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Strategic Planning for Entrepreneurs and SME CEOs

STRATEGY

Seth Bakes' take on strategic planning? You can't turn a bad strategy into a good one through excellent execution. You can, however, ruin a good strategy with poor execution. Planning is key.

Use organized analytical formats, be rigorous and inclusive, avoid conventional wisdom, and take care of business.

By Seth Bakes

For those contemplating strategic direction - a small company entrepreneur perhaps or an acquirer or a manager in a mid-size enterprise—it's well to conduct a business or strategic plan that maps alternatives. Since entire libraries have been written on this topic, what follows is a perspective for those less familiar with strategic planning concepts and a process that may be helpful to get started.

If not familiar with corporate strategy topics get to know the major concepts and analytical frameworks: competitive forces, sustainable competitive advantage, core competencies/outsourcing opportunities, and SWOT analysis (strengths, weaknesses, opportunities, and threats). Consider access to capital, market dynamics, key relationships, and trends. Consider your place in your industry. There are many good books on the subject. Authors James Brian Quinn (associated with The Tuck School at Dartmouth College) and Michael Porter (associated with Harvard Business School) have produced several.

Sustained profitability and growth of real economic value are the desired outcomes. Shareholder value is the key measure. How will the value of the company best be maximized? Consider risk and return. A company's risk profile is, in some, but not all respects, defined by its capital structure, industry, products, and stage of life and the bottom line of most strategies is management's assessment of risk and return and rational for prioritizing / allocating resources.

Be careful about the use of conventional accounting to measure performance. It can obscure true economic performance and lead to bad strategic choices. Return on invested capital (EBIT / Total Assets) is a good measure, for example, of economic performance. Amortization and depreciation are real costs. Cash flow is also a good simple measure of economic value (and the ability to pay bills and dividends).

Keep it simple (if possible). Hopefully, but not necessarily, the strategy will be simple, intuitive, and center on a major theme or two, for example: something as simple and straightforward as working with a major trend, avoiding head-on competition with a dominant player, a new approach to an old business, a cost or revenue advantage, a key relationship, product differentiation, capital constraints ...

SoBe is a great example of the creation of a new product, and even better, the creation of a whole new beverage category as explained to me by Tom Schwalm, one of the founders. Originally South Beach Beverage Company, SoBe introduced a unique line of refreshing energy drinks enhanced with herbs that became very popular and was ultimately sold to PepsiCo. Schwalm was a beverage industry veteran with a new very differentiated product idea. SoBe created a new niche market - one without existing direct competition. Clever and fast, 5 to 10 years. Creative and simple in concept. Not so easy to take from concept to PepsiCo acquisition, but that's another story.

Favorite examples of successful entrepreneurial business stories frequently showcase the transformative changes that take a new business concept to the stratosphere, as in the SoBe example above, or more recently, the story of the social networking phenomena, Facebook. Other favorites are stories that take an existing company to a much bigger and better place, IPOD / IPAD / Apple, for example. However, big new product / new industry successes like these do not come along that often and are frequently not available to many existing businesses. If they are, great, but if not, companies can do well by making good day to day strategic choices rather than transformative thrusts.

Managements can build their companies over time by making good carefully considered choices with things like the direction of R&D, product / market extensions, cost reduction efforts and related resource allocation decisions. It's wise not to neglect "closer in" opportunities. If the truly transformative opportunity arises, great, jump on it, but keep the company running in the interim. It's easier and safer. Frequently strategy evolves rather than explodes. In hindsight what looks like a bold strategic move is really a set of good "closer in" choices that evolve together over time.

A company in a fun industry that illustrates the general idea is Hobie, the manufacturer of Hobie Surfboards, Hobie Cats (the popular recreational catamarans), ultra light sailboats, and other water recreation gear. Hobie Alter started at the Laguna Beach summer home of his father in the early 1950's, shaping and selling custom made balsa wood surfboards to the local crowd and then followed, some say created, lifestyle trends, technology, and product evolutions through the sale of Hobie Cat to Coleman in 1976. Twenty six years from hand shaping and selling one-off balsa wood surfboards in Laguna Beach to professional shapers making foam and fiberglass boards of various types, to retail stores selling boards, beach clothing, and accessories to foam and fiberglass catamarans produced at scale. A great example of picking up on new trends, introducing / popularizing new products, as well as product extensions, and using craftsmanship and technological prowess as differentiators. Not a bad run. Many good decisions made over several decades. It's said that Hobie Alter paid attention to detail.

Good strategic plans can emanate from the executive conference room as senior execs ponder complex choices, but good strategic ideas can also emanate from less formal situations. So be inclusive. Include key managers and consultants in the discussion and also include lower level employees. They may have important insights that may not otherwise enter the discussion. Sometimes lower level staff and line employees are closer to the customers or production processes than senior executives. Include those who will implement the strategy. Ask your customers for their thoughts regarding their needs and the direction of the market. Be creative.

Ask what are you really good at doing: marketing, distribution, manufacturing, technology development, investment decisions, new product innovation? One strategic theme espoused by Quinn (and greatly over simplified here) is to do what you do best and outsource the rest.

Once strategic direction has been established put together a business plan that supports the strategy. A business plan is different than a budget or cash flow projection dressed up with some assumptions. The business plan should touch on each major function of your business: marketing, operations, finance, human resources, key relationships, and technology, and should include financial data such as budgets, cash flow, and profitability and risk measures.

Strategic planning and business planning are separate concepts that are sometimes used synonymously, but it is best to keep them separate. In a nutshell, a strategy articulates what you are proposing to do and why. The business plan will describe how to do it.

There is nothing better than a good strategy well executed. On the other hand, no matter how well you execute a flawed strategy, it is still a flawed strategy. And, you cannot improve a bad strategy with good execution, but you can ruin a good strategy with poor execution. It is hard, but you can do it if you really try.

It may be necessary to change the strategy as issues arise during the preparation of the business plan. So do not rigidly stick to a strategy that needs to be modified. Challenge the basic premises and challenge them early in the process. Use common sense. Use your commercial instincts. Be rigorous. Think things through thoroughly. Avoid making assumptions (or at least refresh the distinction between assumptions and facts from time to time as you proceed).

There are dozens of strategic planning lessons learned that could be shared, but space does not allow more than a few vignettes that demonstrate strategic concepts: competitive advantage, core competence, diversification vs. concentration, synergy, and profits vs. growth or growth in market share.

Lesson 1: Focus on your strengths. A mature land developer and home builder in the southwestern U.S. faced a major dilemma - it was only marginally profitable despite having competitive advantage. It had large land holdings acquired decades earlier resulting in a favorable land cost basis. It also had deep expertise and relationships in land development in its major market.

In order to assess the situation, product cost and profitability analyses were prepared which segmented the two major product categories and delivery processes. The home building business segment, contrary to industry standards at the time, had weak margins. An honest self-assessment determined that the client was just not good in this segment. This was also the segment that incurred most of the company's employee burden and overhead and tied up a lot of capital. The company decided to exit home building, outsourcing it to others. The company stuck with its core competence, the land development business, reducing organizational complexity, overhead, and capital requirements and enjoyed higher profit margins.

Lesson 2: Real synergies are hard to find. A growing software development and sales company in the enterprise database auditing space was contemplating an add-on acquisition with the thought of various marketing synergies in mind. But synergies are elusive. It was originally thought that there would be material marketing cost savings and revenue growth acceleration as the company would be able to present multiple products to the same customers' IT departments. But

after further inquiry it was determined that the purchasing decision maker for the add-on products was frequently in the accounting department, not IT, thus negating many of the assumed efficiencies.

Lesson 3: Growth and growth in market share are not ends in themselves.

Here is an interesting story from a commodity investment business. An office building owner / manager intentionally became the largest landlord in a specific geographic market. There were several prospective benefits to this strategy including, but not limited to: enjoying greater visibility / market presence than the competition and enhancing the ability to capture tenants by offering more space options than other landlords. The idea was that this would positively influence sales volume and revenue.

The company learned, after substantial investment, that having a dominant market share did not produce competitive advantage and that: (a) it's hard to consolidate and dominate a highly fractured market to the extent that this alone produces competitive advantage, (b) lacking any distinct product differentiation, direct competition exists as long as there is one other credible and visible provider of a similar product and this competition will produce pricing pressure which may preclude obtaining higher prices and profit, (c) market boundaries can be amorphous making hard measurement of market share elusive and also providing alternatives to customers, and (d) concentration in one product / market area may have benefits but also has risks associated with contra-diversification, the negative consequences of which typically arise during recessions or market downturns.

Basically the investor wound up holding a lot of office buildings, a commodity product, in the same location during a market downturn and its deep market presence did not produce benefits as there were frequently other competitive opportunities for their customers. In this situation amassing a large concentrated position did not produce competitive advantage, but did have the negative consequence of overconcentration when the market weakened. They might as well have taken the opposite direction and geographically diversified their holdings.

Another example, but this time from the food service industry, is the recent history of Starbucks - a growth story that ran out of gas in the recession as store locations kept expanding, but same store sales and share price eroded. As Howard Schultz said in a recent interview in *The New York Times*, "Growth had a

life of its own ...” Ultimately, Howard Schultz returned as CEO and has been cutting costs, reducing locations, and otherwise redirecting the company.

So, growth and growth in market share are not ends in themselves. Ask what is growth doing for you? Do you get better unit prices, lower costs? What is happening to profits (per unit, per store, per share, ...)? What opportunities are you forgoing? Is your brand staying vibrant? Growth and growth in market share are not as satisfying as growth in profits, earnings per share, and return on assets or return on capital employed. Strong profit margins are a source of a strong balance sheet, working capital for pursuing new opportunities, and cash for paying shareholder dividends.

Lesson 4: It’s easier to hit singles than homeruns. One services and technology company catering to the financial services industry wanted to transform itself into the next big thing. Unfortunately, the company’s initial technology product introduction, a financial analysis tool and digital transaction portal that allowed transaction participants (lenders, investors, lawyers, financial intermediaries, others) to electronically share and update information, using standardized information templates that would theoretically improve efficiency among the transaction participants, had not been accepted by the market. Some said the standardization and portal ideas were a bit ahead of the market. The result was that the company was having financial difficulties.

Fortunately, the company had an enviable and hard to duplicate service platform on which to build that complimented, but could also be used independently of the technology portal. The service business was not glamorous, nor would it provide rapid growth or rich margins, but the service platform was in place and included an existing field staff with national coverage that could perform field auditing and due diligence services on acquisitions or dispositions almost anywhere in the country (a valuable skill and a core competence).

Unfortunately, the company tried to generate, unsuccessfully, transformative ideas that never seemed to gain traction while neglecting some good fundamental growth opportunities and product / market extensions in the service platform that would have incrementally moved the company in the right direction. The company neglected a core competence and unfortunately never hit the homerun.

One last thought regarding things to consider. Take a look at major macro social, political, demographic, economic, and industry trends. Ponder the high impact but low

probability events (the sub-prime and related mortgage quality crises, for example) that could de-rail your enterprise (Bear Stearns and Lehman Brothers, for example) or catapult it forward (Paulson & Co., for example). We tend to skip around the things that are too big to do anything about but have huge consequences when they occur. How are they likely to impact your company, your markets? It is great to be carried along by a major trend and very difficult to fight a trend. There is an old saying, “When the tide comes in it will raise all the ships in the harbor and when the tide goes out it will lower them.” Where is your ship? Where is the tide?

There is another old saying: “Change favors the prepared mind”. This is another reason why business planning and strategy are worthwhile pursuits. They provide a framework for dealing with unpredictable events.



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