CHAPTER 1

A Structured Approach to Holistic Business Planning

STRATEGIC PLANNING:

THE BIG PICTURE

CONGRATULATIONS!

You have been appointed Chief Executive Officer of Company XYZ.

Assume you have just been appointed chief executive officer of IBM, Citicorp, GM, or any other corporation in the world.

This book presents a *structured* framework for quickly and decisively developing strategic plans and complementary implementation plans in order to maximize shareholder value.

Your first task should be to look beyond the current organizational structure in order to discover the true *logical structure* of your company. If done correctly, you will observe that there are:

> **X** number of strategically relevant business units, each requiring a *Business Unit Competitive Strategy;*
>
> **Y** number of strategically relevant horizontal units, each requiring a *Horizontal Unit Statement of Direction;*
>
> **Z** number of business groups, each requiring a Business Group Strategy. The group strategy for the entire corporation is also called the *Corporate Strategy.*

The remainder of this book clarifies and amplifies the above.

STRATEGIC PLANNING

IS THE KEY ACTIVITY

THAT WILL DEFINE A FIRM'S

COMPETITIVE STRATEGY

THAT WILL DIRECT ITS ROUTE TO

COMPETITIVE ADVANTAGE

THAT WILL DETERMINE

ITS PERFORMANCE.

-Michael E. Porter

Strategic planning is the activity of defining a firm's competitive strategy that will direct its route to competitive advantage that will determine its performance.

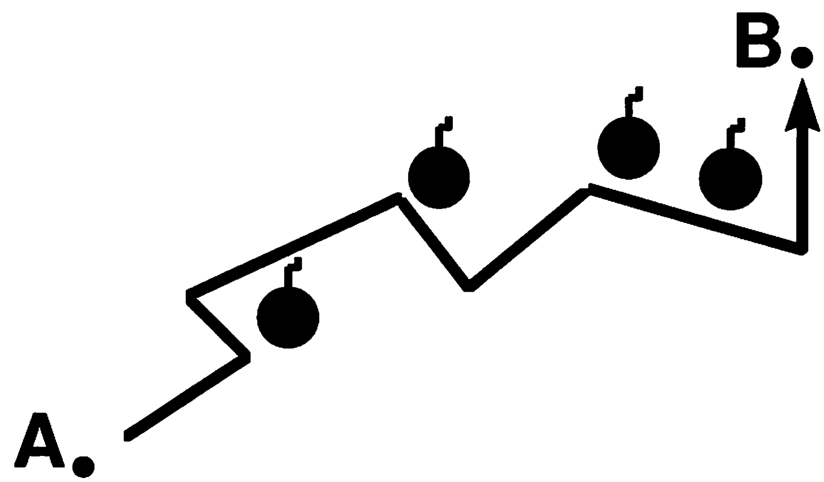
Strategic planning is not only one of the most important activities facing all companies, it is also one of the most creative and most challenging.

Strategic planning should precede and link all other planning activities within the firm. Otherwise, the planning activities of the various functions will not be coordinated, agreed to, or implemented.

In some corporations, strategic planning is not held in high esteem. This is unfortunate. Given today's global, highly technological, highly competitive environment, strategic planning is more important than ever.

It is true, however, that companies have little need for non-professional, non-performing, bureaucratic, centralized planning staffs which do not support the needs of the business. A bad planning staff is worse than no planning staff. Good planning is critically important. A company without a dynamic and flexible planning process that can appropriately evaluate and respond to the changing environment is a company that will soon be playing the blame game.

MOVING FROM POINT A TO POINT B



In the most simple terms, strategic planning is figuring out how to get from point A to point B. This involves three steps.

First, where is point A? Almost every company has a clear financial picture of where it stands today. But far fewer companies understand their current strategic position.

Second, where should point B be? Different people within the organization have different ideas on what the company should look like in the future.

Third, what is the best way to get from point A to point B? Again, different people have different opinions on how to accomplish a common goal.

The *structured* planning process described in this book provides business managers with a structured framework to think strategically, to link planning and implementation, and to link the activities of every business and every department in order to maximize shareholder values.

WHY PLAN?

To improve the odds that Your Company will have above average returns in the future.

HOW WILL THIS BE DONE?

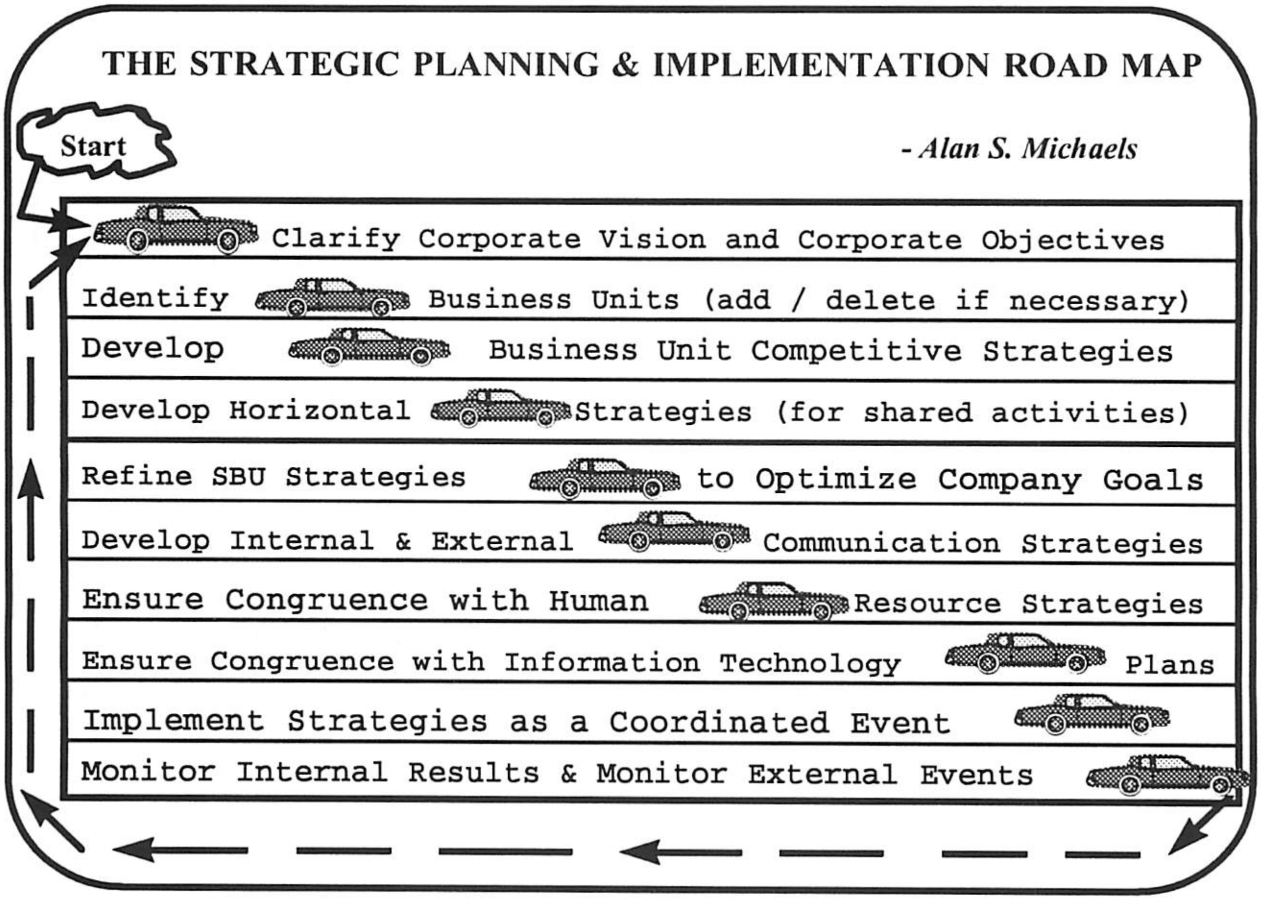
By providing Business Managers with a structured framework to think strategically in order to raise the level of business decision making and business performance. - Alfred Rappaport

The purpose of an explicit planning process is to develop clear business strategies in order **to improve the odds that Your Company will have above average returns in the future.**

Capitalism is spreading throughout the world; and throughout the world competitors are planning to eat each other. Those companies not prepared to meet the challenge will disappear. The days of the "we-are-guaranteed-our-share-of-the-industry's-profits" are gone. It's survival of the fittest - and not all companies will survive to see the year 2010.

To meet the challenges ahead, companies need to become more strategic and more flexible by providing business managers with a *structured* framework to think strategically in order to raise the level of business decision making and business performance.

In practice, business managers are almost always eager to plan effectively. It's when the planning process is illogical and chaotic that things go awry and managers look for cover.



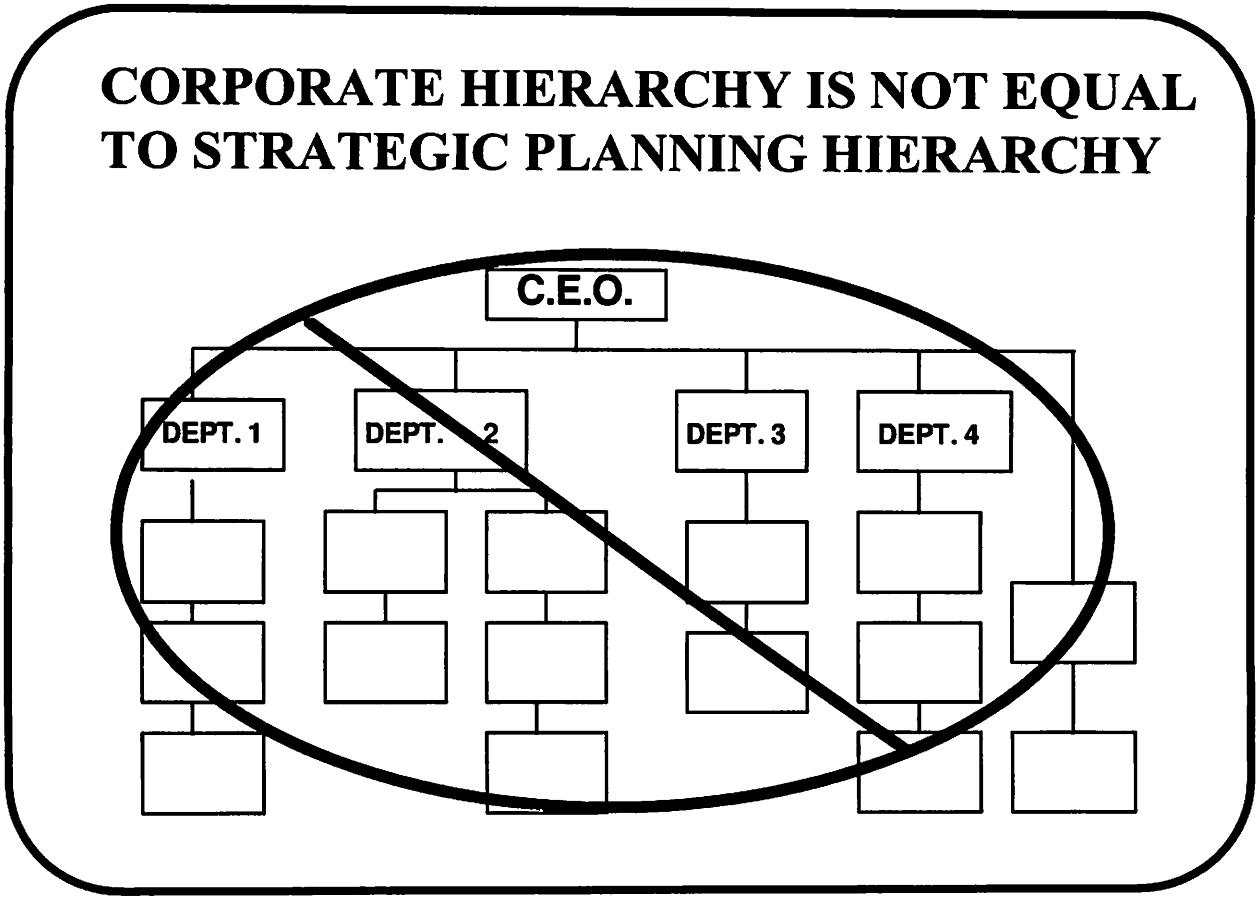
The slide above makes this page the most important page of this book.

It presents the overall road map of the corporate strategic planning and implementation process for any company.

The process is iterative. Although it is usually best to develop and pursue a well developed plan for a long time, global and technological changes and competitive events should be constantly monitored and tested to see if a shift in strategy is required.

Identifying the real businesses in which the company competes is the key step. If avoided, it will dramatically lessen the value of all other planning efforts.

After identifying each of the corporate businesses, the goal of corporate strategy is to maximize the value of the whole corporation. In the words of Michael Porter, "Interrelationships between corporate businesses provide the underpinnings for corporate strategy."

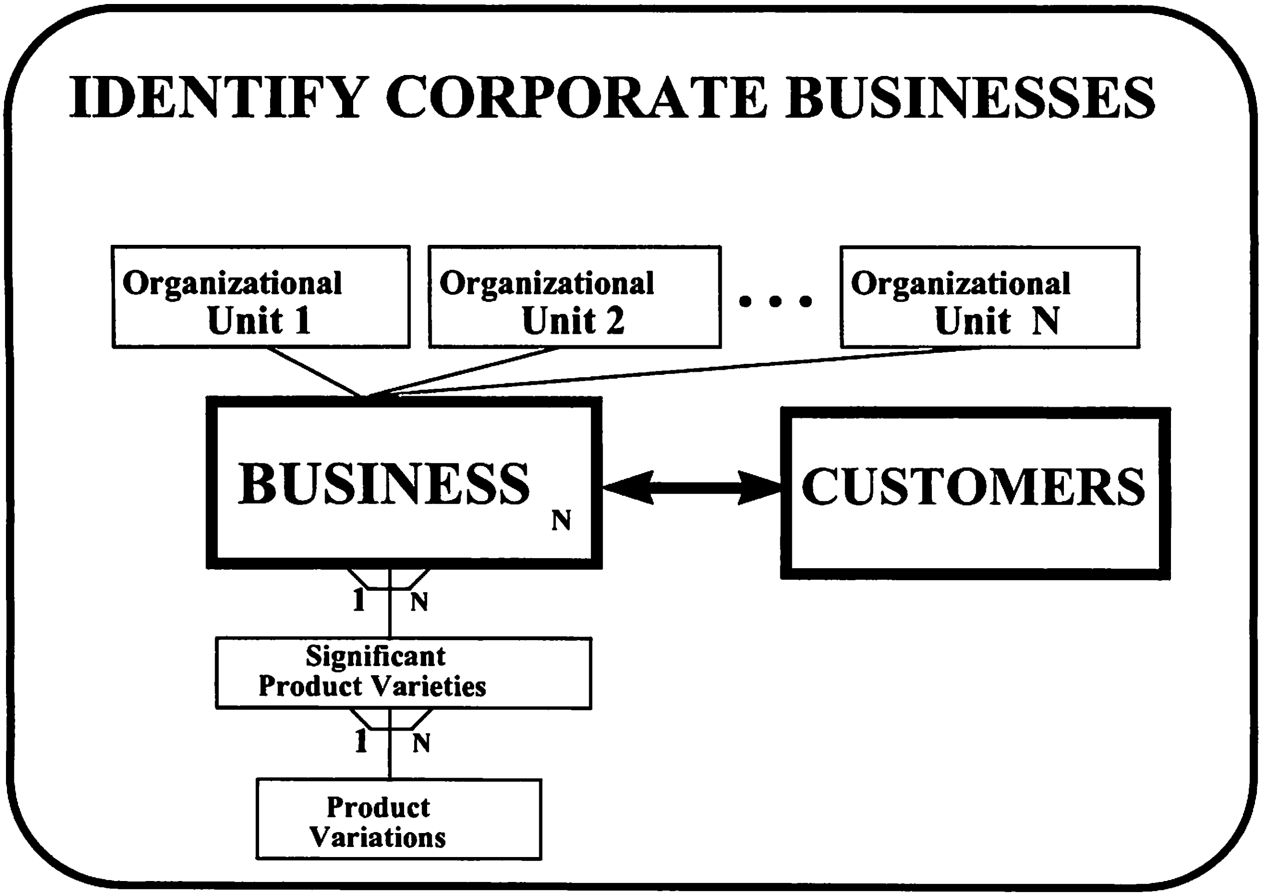


Identifying the businesses in which the company competes is almost always different than looking at the company's legal structure or organization chart. Rarely are companies organized by strategically relevant business units. Even companies that say they are organized around **Strategic Business Units (SBUs)** often are not. Especially in information services and financial services companies, these organizational entities called "SBUs" are often many businesses lumped together. They are not distinct, strategically relevant, business units. The reason these pseudo SBUs exist is often to simplify financial reporting or to satisfy human resource management which often prefers that all 'SBU Managers' have a relatively equal budget and staff.

Many large organizations are really engaged in departmental planning and the planning process is destined to failure from the beginning. Business unit planning, not departmental planning, is the starting point for any successful planning process.

It is possible for a company to reorganize twice a year without entering a new business or exiting an old business. A business can have fewer than ten people, or more than 10,000. The number of people is not relevant.

In short, a company *does not* have to be organized by SBU, but it should know *specifically* what strategic businesses it has.

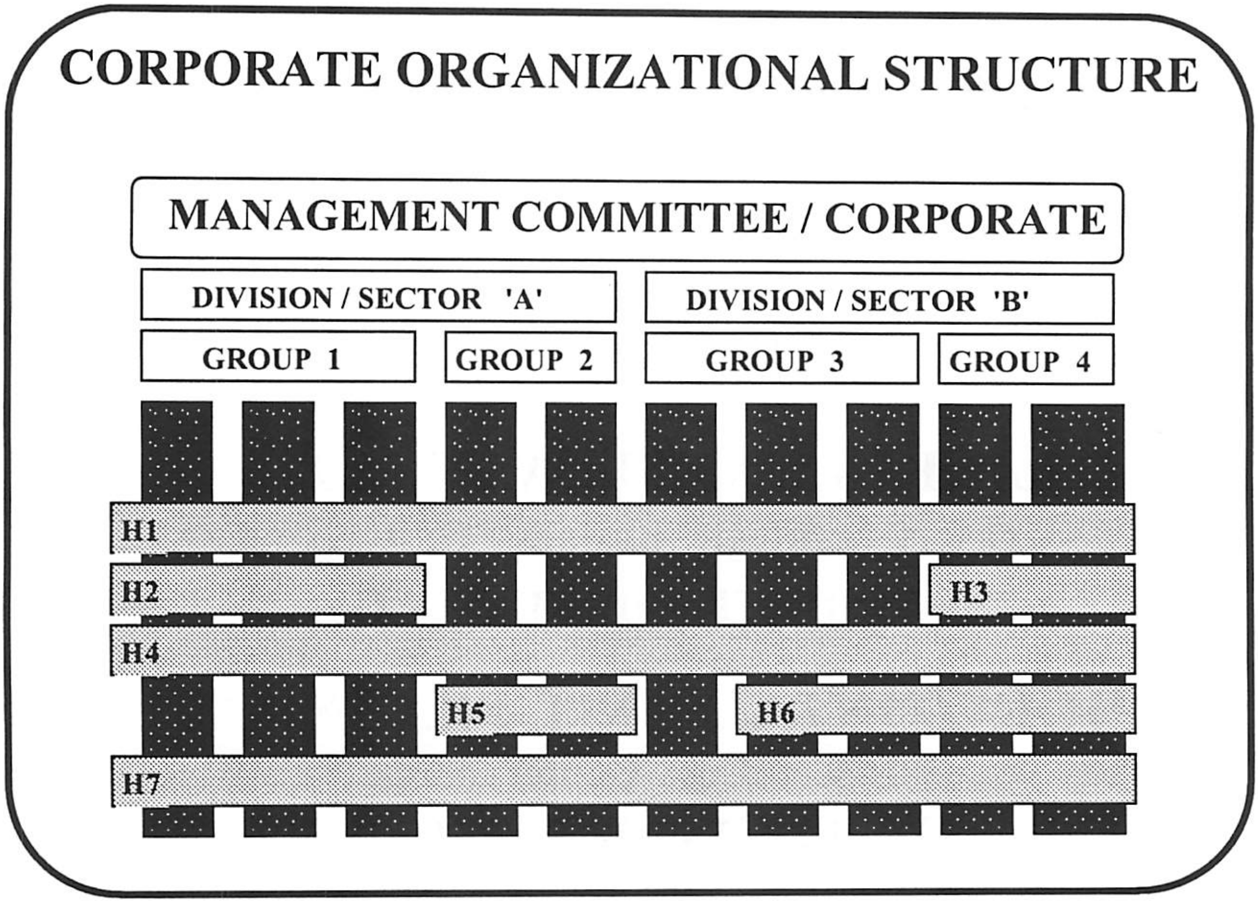


The strategic planning efforts of many companies suffer from what I call the *fruit salad syndrome.* The fruit salad syndrome refers to lumping different things together and giving it one name as if all the elements were the same.

You might believe that you like fruit salad; that you can estimate how much it costs to produce, the number of calories per serving, how much it sells for at the store, etc. But until you know what fruits make up a particular fruit salad, and in what proportion, you really can't even be sure that you would like *today's special* fruit salad.

However, if you were told that a particular fruit salad consists of 30% cantaloupe, 20% honeydew, 20% watermelon (without the seeds), 15% banana, and 15% peaches - you can begin to evaluate whether or not you will like it, how many calories per 16 ounce serving, etc.

Using a banking example, cash management is like a fruit salad. The industries (fruits) which need to be clearly identified include funds transfer, lock box services, checking services, treasury workstation services, and many more. Each of these industries, like the 105 elements found in nature, need to be analyzed individually, before combining with other industries, elements or fruits as the case may be.



After by-passing the current organizational structure and being careful not to lump distinct businesses together, it becomes clear that every company can be logically viewed as **a collection of "N" businesses.**

In order to reap economies of scale and other advantages, corporations often establish **horizontal units** (centralized departments or cost centers) for functions like information systems development and human resource management in order to serve the needs of two or more businesses. These horizontal units are shown as the gray bars going across the page. Note that not all horizontal units perform an activity for every business unit within the corporation.

The total set of business units and the total set of horizontal units comprise the basic components of **corporate strategy.**

THREE (3) TYPES OF PLANNING

1. CORPORATE / GROUP PLANNING

<< Insert Business Group Name >>
CORPORATE (GROUP) STRATEGY

2. BUSINESS UNIT PLANNING

<< Insert Strategic Business Unit Name >>
COMPETITIVE STRATEGY

3. HORIZONTAL UNIT PLANNING

<< Insert Cost Center Name >>
STATEMENT OF DIRECTION

This leads to the observation that there are three very different types of planning.

1. **Corporate (or Group) Planning:** involves the allocation of resources among the various businesses so that overall corporate value is maximized.

2. **Business Unit Strategic Planning:** is product to market driven. The issue is how a sustainable competitive advantage can be established. Strategy for a business unit should be based on its competitive position and consideration for the future industry structure.

3. **Horizontal Unit Planning:** exploits tangible interrelationships between business units. For example, every business unit in the corporation might need tax accounting, but the corporation might need only one tax accounting department.

The remainder of this chapter discusses these three different, complementary efforts.

1

A STRUCTURED APPROACH TO CORPORATE (GROUP) PLANNING

CORPORATE MANAGEMENT RESPONSIBILITY

Assumed / Suggested Responsibility of Corporate Management:

"To set forth the best possible corporate vision and to promote a complementary corporate culture in order to obtain the optimal mix of businesses, and to optimally coordinate their efforts, in order to maximize shareholder values."

- Alan S. Michaels

If not for the responsibility highlighted above, what value do group managers provide?

Group managers need to take an active role in resolving conflicting objectives between business units that share an activity (like information systems). They should also promote opportunities where one business can benefit from another (like cross-selling). Win-win situations are easy for a group manager to address. From a strategic point of view, the justification for paying high salaries to group executives is their ability to modify the actions of one business, even if the performance of that business will be less than optimal, in order to improve by an even greater amount the results of one or more of the other corporate businesses. This takes leadership.

Creative human resource management practices including flexible compensation programs may be required to ensure that business unit managers will modify their actions in order to maximize the results of the group, rather than focusing only on maximizing the results of their own business unit.

CORPORATE STRATEGY DEVELOPMENT

A. Establishment of Corporate Vision and Corporate Objectives

B. Business Mix Selection including Mergers & Acquisitions

C. Horizontal Strategies & Organizational Structure

Corporate (group) strategy development involves the concept of maximizing the value of two or more business units.

This section will discuss the following:

A. Corporate vision and corporate objectives - setting the corporate direction and corporate objectives *in priority order.*

B. Business mix selection - deciding which businesses to compete in.

C. Horizontal strategies - establishing policies, procedures and activities which cut across multiple business units.

A. CORPORATE VISION & OBJECTIVES

Keep it simple.

Vision

Where is point B? Where are we going?

What do we want to be? What businesses should we be in?

What will be the glue that binds the mix of businesses together?

What corporate values and corporate culture should we promote?

Objectives

In priority order, what are the objectives of the company?

In thinking about the *corporate vision,* there is a tendency to define the company in terms of what it has been with a slight incremental change. At an off-site meeting with the company president, this approach might seem to be the safest route. However, choosing a dramatically different path may not necessarily be a riskier alternative. Some industry gurus believe that changing slowly is usually a recipe for failure. The best alternative depends upon the position of your company within the context of its environment.

Establishing a corporate vision is critical and takes thought. But a company should spend less than a year thinking about it. A three-day weekend in the right setting will often do just fine.

An example of vision comes from Ortec International, a small biotechnology company. Its vision is to develop and market a cultured skin equivalent for burn victims and for people with EB disease around the world.

Along with establishing a corporate vision it is important to set corporate objectives in priority order. They may be financial objectives as well an non-financial objectives (like helping the community). The more specific and the more measurable the better. The list of objectives should be viewed as the framework for a corporate report card with expected targets (grades) to be achieved at specific time frames in the future.

B. BUSINESS MIX SELECTION

WHEN BUYING STOCK, TWO CRITICAL ISSUES

1. **Which industries will be very attractive in the future?**
2. **Which firm in each industry will be the most successful?**

WHEN MANAGING A COMPANY, TWO CRITICAL ISSUES

1. **Which industries to enter / exit?**
2. **What should be the competitive strategy (competitive positioning) of each business?**

Investors in stocks recognize the dual aspects of analyzing an equity investment opportunity. First, how attractive is the industry? Second, what are the competitive advantages and disadvantages of the company under consideration for investment?

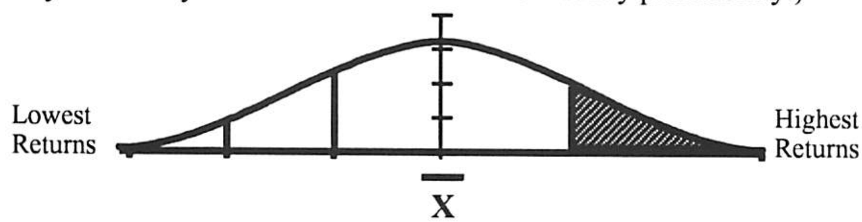
These concepts need to be discussed inside the ranks of corporate management. First, corporate management needs to select the best industries in which to compete. Second, corporate management needs to facilitate the process whereby each business develops a competitive strategy to build and sustain a competitive advantage.

The process of developing a corporate strategy, including identification of desired business mix, doesn't have to be long or complicated. The process of developing business unit strategies doesn't have to be long or complicated either. In practice, *if necessary,* the corporate plan can be on one page, and each business unit plan can be on one page. A sample format for both of these one-page plans is presented in the chapter on implementation (Chapter 5).

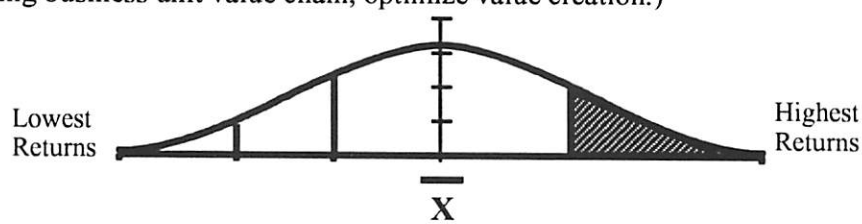
The important message, however, is that corporate management needs to appreciate their vital, ongoing responsibility for business mix selection and for allocating resources among the corporate businesses.

B. Business Mix Selection (continued)

Goal #1: Choose those industries which offer above average returns.
(Analyze industry structure to estimate future industry profitability.)



Goal #2: Out perform competitors by creating and sustaining a competitive advantage.
(From industry segmentation matrix, target buyer types & product varieties. Using business unit value chain, optimize value creation.)



Bonus: Improve industry structure for the benefit of all industry competitors.

Viewed in another way, imagine a graph that plotted the expected long-term profitability of thousands of industries. The primary corporate goal is to enter and grow businesses in those industries that will yield the highest returns (represented by the shaded area).

Unfortunately, it is emotionally difficult for some corporate executives to exit an industry. It is also difficult for some executives to (politically) risk entering a new industry. The result is often continuing yesterday's business mix in today's environment.

Next, for each industry selected, imagine a graph that plotted the expected long-term profitability of a hundred different business unit strategies. The goal is to select the strategy that will yield the highest return (represented inside the shaded area).

An environment needs to be created where business managers can openly discuss alternative strategies. A strategy may prescribe serving a particular type of customer, or providing a particular product variety. Discontinuing a product line also represents an alternative strategy that should be evaluated. Business managers should not be confined to minor adjustments in strategy assuming that the status quo is the safest alternative.

B. Business Mix Selection (continued)

Adapted from McKinsey & Co.

As previously discussed, the decision to enter a new business should be based upon industry attractiveness and the firm's ability to attain a sustainable competitive advantage. The chart above graphically represents a corporation with twelve SBUs. The arrows indicate the change in budget. The absence of an arrow indicates a flat budget. The three thick circles represent the corporation's largest businesses in terms of revenue.

The chart above is presented in Russian to highlight that this activity of reviewing the company's mix of businesses is occurring everywhere. Since the end of the cold war, even Russian companies are restructuring. Historically, Russian companies in small towns have been engaged in many diverse businesses because the town and the company were run by one party of individuals. For example, one of the largest gold companies in the world, Yakutia, is also in silver, diamonds, tin, timber, home construction, road building, agriculture, animal farms and most everything else the town needs.

One shortcoming of the chart above is that it doesn't show linkages between SBUs. An SBU should rarely be viewed as a stand-alone entity; and an SBU competitive strategy should include how it is linked with other corporate SBUs. An SBU with a poor competitive position in an unattractive industry should likely be discarded *unless it can show how it supports other corporate businesses.*

B. Business Mix Selection (continued)

MULTIPOINT COMPETITOR ANALYSIS

	Bus. 1	Bus. 2	Bus. 3	Bus. 4	Bus. 5	Bus. 6	...	Bus. N
Your Company	X	X	X			X		
Competitor 1			X			X		X
Competitor 2			X	X	X			
Competitor 3				X		X		X
Competitor 4	X	X		X		X		X
⋮								
Competitor N			X		X		X	

It is also important that diversified corporations compare their list of businesses in which they compete with other traditional and non-traditional competitors.

AIG is an example of a broad-based financial services company which is in many businesses, not all of which fit neatly within the umbrella of insurance. Hartford Steam Boiler is an example of a company with a far more limited portfolio of insurance-related businesses. Both companies have been successful.

There is clearly no magic number of businesses which will ensure success. **But a key goal for every corporation which competes in more than one business is to maximize the value of the interrelationships among the corporate businesses.** More than just a slogan: working together makes good business sense.

The diagram above is useful for planning diversification strategies, for anticipating competitor moves, and for maximizing your company's interrelationships vis-à-vis each competitor.

C. HORIZONTAL STRATEGIES

- Adapted from Michael Porter

THE COSTS AND BENEFITS OF SHARING

COSTS	BENEFITS
Cost of Coordination (Scheduling; setting priorities)	**Lower costs via Economies of Scale**
Cost of Compromise (Consistency may not be optimal for either business unit)	**Lower costs via Capacity Utilization**
Cost of Inflexibility (Higher exit barriers; Slower responsiveness to competitors)	**Lower costs via Cumulative Learning**
	Increased Uniqueness

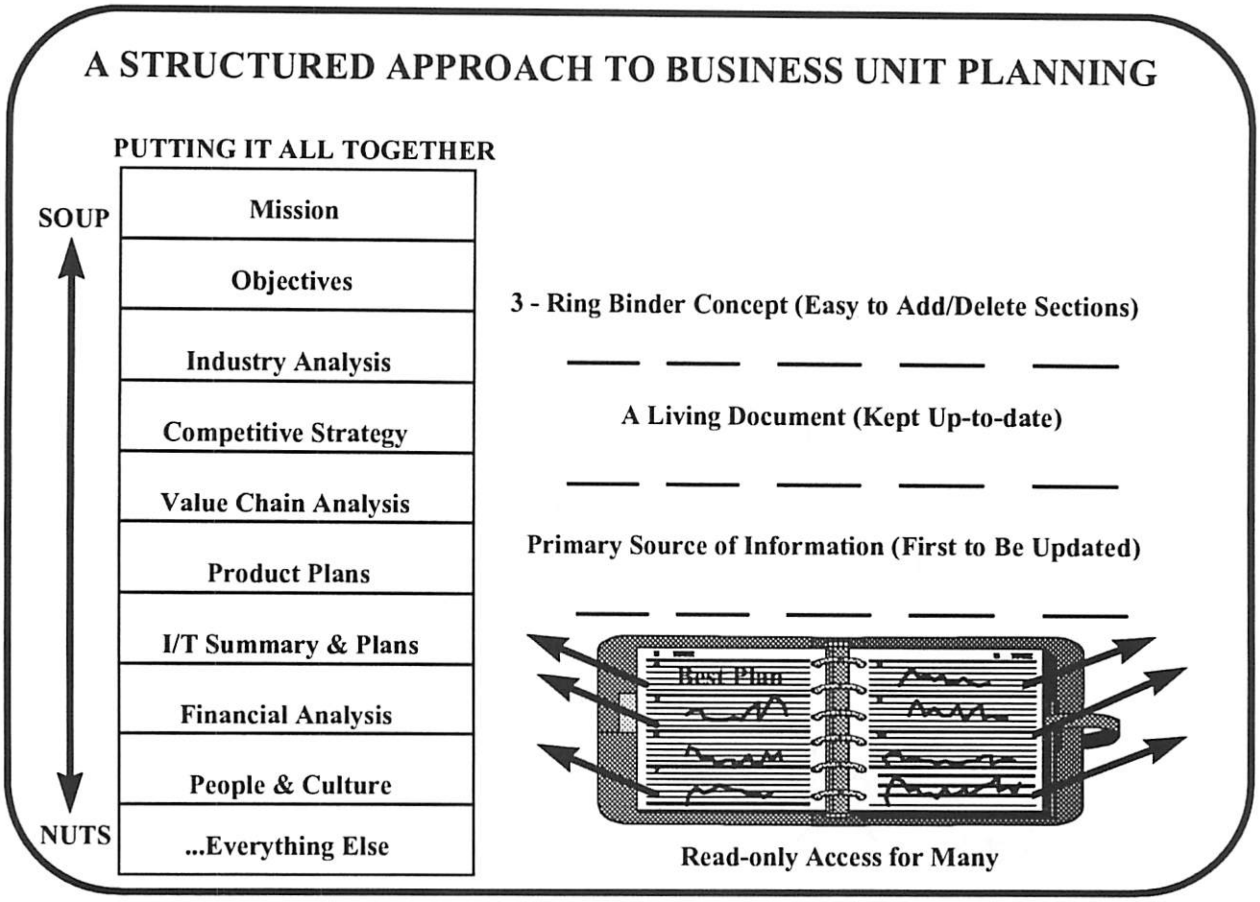
COSTS Vs. **BENEFITS**

A lot of time can be wasted in corporations switching back and forth from a centralized organization to a decentralized structure. Industry changes or a shift in strategy could well justify some of these organizational flip-flops. But unfortunately the changes are often made to give the appearance that management is doing something to correct past mistakes, even if the political reshuffling has nothing to do with the past failures of the company or its future needs.

Organizational discussions need to evolve into a more objective and *structured* approach that weighs the relative costs and benefits of centralization versus decentralization *for each strategically relevant activity.* For example, in many large companies one of the biggest issues is whether or not to centralize the information systems department. The answer may well be that mainframe support and telecommunications activities should be totally centralized; that traditional applications development be totally decentralized within each business unit; and that image processing, expert systems development, and local area network support functions be partially decentralized. Different companies with different strategies can have different results. But the discussion needs to be more systematic and structured than simply asking, "Do we anoint a chief information officer, or shall we blow it up and outsource the whole thing?"

2.

A STRUCTURED APPROACH TO SBU PLANNING



The diagram above describes the overall planning process for a single business unit. This page is the second most important page in this book. (The most important page is the page that describes the overall planning process for the whole company.)

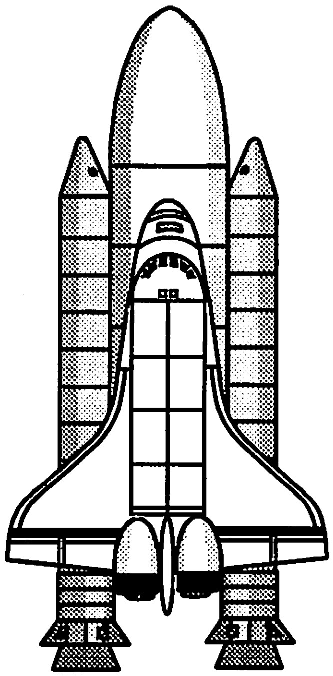
The key action steps shown for the business planning process are described on the following pages. Besides the planning activities themselves, there are some basic ideas about the planning process and the planning document that are also important.

The planning process should be considered an ongoing process, not an annual event. Regardless of whether your plan is three pages long or three-inches thick, the document should be written in sections and kept in a three-ring binder to make it easy to insert new sections and to keep the document up-to-date.

In practice, the planning document should represent *the most up-to-date thinking on the strategy of the business.* Avoid the common mistake of writing a lengthy plan which resembles a novel that is read once, and outdated the day after publication because it is too cumbersome to update.

The best way for executive management to ensure that every business unit keeps their plan current is to respond to requests for resources with the statement, "Show me how the additional resources will help implement your competitive strategy."

BUSINESS MISSION



Choose a destination.

Look before you leap.

Vision precedes reality.

Otherwise...

If you don't change your direction, you are likely to end up where you are going.
- Chinese Proverb.

The business mission is a clear statement indicating the direction of where the business is trying to go; a statement clarifying the purpose of the business.

The format of a mission statement might resemble the following: "To provide.... customers with..... products that are.... in order to.... "

For example: "To provide large U.S. financial services companies with the best training in strategic planning methodologies in order to improve their corporate planning process and to enhance their long-term profitability."

Second example: "To provide all types of companies around the world with a structured planning framework that is so well designed that business managers in great numbers will actually use it, rather that just read about it and plan as usual."

Third example: "InterAmericas Corp. which is based in Greenwich, Connecticut provides mid-tier U.S. and Latin American companies with investment banking services including raising capital and facilitating cross-border mergers and acquisitions in order to meet the long-term strategic goals of both parties in the transaction."

SAMPLE BUSINESS OBJECTIVES

- **Increase Market Share**
- **Build a Better Product than the Competition**
- **Maximize Customer Satisfaction**
- **Help Other Corporate Businesses**
- **Reduce Number of Employees and Cut Expenses**
- **Maximize Revenue**
- **Maximize Annual Profit**
- **Maximize Total Return on Investment (or ROE; or ROA)**
- **Maximize Stock Price**
- **Maximize Shareholder Value & Discounted Cash Flow**
- **Expand into New Markets; Minimize Risk; Raise Capital; Provide for the Employees; Help Community; etc.**

Different objectives imply different courses of action. In order to guide future decisions, it is necessary to clarify, in priority order, the objectives of the business. Long winded business goals like "To be the best in every activity and to produce the best products at lowest cost and to maximize this year's profitability and shareholder value - all at the same time" sound great, but mean little.

The challenge for most businesses is *establishing priorities.* The more specific the objectives, especially when presented with measurable goals, the better.

For example, imagine it's December 1 and an opportunity presents itself whereby a manager could overspend the budget by $1 million to earn a guaranteed $3 million in the next fiscal year. If annual profitability and annual bonuses rank as higher objectives than maximizing shareholder value, *from the business manager's point of view,* the opportunity will not be pursued.

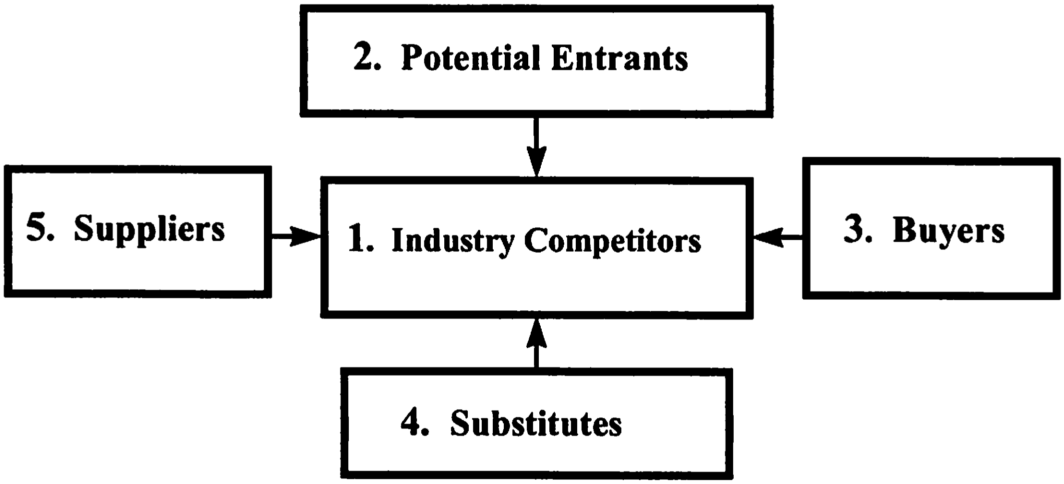
In practice, market share goals are the most likely goals to conflict with annual profitability and other goals. Even after the debacles in the banking and real estate industries in the eighties, many managers still measure success primarily in terms of market share.

The bottom line is that objectives need to be specific, well thought out, in priority order, agreed to, and communicated.

INDUSTRY STRUCTURE ANALYSIS

Michael Porter's Competitive Forces Model:

"The collective strength of these five competitive forces determines the ability of firms in an industry to earn, on average, rates of return on investment in excess of the cost of capital."



✓ Every industry is unique and has its own industry structure.
✓ Industry structure changes - sometimes slowly, sometimes quickly.
✓ Each firm in the industry should try to improve industry structure.

A business needs to understand the industry in which it competes. The question is how? The best answer is to use Michael Porter's industry model which is shown above. This analysis is a useful way of analyzing *any* industry. The analysis views the industry along the following five dimensions:

1. *Industry competitors.* Existing competitors should be analyzed in terms of competitive advantages and disadvantages, as well as likely shifts in strategy.

2. *Potential entrants.* New entrants into the industry will increase competition and potentially bring new strategies that alter the basis of competitive advantage.

3. *Buyers.* Buyers are not all alike and should be analyzed based on their needs.

4. *Substitutes.* Substitutes represent products and services that could be used instead of the industry's products. For example, contact lenses and eye surgery are substitutes for eyeglasses. Ignore substitutes at great peril.

5. *Industry suppliers.* Suppliers affect costs and the ability to differentiate.

The relative strength of each of these five forces is different for each industry, and changes over time. This topic will be discussed in greater detail later in this book.

INDUSTRY ANALYSIS (continued)

INDUSTRY SEGMENTATION MATRIX

Product Variety \ Buyer Type	Buyer Type 1	Buyer Type 2	Buyer Type 3	Buyer Type 4
Product Variety 1	1	5	9	13
Product Variety 2	2	6	10	14
Product Variety 3	3	7	11	15
Product Variety 4	4	8	12	16

KEY COMPETITORS:

Competitor 1	Competitor 4	Competitor 7
Competitor 2	Competitor 5	Competitor 8
Competitor 3	Competitor 6	Competitor 9

For a given industry, not all buyers are alike. Whether a firm's customers are individuals, corporations, or government entities, a firm cannot equally satisfy the different needs and purchase criteria of all types of buyers. For example, corporate customers may differ by geographical location, industry, company size, and a host of other variables, any of which may be relevant for understanding how to best group customers based upon common needs.

A firm needs to clearly articulate which set of customers it will serve, and which customers it *will not* serve. It is also important to understand how the needs of customers will likely change, and how to take advantage of those changing needs.

The basic theme, however, is that strategy is *deciding* which segments to focus on, and which segments to leave for other competitors.

Each of the sixteen industry segments represented in the chart above has its own segment attractiveness. Each segment can be discussed in terms of: current and future competitors; current and future customers; current and future revenue and profitability; etc. In practice, developing an industry matrix is an excellent team building task that greatly facilitates a common understanding of the industry structure and industry dynamics. (It's the next step, choosing which industry segments to target, that sometimes leads to not-so-subtle differences of opinion.)

INDUSTRY ANALYSIS (continued)

INDUSTRY SEGMENTATION & TARGET MARKETING

Product Variety \ Buyer Type	Buyer Type 1	Buyer Type 2	Buyer Type 3	Buyer Type N
Product Variety 1	X	X		?
Product Variety 2	4	6	1	?
Product Variety 3	5	7	2	?
Product Variety 4		8	3	?
Product Variety N	?	?	?	?

n = Target Market (The lower the number, the higher the priority.)

X = Not a targeted segment. = Not a feasible segment.

It is important that each business within a corporation develop its own industry matrix, including its own view of how to segment buyers. For example, the top fifty U.S. banks, each of which competes in 50 to 250 businesses, should not expect each business to segment its customers the same way. Different criteria are relevant for each business unit depending upon the particular products or services provided and how customers purchase and use them.

For example, the retail credit card business may segment its customers based upon income, or language spoken, or age, or credit history, or travel habits, or even on favorite sports team or charitable cause. The wholesale funds transfer business, however, should segment its customers quite differently. It may segment its customers based on if the customer is another bank or a corporation; the volume of transactions per day; the method of sending transfer instructions, whether by phone, fax, or PC; or any other relevant criteria.

After analyzing the total industry (playing field) a firm should pick which industry segments to target, and in what order.

In practice, it is useful to think of 100 poker chips representing 100% of the total budget (or 100% of the total number of employees). Objectively place the 100 poker chips in the industry segments to reflect *current* resource allocations. Next, strategically (subjectively) place your bets through *future* allocations.

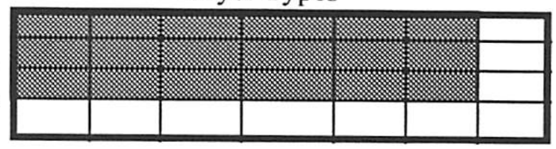
COMPETITIVE STRATEGY

Choose one of four alternatives:
(Adapted from Michael E. Porter)

1. Cost Leadership
(The low cost provider in many or all segments)

Buyer Types

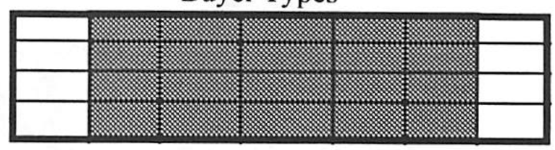
Product Varieties



2. Differentiation
(Unique in many or all segments)

Buyer Types

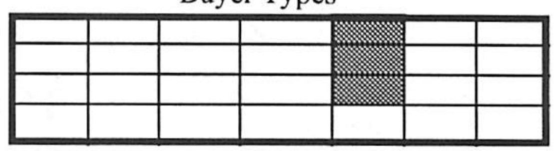
Product Varieties



3. Cost Focus
(The low cost provider in one or a few segments)

Buyer Types

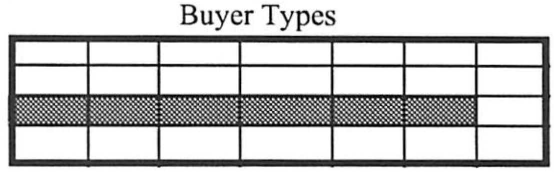
Product Varieties



4. Differentiation Focus
(Unique in one or a few segments)

Buyer Types

Product Varieties



The heart of any SBU plan must be a specific understanding of competitive advantage. As mentioned earlier, a business should choose which segments it plans to target, and which segments will be left for competitors.

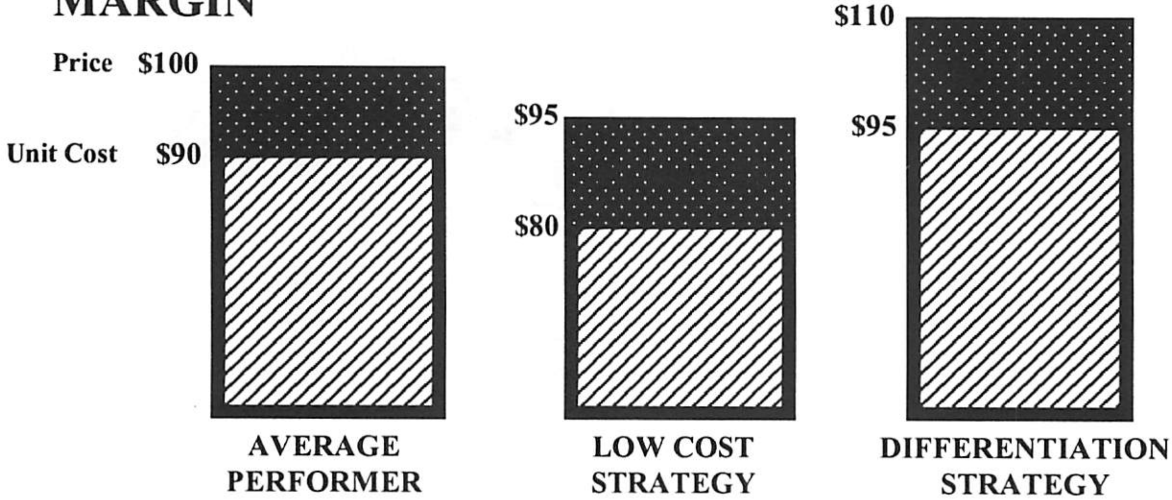
A firm can target many segments, or focus on just a few; and it can seek a cost advantage, or be unique in some way that customers will pay higher than average prices or purchase higher than average quantities. The slide above, adapted from Michael Porter, portrays four fundamentally different generic strategies facing a business seeking a competitive advantage in any industry. Not making a choice often results in poor results because the firm is left in a weaker position in every segment relative to a focused or broad based competitor.

With the understanding that choosing one of the four strategies above is what strategic positioning is all about, it follows that 'build,' 'hold' and 'harvest' as well as revenue goals and pursuit of market share leadership are not really strategies. "They are the result of a strategy (or inability to achieve any generic strategy and hence the need to harvest)." - M. Porter

It is important that industry competitors develop different strategies. If all firms follow the same strategy, all competitors will suffer. Price warfare will result and erode industry profitability for all.

COMPETITIVE STRATEGY (continued)

STRATEGY SELECTION AND PROFIT MARGIN



- Adapted from Michael E. Porter

There is an obvious difference between a Toyota and a Rolls-Royce. Put simply, a Rolls-Royce costs more to make because of the higher priced materials used and the greater time-consuming craftsmanship required to build the product.

The choice to spend more is a strategic decision based on the belief that customers will pay a price premium greater than the additional cost. In financial services, information services and many service industries, this basic strategic choice is often overlooked, even though the concept is just as important. Every business should have a clear understanding of how it is trying to position itself.

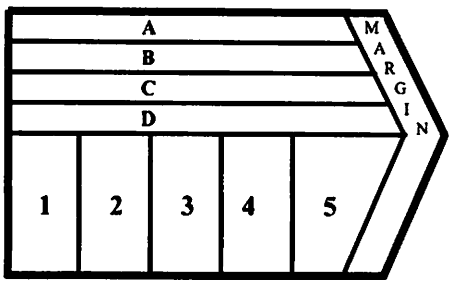
For service businesses and businesses which produce a non-physical product like software, it is sometimes helpful to ask, "If we were producing a car, what kind would it be?" In practice, this one question can lead to a very constructive dialog among the people within the organization because it focuses attention specifically on positioning.

The message is that firms can strategically choose to spend more or less for materials, labor, equipment, or anything else. But no matter what strategy a firm chooses, it should never waste a dime. A common misperception is that only firms with a cost leadership or cost focus strategy carefully monitor spending.

It is also true that any activity, not just in production, can result in a cost advantage.

PORTER'S VALUE CHAIN ANALYSIS

(or, "What activities do people do around here?")



* SUPPORT ACTIVITIES
A. **Firm Infrastructure** (gen'l management; accounting; etc.)
B. **Human Resource Management** (personnel activities)
C. **Technology Development** (R&D and more)
D. **Procurement** (the function of purchasing inputs)
---
* PRIMARY ACTIVITIES
1. **Inbound Logistics** (receiving inputs; inventory control)
2. **Operations** (building the product; providing the service)
3. **Outbound Logistics** (distributing the product to buyers)
4. **Marketing & Sales** (pre-sales activities)
5. **Customer Service** (post-sale support)

If you had $1 added to your budget/capital structure, in which activity would you spend it? Why?

How much does your business spend on Activity X compared to Competitor XYZ?

Does your spending support your competitive strategy and route to competitive advantage?

The diagram above is called a "value chain" by Michael Porter. The principal idea is to identify the strategically relevant activities performed by the business. Each activity should be analyzed for its role in creating value for the business. The activities can also be grouped into meaningful categories and compared on a relative and an absolute basis with competitors.

In practice, it is best to start with a simple list of the activities of the business. Then, after the list is compiled, group the activities into major categories. For example, grouping all activities directly related to building the product or providing the service into one group of activities called "Operations." All marketing and pre-sales activities like advertising, market research, sales administration, and selling should be grouped into a category called "Marketing & Sales." The diagram above lists the major categories which are general enough to include every activity performed by any business (although not all firms perform every activity).

The value chain shown above is drawn to illustrate the general flow of the activities necessary to produce the product, market the product and provide customer service (the primary activities listed from 1 to 5). The value chain also separates out the support activities (shown in the diagram as A, B, C and D).

In many situations requiring strategic decisions, the value chain is a far more useful tool than are standard financial statements.

PRODUCT PLANS & MAJOR ACTION PLANS

PRODUCT PLANS

Product One: ---

Product Two: ---

Product Three: ---

OTHER MAJOR ACTION PLANS TO SUPPORT THE BUSINESS

Action Plan 1: ---

General Goal & Benefits Expected: -------------------------
Person Responsible: M-. ---------------
Time Frame: xx / xx / xx

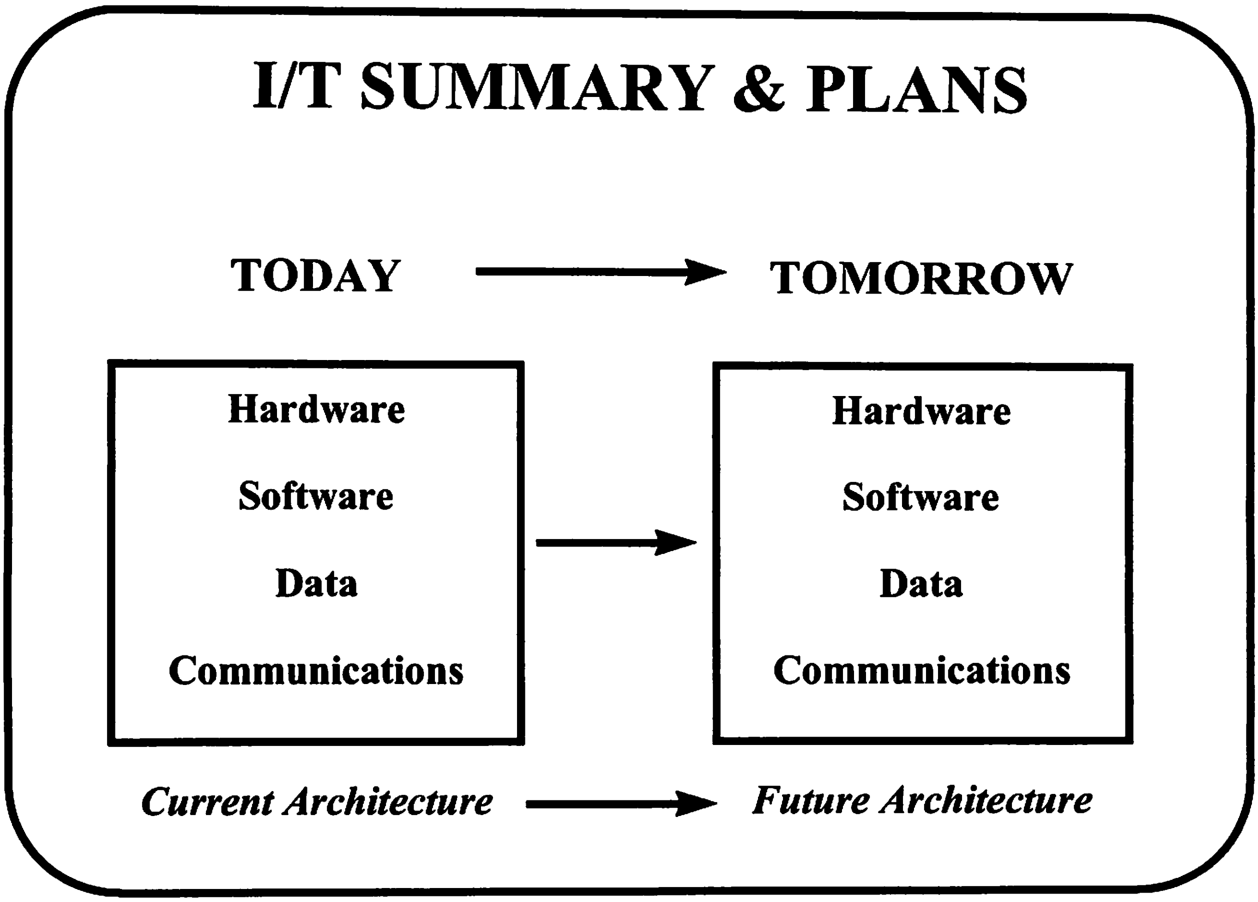
Action Plan 2: ---

General Goal & Benefits Expected: -------------------------
Person Responsible: M-. ---------------
Time Frame: xx / xx / xx

Developing product plans and major action plans are routine in most organizations. Standard procedures and practices should include the following:

1. Ensure that all product plans and action plans are performed in priority order in concert with the competitive strategy of the business;
2. Assign a time table and a person responsible for completing each task;
3. Set high standards and measure results;
4. Ensure that compensation and/or other rewards are tied to results.

The resources of the business should be allocated in concert with forecasted product profitability and, more specifically, with the business strategy.



Information technology (I/T) is a broad term encompassing computer hardware, software, data and communication facilities. Its proper use within the corporation is vital, and its importance in the development of the product or the delivery of the service varies by industry. The general trend for most industries is that information technology is growing in importance every year.

In most companies, the proliferation of information technology is rarely limited to just the activities of the information systems department. Personal computers and local area networks are spreading rapidly throughout most organizations. In general, the information systems department of today no longer controls all I/T spending as it did in the 1970's and early 1980's.

I/T expenditures have become such a large percentage of costs and have such a significant impact on competitive advantage that most business strategic planners need to comprehend the role of I/T in their business and industry or they are missing the boat.

It can also be said that most I/T managers need to understand the business in order to effectively allocate scarce resources in line with the needs of the business. There are many exceptions to these general rules. But today is very different from the 1980s when it was rare for managers to understand business *and* information technology.

SHAREHOLDER VALUE ANALYSIS

Estimate Value of an Investment

↓

Estimate Future Cash Flows

↓

Estimate Future Dividends and Price Appreciation

EXAMPLES

Estimate value of a Company
Estimate value of an Acquisition
Estimate value of a Merger
Estimate value of a Capital Expenditure
Estimate value of a *Business Strategy*

USES IN PLANNING

Corporate Planning Process
Business Unit Planning Process
Product Planning Process

- Adapted from Alfred Rappaport

Most corporations report that their number one goal is to maximize shareholder value. Unfortunately, there is often a big disconnect between this lofty goal and the reality of how corporate business units are managed.

The shareholder value approach is different from the return on equity (ROE) approach or the return on income (ROI) approach. It is also different from the goal to be the market share leader at any cost. Although it often helps to be the market share leader, especially when strong economies of scale are present, the ultimate goal of the shareholder value approach is not market share, but rather, to maximize discounted cash flow.

For a typical business unit, maximizing cash flow can be estimated by adding 1) the discounted value of projected cash flows (inflows and outflows) for the next ten years, and 2) the discounted value of the projected sale price of the business at the end of the tenth year. For a typical corporation, the shareholder value of each SBU should be added together and then added to the discounted value of the projected cash flows from corporate investments.

It is important to recognize that a change in strategy implies a change in projected cash flows and, therefore, a change in shareholder value. For an excellent discussion on the shareholder value approach, read Alfred Rappaport's, *Creating Shareholder Value,* 1986, The Free Press.

Strategic Balance Sheet

as of 12/31/97

EVALUATION CRITERIA	1997	1996	1995
Product / Service Quality	HIGH	MEDIUM	POOR
Market Image and Market Reputation	HIGH	MEDIUM	POOR
Number of Customers	4,000	2,500	2,400
Innovation & New Product Development	MEDIUM	MEDIUM	POOR
Information Technology Architecture	MEDIUM	POOR	POOR
Employee Morale	HIGH	MEDIUM	POOR
Cost Structure	LOW	MEDIUM	HIGH

etc....

Financial statements are very important to measure the financial performance and condition of a business, but they do not represent a complete picture of the health of a business.

Two companies with identical financial statements are not necessarily equal. One company could be on the verge of a major upturn, the other could be out of business in a year.

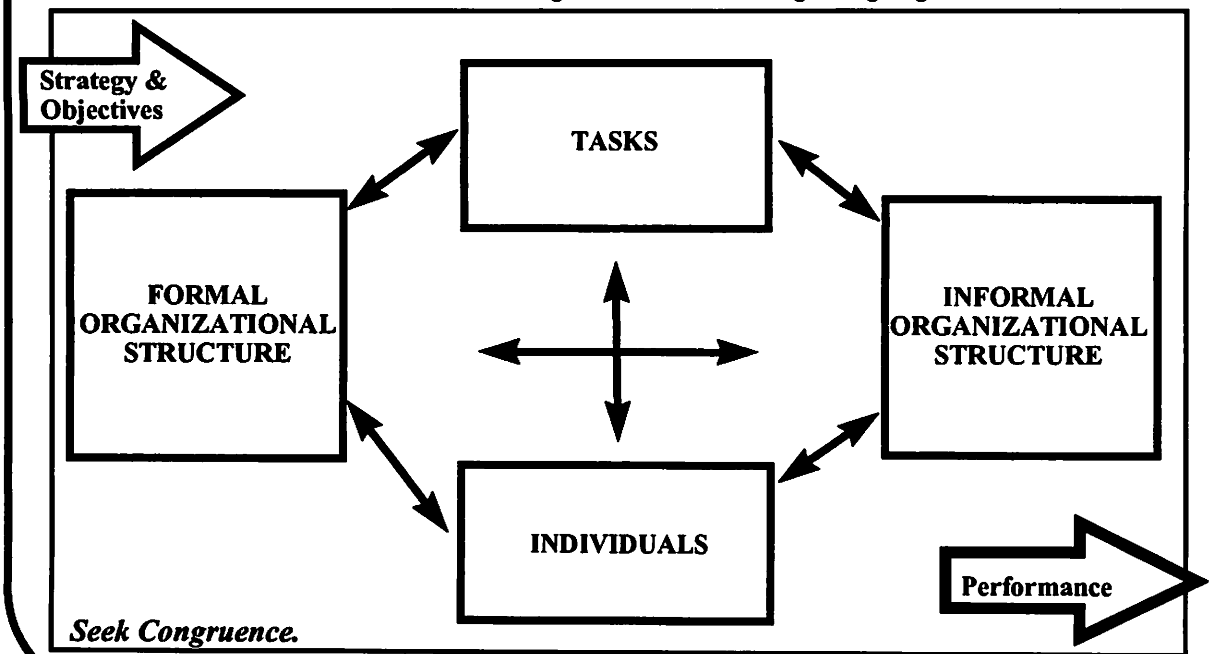
A *strategic balance sheet* is used to measure important strategic information about a business at a moment in time. Any financial or non-financial indicator that is strategically relevant and not represented in the financial statements should be included.

Some standard line items which should be on most strategic balance sheets are listed above. (A more complete list is presented in the SBU template document which is discussed in Chapter 2.)

Almost every industry will also have some of its own industry specific, strategically relevant criteria to measure the strategic health of competitors. For example, in the office superstore industry, strategic balance sheet line items might include the number of stores and the average size of each store.

PEOPLE & CULTURE

Adapted from Michael Tushman's
"A Congruence Model for Diagnosing Organizational Behavior"



When all is said and done, it still takes people to get things done. Even with a perfect understanding of the industry and a brilliant competitive strategy for success - people must act. In fact, part of a "brilliant" strategy must take into account the current employees, the current reward system, the current organizational structure, and the current corporate culture.

Whether the full plan requires changing the reward system, changing the organizational structure, changing the culture, and/or changing the employees, the strategic plan needs to include the action steps necessary to make these changes. The consequences of making these changes need to be anticipated and planned for as well.

The overriding goal, according to Michael Tushman, is to seek congruence between strategy, people, and formal and informal organizational structure.

For example, if a company wants new creative ideas, then people should not be ostracized for less than perfect suggestions. If a company wants to promote teamwork, it should have team awards. If a company wants to differentiate based on superior customer service representatives, then the people in customer service should be better trained than the competition.

3.

A STRUCTURED APPROACH TO HORIZONTAL UNIT PLANNING

A STRUCTURED APPROACH TO HORIZONTAL UNIT PLANNING

1. Identify strategically relevant activities performed.
2. Identify which businesses require each activity.
3. Resolve conflicts between businesses with different objectives in the performance of a given activity.
4. Perform activities in the best manner possible consistent with the objectives of the businesses.
5. Analyze competitors.
6. Analyze suppliers.
7. Re-evaluate how activities are performed, including how activities are linked with other activities.

For a stand-alone business there are no centralized cost centers or horizontal units. By definition, it takes two or more corporate businesses to share a centralized department.

The strategic imperative of a horizontal unit is to understand the strategies and objectives of the business units it serves, and to perform the unit's specialized activities in the best manner possible within the framework of those business strategies and objectives.

In some cases, businesses have different objectives relating to the performance of an activity. For example, one business might want an activity performed with the highest level of quality, and another business just wants to be charged the lowest amount and doesn't care too much about the level of quality. At this point, the issue should be resolved by bringing the parties together in the same room and working out a common solution, or, the group executive should make a decision for the good of the company. If the conflict in objectives is not resolved, all parties will likely feel that they are working in a hostile environment where they are not free to maximize their own potential. Internal politics will consume scarce resources.

HORIZONTAL UNIT PLANNING

FUNCTIONAL UNIT	Bus. 1	Bus. 2	Bus. 3	Bus. 4	Bus. 5	Bus. 6	...	Bus. N
Activity 1				X		X		X
Activity 2			X	X	X			
Activity 3				X		X		X
Activity 4	X	X						
Activity 5	X	X		X	X	X		X
⋮								X
Activity N				X		X		

GOAL:
Identify relevant SBUs and use their strategies to guide the plans of the SHU.

Functional managers for each strategic horizontal unit (SHU) need to develop a *Statement of Direction.* I use the term "Statement of Direction" to clearly signal that it is very different from an SBU *Competitive Strategy.*

When developing a Statement of Direction, the horizontal unit should identify the business units to be served and use their strategies to guide the plans of the SHU.

This analysis should recognize that not all corporate businesses require every activity performed by the horizontal unit.

In practice, there are two key points that should be kept in mind. First, some managers believe (incorrectly) that it is less noble to run a horizontal unit than to run a business unit, no matter what the compensation or title.

Second, it is possible that a horizontal unit can become a business unit. The decision should be based upon the company's vision, objectives, and the realistic competitive position that the new business would have. The decision rests with corporate management and is part of their primary role of determining which industries to enter and which industries to exit. Many horizontal units, in the course of serving the corporate businesses, develop a product or service that can be successfully marketed. However, just because a horizontal unit can market its services doesn't mean that it's in the best interest of the corporation overall.

INFORMATION TECHNOLOGY PLANNING

	Bus. 1	Bus. 2	Bus. 3	Bus. 4	Bus. 5	...	Bus. N
Data Center Support	X	X	X		X		X
PC Development	X		X	X	X		
Image Processing			X				X
LAN Support	X			X			
Internet Development	X		X	X			X
Telecommunications	X	X	X	X	X		X
⋮					X		
Activity N		X		X			

The information systems (I/S) department is often, but certainly not always, a cost center. The key to I/S planning is to first identify each of the strategically relevant activities it performs. With the proliferation of new types of information technologies, along with the maintenance of old technologies, the number of activities that require a different type of professional skill is growing significantly. COBOL programming on a mainframe is very different than 'C' programming on a PC, and both are different from image processing, global telecommunications, client-server computing, and multimedia development.

The slide at the top of this page is a simplified representation of several I/S activities. Instead of just placing an 'X' in the various cells, it is often useful to identify the number of people or the amount of money allocated for each corporate business.

The I/S department should also have a general understanding of the business objectives of each SBU. In those cases where each business unit has the same expectations and objectives for the way in which an SHU activity should be performed, the horizontal unit manager has clear direction. The challenge arises when the business managers have different goals, strategies and expectations for the performance of a particular activity.

A STRUCTURED APPROACH TO HOLISTIC BUSINESS PLANNING

Chapter 1 Summary

Chapter highlights:

✓ For each strategically relevant business unit, develop a *Business Unit Competitive Strategy;*

✓ For each strategically relevant horizontal unit, develop a *Horizontal Unit Statement of Direction;*

✓ Develop one *Corporate Strategy.*

(Optionally develop a *Group Strategy* for any organizational group that requires it.)

The next three chapters describe template documents that facilitate the above.

The chapter following the template documents focuses on implementation in the corporate environment.