relationships among the firm and various actors external to it, and the strategic product is the more

[3] See Post and Mahon (1980) for an example of the consequences faced by an industry that attempted to withdraw from a regulated relationship.

substantive outcome, or result, of the regulatory process. This 'product' is generally couched in the relatively familiar terms of a product-/service-market strategy, involving product and/or service specifications (such as authorizations for branch banks, etc.), price (i.e. tariffs or rate structures), and prescribed levels or quality of service, including innovation (as allowed for in depreciation guidelines, research and development capitalization, and so forth). It is our view that any regulated firm would therefore require two strategies, one dealing with the more substantive content of its business, which, in turn, represents the more technical aspects of the regulatory process (see Post and Mahon, 1980, for an expansion of this point) and the other dealing with the management of its relationships with external entities.

We shall return to the strategies required by firms in regulated environments shortly, but let us now consider how the regulated environment serves as a focusing agent for the environment itself. To pursue this point we will have to review the environmental states literature.

Different strategies for different environmental states

In an analysis of the 'degrees of system connectedness' among components of the environment, Emery and Trist (1965) argue that there are four types of environments: (1) placid, randomized; (2) placid, clustered; (3) disturbed–reactive; and (4) turbulent fields. They assert that there is no causal connection between the unchanging and separate parts of placid, random environments, and so relatively small undifferentiated organizations can exist there. In placid, clustered environments, organizations must have a high degree of specialization and adopt strategies to cope with an environment that is causally connected. An appropriate organizational type for this environment is hierarchical with centralized control and coordination. In a disturbed–reactive environment there are a number of like organizations sharing the same market, and each organization will know what the others know. As a consequence, strategies and tactics are not likely to differ significantly. Only in operational details are organizations likely to differ, and it is in these areas that they tend to choose competition, cooperation, or cooptation with other like organizations. Finally, in a turbulent field, the environment itself is interacting with the firms to produce change, and a high degree of uncertainty exists. An appropriate organizational type for this environment is the matrix form, and all competitors which share the same fate should seek a high degree of cooperation.

From this taxonomy flows the clear implication that organizations' environments significantly affect their strategic planning processes and structural arrangements. Post (1978) further suggests that as organizations move from a placid, randomized to a placid, clustered environment, they can predict change, and thus the concept of strategy emerges as a useful tool for the manager. In a disturbed–reactive environment, strategy becomes even more important and changes are made in the internal organizational structure to better serve strategy. Finally, in turbulent fields, with a great deal of uncertainty, companies must form coalitions with other industry participants and/or 'outside' organizational entities. The problems they face are too great and the situations are too complex to be stabilized by the actions of only one actor and hence the need for cooperation.

The 'turbulent field' environment represents most closely non-regulated industries whereas the 'disturbed–reactive' environment seems to mirror the situation found in regulated industries. With respect to regulated industries though, greater precision seems possible. In an extension of Emery and Trist's typology, Chin (1976) introduced the concept of articulated turbulence as an environmental state. In these environmental 'systems' there are clearly identifiable mechanisms that organize, channel, and process turbulent forces and provide information about them to other components of the system. In other words, a central feature of an articulated turbulent environment (our regulated industry) is the presence of an element (regulatory agency) that focuses on change for the benefit of all elements within that system (other companies in the industry).

Regulatory agencies as buffers

Since the regulatory body serves as the 'articulator' for the industry, the precise role that the regulatory commission assumes is quite important. The regulatory agency can act as either a buffer or change agent. Regulatory agencies often act as buffers by protecting the firm from market and competitive forces. In this way regulation provides a great deal of stability and certainty in the environment. Regulatory agencies limit market entry by outsiders (for example, consider the scant number of new trucking lines approved by the ICC). 'Market entry' is even controlled *within* a regulated industry (for example, the previous careful allocation of air traffic routes by the CAB). Regulatory bodies also provide a certain amount of price stability by setting rates so as to allow adequate returns on investment in good *and* poor economic times.

Regulated companies also benefit from the neutralization of many competitive actions and reactions ordinarily available to firms in non-regulated environments. Any competitive edge obtained by introducing new services or cutting prices is often blunted, if not lost, by the frequent regulatory requirement that firms submit proposals for such new initiatives a specified time period in advance of final approval. These filings are usually public knowledge, and this gives others in the industry sufficient time to prepare their own competitive replies. It also allows for another type of action not available to firms in non-regulated arenas. A firm can contest the actions of its competitor in a hearing before the regulatory agency and attempt to have the agency deny or revoke the change or innovation. As a result, 'competitive' responses in regulated industries often lag those observed in non-regulated industries. Moreover, the regulatory process often requires uniformity across the industry in a variety of ways (internal procedures, methods of rate compilation, methods of rate assessment, etc.) which serves to further stifle competitiveness in an industry.

Since many of the traditional market and competitive factors are weakened in a regulated environment, and because of the influence and impact of the regulatory agency, the focus of organizational planning and action shifts from the consumers or customers to the regulatory body itself. This demands that the firm become adept in political analysis and negotiation skills, techniques that go beyond the traditional knowledge and skills associated with planning, such as micro- and macro-economics, industry analysis, and so forth. Frequently, the firms that have made this shift in regulated industries display weaknesses in their traditional planning capabilities. As the regulatory body reduces the advantages of traditional economic planning (pricing strategies, marketing strategies, etc.) the firms become involved in a process of what we would call organizational 'delearning'. That is, the organization loses expertise in competitive strategic planning much like the human muscle that atrophies from underutilization. This loss can show up clearly in the event that the industry is deregulated.[4]

Regulatory agencies acting as buffers also encourage industry participants to use what McCaskey (1974) terms programmed strategies. These are rather deterministic plans, planned in a detailed, integrated way and analogous to standard operating procedures—good for 'more of the same'. Under conditions of environmental stability and well defined organizational roles, such programmed strategies may be quite appropriate. An example would be the fairly routine scheduling of more generating capacity by electric utilities in anticipation of a virtually assured 7 per cent annual increase in demand for electricity in the early 1970s.

Yoshihara (1976) would label this approach one of exploitative adaptation, wherein a firm preserves its historical links to the environment, and relies not so much on strategy as a constant interplay between operational decisions and administrative structures to achieve its objectives. This type of interplay would seem to be both appropriate and sufficient in regulated situations where stability exists by virtue of the regulatory body acting as a buffer, but Yoshihara argues that there are two processes of adaptation available to a firm. The other is strategic adaptation in which the firm attempts to change its linkages to the environment. This involves the articulation of a strategy, the operational decisions necessary for implementation, and the placement of the appropriate administrative structures to monitor the entire process. Strategic adaptation would be appropriate in instances where, instead of acting as a buffer, the regulatory agency takes on the role of a change agent.

Regulatory agencies as change agents

We have spent some time discussing the situation where the regulatory agency serves as a buffer for the industry. Although this has been the historical relationship, it may now be changing to one of a change agent as well. In fact, when regulatory agencies change their roles, regulated organizations face their greatest uncertainty. It is during these transitional periods that companies in regulated industries have to be particularly alert and anticipatory. In this situation a firm has to pay particular attention to the process, that is, its evolving relationships with external entities, and avoid focusing solely or too narrowly on substantive details of the regulatory process (rate decisions and the like). Using systems theory as a conceptual base, Post and Mahon (1980) analysed just such a situation in the insurance industry in the state of Massachusetts. Post and Mahon concluded that successful management within a regulated environment involved the simultaneous playing of two games by a company. The first game centred on the specific and technical issues (rate determination and risk assessment) and the second game focused on the relationships between the actors. This relationship aspect involved the process of interactions between the actors and the nature and form of influence attempts made by both the firms and the regulatory agency. This second game was more important for the industry in the long run, but it received the least attention. This relational aspect (or the process as we have termed it) is extremely important in a regulated situation. In a non-regulated environment, the actors can terminate unsatisfactory relationships, and as a consequence there is no need to place great emphasis on maintaining relationships as other substitutes can be found.

[4] The airlines may be a perfect case illustration. As the industry is being deregulated, organizations are attempting to engage in competitive actions that are not well thought out or very successful. See Alexander Stuart's 'Braniff's dizzying takeoff into deregulated skies', *Fortune*, March 26, 1979, pp. 52–61.

It is important to recognize that the regulatory agency serves not only as the focus of corporate action, but of public interest group and pressure group action as well. This is a key point, because in non-regulated environments interest groups have to divert their efforts to a variety of targets in their attempts to influence corporate actions. These efforts, dispersed as they are, are usually less effective than well focused undertakings. The regulated environment provides just such a focus for concentrated action in the regulatory body itself. This board (or individual) is highly visible and its actions clear. It is an excellent target for the actions of pressure groups, consumer interest groups and other parties seeking to influence corporate actions, and insofar as it attempts to be responsive to those pressures, it can actually form part of Dill's active intrusive environment. This in turn requires the regulated firm to develop some social or public policy strategy to counter this unique threat. The firm generally feels that it can ill afford to stand by and allow these groups (whether public or special interest in nature) to pressure the regulatory agency. It would be preferable for the company to counter, deflect, or perhaps even intercept and confront these groups prior to their impact on the regulatory body. This demands a well thought out, clear, and articulate strategy for dealing with public interest groups—what we would call a public policy or social strategy.

IMPLICATIONS FOR RESEARCH

Intertwined in our discussion of regulated environments are several emergent propositions which we propose here as empirically testable and therefore useful for guiding subsequent research:

A. As the environment in which the firm operates becomes more regulated:
   1. the longer the planning horizon will be and the greater the reliance on programmed strategies;
   2. the less the focus of organizational planning on the consumer or customer and the greater the emphasis on the regulatory agency as the centre of planning;
   3. the firm will rely less on multiple boundary spanning roles; a few contacts will suffice (in Lawrence and Lorsch's (1967) terms, the less the level of differentiation and the less the need for, and use of, integrators);
   4. the greater the need for the firms to anticipate issues and interact with the regulatory agency. That is, the problems of managing relationships (per systems theory) will assume even greater importance;
   5. the higher the indirect costs and the greater the pressure for managers to anticipate future regulatory action (similar to (4) above, but the emphasis here is on the product of regulation, that is, the technical issues).

B. The movement of the regulatory agency from a buffering role to that of change agent (and vice versa) will profoundly affect system relationships.

C. The recognition of a continuum of regulation and the synthesis of life cycle theories of the firm with life cycle theories of the regulatory agency (Bernstein, 1955) will lead to more successful strategies by the individual firm (successful defined as the achievement of corporate purpose with regard to specific issues).

It should be noted here that these propositions are illustrative of what we would expect to find in regulated companies, not necessarily what we would recommend. However, the propositions represent an area of research that is ripe for exploration. The practical implications of greater knowledge are significant, and they have been addressed elsewhere in the context of deregulation (Mahon and Murray, 1980).

As firms move in and out of regulated environments they will have to adjust their structures and planning processes. Thompson and McEwen note that:

> We have stressed that it is improbable that an organization can continue indefinitely if its goals are formulated arbitrarily, without cognizance of its relations with the environment. One of the requirements for survival appears to be an ability to learn about the environment accurately enough and quickly enough to permit organizational adjustments in time to avoid extinction (1958: 29–30).

For example, as airlines are deregulated they will have to relearn how to plan, act and respond in a much more competitive environment. The same is true of AT & T now. On the other hand, as companies in the oil and gas industries become more regulated they will have to learn to respond, plan, and act around a regulatory body in strictly competitive settings.

The hypotheses extended

We see organizational planning for regulated environments involving as many as three distinct yet overlapping and not incompatible strategies: economic, political, and social (see Table 1).

The first, or 'base case', strategy that is necessary consists of a traditional economic orientation. The firm in a regulated environment still has to be concerned with costs, prices, profits, and the like. This is clearly, however, the least sophisticated strategy for reasons we have already articulated. The organization should be well aware of this fact; however, it should not allow its economic planning skills to decline. For example, in instances of relatively quick deregulation (as in the airline industry) a reemphasis on economic strategy and competitive analysis would be required.

We contend that a firm in a regulated environment also needs a political strategy to manage its relationships with the regulatory body, and other political elements (e.g. legislatures, governors, etc.) as well as other firms in the regulated industry. This strategy requires different skills than those normally found in non-regulated situations. Structures designed to foresee changing political and regulatory climates will be necessary and a mechanism to introduce these considerations into the traditional planning arm of the firm will be required. Since the firm cannot withdraw from the regulated environment, a premium should be placed on the development and maintenance of good relationships.

But even the use of a political strategy to augment a firm's economic strategy seems insufficient to us. A third, and more sophisticated, requirement is a social or public policy strategy. Since the regulatory agency is a prime focal point of interest group action, the firm has to develop strategies for the long term management or relations with these action groups as well as its relations with the regulatory agency. To be successful, the firm must deal with these groups prior to the involvement of the regulatory agency. The advantage of this strategy is that the firm will maintain more options and greater discretion in dealing with these groups prior to the involvement of

Table 1. Strategies and outcomes as a function of assumed roles in regulated environments

Degree of regulation	Organization's assumed role for planning purposes	Organization's assessment of the regulated environment	Relational context	Strategy	Outcome
(Decreasing)	Economic—the "base case"	Inputs are by and large determined by actions of the regulatory body (the firm's domain is clearly identified)	Competition that does exist occurs in the public arena at rate hearings; some competition also occurs in costs, quality of service, and 'image'	Traditional economically oriented business strategy defined in typical product or service market terms	Effort focused on the product of the regulatory process, that is, on specific technical issues
	Political—more complex and sophisticated	The regulatory agency is key to goal setting and attainment (the firm's task environment is clearly identified)	The firm cannot withdraw or terminate the relationship because of legal restrictions	Political strategy or negotiated approach required to manage relationships with regulatory body	Concern is for process—that is on the relationship of the firm to the regulatory agency
(Increasing)	Social—most intricate and sophisticated	The expectations of corporate behaviour are clear and known to other social actors in addition to the other regulated firms (a domain consensus exists, and the domain and task environment are both clearly identified)	The environment consists of a relatively limited number of potentially diverse participants (i.e. interest groups enter into the environment of the firm)	Social or public policy strategies necessary to address broader concerns of multiple, diverse constituencies	Focus on both the relationships (process) and the outcome of the regulatory decision (or product)

the regulatory body. Once public interest groups are heard by the regulatory agency, the problem has moved into the public arena, and other actors outside the regulatory system may become involved. In short, the conflict is expanded, and any solution will have to satisfy more parties. There is also increased public scrutiny of and pressure on the regulatory agency to respond. This pressure can be reduced if the firm can intercept the interest group before it gets to the public arena so as to diffuse or accommodate their demands in some way. This requires continuous monitoring of social issues and trends by the corporation including establishment and maintenance of a capability to respond when and where necessary. Few firms maintain this type of capability today.

Political and social strategies are appropriate for firms in non-regulated environments as well, but results are much more difficult to measure and interpret. This is because the focus of the actor and the action itself is greatly dispersed in a non-regulated setting. In a non-regulated environment, economic forces tend to be the focus of organizational action because of their proximity and familiarity. The firm is used to dealing with economic and competitive data and situations, and success or failure is easily measured. Once the firm moves away from the economic arena, however, the organization risks an excursion into uncertain and troubled territory. Unlike a

Table 2. Propositions relating economic, political, and social strategies

A. Where regulatory agencies serve as 'buffers', the more successful purely 'economic' strategies will be in achieving desired results.
B. Where regulatory agencies serve as 'buffers' the less the likelihood that outside actors (political, social) will become involved in the regulatory process.
C. When key regulatory agency personnel change (e.g. the chairman):
   1. the greater the temptation to press forward with purely 'economic' strategies; however,
   2. the greater the success of 'political' versus 'economic' strategies.
D. Where the regulatory agency serves as a 'change agent' and the firm relies on purely 'economic' strategies, the greater the likelihood that political and social actors will become involved in the regulatory process to the detriment of organizational goals.
E. Where regulatory agencies serve as 'change agents', the less successful purely 'economic' strategies will be in achieving desired results.
F. As firms come to a recognition that 'political' and 'social' strategies are necessary, the stronger the links will be between strategic planning units and other boundary spanning units (particularly public affairs departments).
G. In most firms economic and other types of planning are separated at a cost of reduced efficiency and effectiveness which in turn increases the likelihood of being caught by surprise by non-market forces.
H. In the long run, when a firm utilizes political and social strategies in a regulatory situation:
   1. the less likely the conflict in the public domain;
   2. the greater the support for corporate or industry proposals; and
   3. the greater the acceptance of 'economic' strategies; and
   4. the more successful the organization in achieving its goals.
I. The articulation of social and political strategies will lead to improved identification of relevant stakeholders and improve corporate assumption making processes (Mitroff and Emshoff, 1979).
J. The pursuit of political and social strategies will have consequences beyond the regulatory arena for the firm, to wit:
   skills developed in a political and social strategy can be applied to union/labour problems, or to thorny issues like plant closings and relocations.
K. The utilization of a three tiered strategy will better prepare an organization for any potential deregulation.

regulated environment, the domain and task environment of an 'unregulated' organization is very large. Consequently, action in the political and social spheres is often fragmented and disjointed. This means that the exact steps or procedures to be followed by the firm are vague and ambiguous. The sheer number of actors involved in the non-regulated setting makes it impossible to predict with any certainty the outcomes of particular action. There is no one actor that these firms and their opponents can focus on for a resolution of political and social issues.

The existence of a three tiered, interrelated strategy for regulated environments raises additional hypotheses of research interest, some of which are presented in Table 2. It is our belief that they, together with the hypotheses introduced above, represent a beginning research agenda for a largely unexplored arena.

CONCLUSIONS

In the regulated environment, the regulatory agency serves as the final arbiter of controversy and disagreement. Corporations have, and still are, learning how to deal with regulatory agencies in this political and social arena. Simultaneously, their critics also are learning how to deal with regulators to achieve their programs and goals. In a regulated environment, because of the more restricted domain and task environment, we see positive, measurable results obtainable from political and social strategies over and above those benefits derived from purely economic strategies. Although we have analysed these strategies as if they are distinct and separable, we suspect that this represents an analytical versus practical distinction. Astute managers of regulated companies will recognize the inter-relationships and act, using all three strategies in a thoughtfully orchestrated fashion. However, many managers still seem unaware that more sophisticated political and social strategies are necessary and the integrative mechanisms required to align these strategies with the economic planning of the firm are not yet in place.

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