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3rd Edition

Business Plans

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Paul Tiffany, PhD

Award-winning professor, consultant, and speaker

Steven D. Peterson, PhD

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Contents at a Glance

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Introduction

So, you were searching the web for something about business start-ups, or maybe you were assigned to honcho a hot new project at the office, and up pops a promo for this book. You clicked "buy now." Sweet, we like you already! Great minds must think alike because while you may not know how to construct a business plan yet, you're savvy enough to have surmised that a plan is important — which is exactly what we know. From years of working with numerous organizations both large and small, old and new, profit or nonprofit, local or global in scope, we concluded that a business plan is more than just another factor for goal achievement — indeed, it's usually the single most important task prior to actually jumping in there and getting started!

Some people visualize a business plan as something they have to put together to raise money for a new venture or convince the higher-ups to sign off on for some upcoming project — at best, a formality with lots of splashy PowerPoints in which all graph curves streak upward; at worst, a waste of everyone's precious time and effort. But you don't create a business plan just to secure funding or check a bureaucratic box; *au contraire!* Rather, you should embrace and own your plan as a powerfully performative tool — one that makes your organization a better place at which to work and your business a more successful operation for everyone it touches.

Is a business plan a guarantee? Hardly. In today's "VUCA" world (*Volatility, Uncertainty, Complexity, Ambiguity*), it's increasingly hard to tell what even tomorrow will bring. But *prediction* is not the point of planning. Rather, planning is in fact a matter of *process.* A business plan works because it forces you to stop and think about what you're doing. It prompts you to figure out what you want your company to become in the future and how you intend to make that future happen. Your plan acts as a template, guiding you through the steps required to meet your goals. And by engaging in this planning process, you are going to not only learn much more about what you're trying to do but will also dramatically enhance your ability to both survive and thrive when the inevitable unknowns and pitfalls emerge. For example:

» A business plan requires you to look carefully at your market, your customers, and the competition to determine what your real opportunities are and what threats you face.

- A business plan takes a good hard look at your organization so that you can honestly and objectively recognize your capabilities and resources, your strengths and weaknesses, and your true advantages as well as the problem areas that need repair.
- A business plan coaxes a financial analysis, a forecast, and a budget out of you so that you know where you stand today and what the future will require in terms of cash and other financial resources.
- A business plan prepares you for potential uncertainties by encouraging you to come up with alternative business strategies to increase your chances of success down the road if and when those unknowns pop up.

About This Book

This book helps you create your business plan step by step. Along the way, you'll discover things about your business that you never realized — information that just may help you beat the competition. Heck, we even throw in a few laughs as well — no joke.

Business Plans For Dummies, 3rd Edition, can help your business succeed no matter who you are or what your job description says, whether you're part of a large corporation or a one-person show. Depending on your situation, you may find yourself dipping into and out of the book in different ways:

- If business plans are new to you, you may want to start at the beginning and let us be the guide by your side. We take you from your company mission all the way through to making your business plan work, and we keep your head above water the whole way.
- If you have more experience, we'll be your sage on the stage; you may want to head for one of the more interesting chat rooms (or chapters as they're called), such as how to recognize the critical success factors in your business, or where to look for your company's strengths and weaknesses. After dropping in somewhere, you may discover yet another section where you want to spend time and do a deeper dive.

Just remember — no matter where you are, it's never too late to start a business plan, and it's never too late to make the one you have even better. In each case, you can find what you're looking for between these bright yellow covers.

Note that you don't have to read all the sidebars scattered throughout the book. Just because we find these little facts and fables fascinating doesn't mean you will. You can pass over the text accompanied by the Technical Stuff icon, too. The text marked with this icon gives some fascinating but nonessential information about business plans. And you won't hurt our feelings if you don't read this book from cover to cover (well, maybe a little; we just love those little sidebars!). Whatever, feel free to skip around; pick and choose what you're really interested in, and then go for it.

One last thing: Within this book, you may note that some web addresses break across two lines of text. If you're reading this book in print and want to visit one of these web pages, simply key in the web address exactly as it's noted in the text, pretending as though the line break doesn't exist. If you're reading this as an e-book, you've got it easy — just click the web address to be taken directly to the web page.

Foolish Assumptions

Believe it or not, we don't need to consult a fortune teller to know a bit about your background. In fact, we can assume that you're probably in one of the following situations:

- You have a great idea for some radically disruptive new online service and can't wait to get your own company up and running and start crypto-ing the cash.
- Your boss just turned over a new leaf and wants a business plan from you in three weeks.
- You've always run your business without a business plan, and you're the one who turned over the new leaf.
- You thought you had a business plan for the company, but it isn't doing the job that it should.
- You're taking a course in management somewhere and have come to realize that your textbook is great on theory but lacking in practicality.

Are we close? Whatever your situation, you don't need that crystal ball to make a business plan; just read this book. We can't tell you the future of your business. But the business plan that we help you put together prepares you for the future. And we're here with you every step of the way.

Icons Used in This Book

To guide you through your business plan preparation, we include icons in the left margins of the book. Here's what they mean:

TIP

This icon flags situations that apply mostly to large companies, but that may help small companies with their business plans as well.

WARNING

Ouch; you may get burned unless you heed these warnings.

REMEMBER

Don't forget these timely tips about business plans.

TECHNICAL STUFF

This icon flags information that delves a little deeper than usual. These bits of text are interesting but nonessential to your understanding of business plans.

Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product comes with some access-anywhere goodies on the web. Check out the free Cheat Sheet for info on the elements of a business plan, a checklist of planning essentials, and much more. To get this Cheat Sheet, simply go to `www.dummies.com` and search for "*Business Plans For Dummies* Cheat Sheet" in the Search box.

Where to Go From Here

Take a minute or two to thumb through the book and get comfortable with what's inside. Pick out a couple of chapters whose topics you've pondered in the past but never had the time to dive deeper. Better yet, turn to a chapter that covers a subject you think you already know about. Or if you're really daring, just turn the page and start at the beginning.

Don't forget to use the table of contents for a chapter-by-chapter breakdown. The index is also an excellent place to turn to find a specific topic right away. Meanwhile, good luck and may your business dreams come true!

1 Getting Started with Business Plans

IN THIS PART . . .

We start by looking at what a business plan is all about. We convince you of the importance of a plan, just in case you're still undecided.

After you're sold on the idea, we identify some really useful planning resources. And to help you get your own plans underway, we outline a planning process for you and review the major pieces of a business plan.

We point out why values and ethics are so important to your company and show you how you can make practical use of them in your planning. We look at how a vision for your company gives you something to aim for and a direction to take.

Finally, we look at how to establish a mission for your company and develop effective business goals and objectives to fulfill that mission.

IN THIS CHAPTER

- Getting your planning resources together
- Figuring out who needs to work on the plan
- Laying down some planning ground rules
- Checking out what the written plan looks like

Chapter 1

Preparing to Do a Business Plan

Planning is serious business. For many companies, a solid business plan is the difference between success and failure. Many people going into business for the first time want to rush right in, create a website or hang up a sign, and start making money — a natural response for anyone excited about a new business idea. But taking time up front to prepare can pay off in many ways down the line, especially when it comes to writing a business plan. And face it: After your company is up and running, you may not have all the time you need to devote to the major pieces of your plan. So, first lesson learned: A business plan is not an expense of either time or money; it's a necessary investment for a profitable future!

But all that being said, we also want to make something else abundantly clear to you: We live in volatile times! In fact, it's hard to find anything in the recent past of business and economic life that hasn't been as disruptive as the present — a revolution in communications technology, globalization, a potentially "new world order" emerging, financial market gyrations, artificial intelligence (AI) and robotics, breakthroughs in neural science, environmental disasters, and on and on. So how can you plan when who knows what might come next?

Fair question. But before you get started on this admittedly lengthy journey, we want to let you in on a little secret: Planning is *not* about prediction. Nope. What it's actually about is a rational *process of understanding* — your market, your customer, your competitors, your organization, and yourself. That is, serious planning forces you to consider exactly and precisely what's going on out there today. Where you go after that all depends; some things do have a higher probability of occurring than others. But by knowing the realities of the present, you are going to be far better prepared to quickly pivot when those pesky unknowns pop up — and trust us, they will. They always do; that's life.

So put aside any starry-eyed thoughts you might have about this book being your magical little crystal ball to gaze into the future. It isn't. But it is your realistic guide to comprehensively analyze a potential business venture and undertake a deeply detailed review of what needs to be done to get that venture off the ground. And if something totally unexpected jumps up to bite you? By rigorously internalizing what we cover in this book, you'll be far better prepared than anyone else to respond quickly and proactively to get back on the road to success. That, dear reader, is our solemn commitment to you. Now let's buckle up and get started!

Identifying Your Planning Resources

Having the right resources at the right time can make business planning easier and more successful. Fortunately, you can now find more useful and usable business-planning resources than ever before, from websites, books, seminars, and real, live experts. Of course, you may also find plenty of stuff that isn't worth looking at — much less paying for. And just as you can't always judge people by their resumes, you can't evaluate a site simply by its likes.

As you begin to put together your business plan, you may discover that you need some additional tools — an online tutorial in marketing, for example, or business-planning software that can help you create and refine your written document. Don't be afraid to use these — they can help!

REMEMBER

But let's also recognize the obvious: *You* are the single best resource for your business planning efforts — your creativity, persistence, and willingness to dig in and do the heavy lifting. No pain, no gain.

Checking out the variety of sources out there

Obviously, you've already selected one of the best hands-on business-planning sources around (all right, the best, in our humble opinion). But admittedly, you can also find other useful business-planning tools out there — particularly ones that concentrate on specific areas, such as how to do digital marketing, the ins and outs of start-up financing, or others that focus on particular kinds of businesses, such as not-for-profits or selling on eBay. Hey, we even have a slew of these alternative sources available within the *For Dummies* series — check 'em out!

While you can't always tell a book by its cover, you can find out a lot by reading through its table of contents. You should also try dipping into the first chapter. If you're browsing on the web, booksellers like Amazon.com often include a detailed table of contents, along with the first chapter, directly on their website. Readers' reviews and ratings that you can find online can also help steer you toward other particularly useful books. And don't forget to ask colleagues, business advisers, family and friends, or investors to list their favorite business-planning go-to sources. The results may surprise you.

REMEMBER

The basic principles of business planning may be timeless, but certain subjects — where and how to acquire funding, for example — change rapidly. An unrevised three-year-old site may already be ancient history. If you want to find timely information, such as details about tax considerations for a small business, be sure to check the source's original posting or publication date.

TIP

For the timeliest info, turn to relevant blogs, podcasts, social media, chat rooms, magazines, newspapers, and journals. For a broader and deeper sweep of trends and events, read the books. They offer a terrific way to keep up on what's happening in the world of business in general — and your industry in particular. The business press also provides an efficient way to routinely scan the business environment for trends or new developments that may affect your business plan. If you're not sure what online or print sources focus on your particular industry or your geographic region, do a quick search on the Internet (see the next section for more details).

Surfing the Internet

TIP

Today, countless numbers of websites offer information on business planning. Some are free; others tease you with a sample of what they have to offer and then charge you for more detailed data via "freemium" options. In our experience, some of the freebies can be just as helpful as the pay-now sites, so we suggest that you first check the no-cost offers before surrendering your credit card data. In

INTERNET HOTSPOTS FOR BUSINESS-PLANNING INFO

A treasure trove of business-planning information and resources is available online. To help you sort through all the riches, we've put together a list of popular sites that provide useful and reliable tips, tools, and examples — including dozens of real-life business plans:

- **www.sba.gov:** The Small Business Administration (SBA) site is far and away the best source of information about planning, funding, starting, and running a small business. You find useful FAQs, as well as counseling help and shareware software programs that you can download for a nominal fee.
- **www.irs.gov/smallbiz:** A great site if you run a small business or are self-employed. The IRS provides all kinds of useful industry and profession-specific information. The site also includes links to other helpful non-IRS business resources on the web.
- **www.nfib.com:** The National Federation of Independent Business (NFIB) calls itself the largest advocacy organization to represent small and independent businesses in the United States. Its website features a set of tools and tips that small business owners may find useful.
- **www.score.org:** The Service Corps of Retired Executives (SCORE) offers free consulting to start-up business owners. Along with a way to contact SCORE, their website includes updated success stories about a variety of small- and medium-sized businesses. Also useful is a list of business-related links.
- **www.nolo.com:** You can't find a better place than Nolo to turn for basic information on the legal aspects of virtually any kind of business. The website also offers free advice, including info on insuring your home business, independent contractor arrangements, trademarks and copyrights, debts, bankruptcies, and employment law.

particular, the U.S. federal government offers heaps of solid information on planning, starting, and operating your own business through its Small Business Administration site (www.sba.gov). And if you reside outside the United States, you will likely find that many public institutions in your region offer similar resources; business planning, after all, is not a U.S. monopoly.

Lists of the hottest business-related websites have a way of going out of date fast — kind of like teenage fashion when you think about it. And a resource that appears hot to one would-be entrepreneur may not be suited for another. Your best bet is to scout around the web yourself, looking for useful resources. On

search engine sites, the keywords *business* and *plan* lead you to plenty of generic business-planning information; if you Google "business plan website," you will be taken immediately to countless pages that link to sources, some that offer free advice, others that sell products. For a more efficient hunt, tailor your search by using keywords specific to your business area (*technology, retail, travel, children's games, social media influencer, ethnic beauty products, financial services,* and so on) along with the words *business plan* and see what you come up with. Make sure to bookmark any promising sites so that you can return to explore them later in more detail. Check out the nearby sidebar "Internet hotspots for business-planning info" for helpful website addresses.

TIP

Beyond sharing some basic business-planning tools, the Internet is also a great place to search for the latest information about competitors, markets, business trends, new technologies, you name it — all the things you need to know to put together a complete picture of your business environment. We're constantly amazed at how much information you can find in corporate press releases, company home pages, executive bios, online business blogs or magazine articles, Securities and Exchange Commission (SEC) registrations, and thousands of other publicly available online documents.

And one last thing: Don't be hesitant to simply email or dial up a potential source of information relevant to your search. You'd be surprised at how helpful others can be when you ask them in a polite and sincere manner. Kindness counts!

WARNING

The Internet may be a gold mine of business information, but you may also find plenty of fool's gold. Unlike typical print-based informational articles, which are typically fact-checked for accuracy, as we've sadly come to know much of the info on the Internet hasn't been validated. Often the website providing the info is simply trying to sell you something or scrape and then peddle your private profile. So be cautious out there.

REMEMBER

Follow three simple rules when you use the Internet for business research:

- **Make sure the material is current.** Many web documents aren't dated, so you may not know whether what you read is the latest scoop or ancient history. Look for a date. If you can't find one, dig a little further to make sure that the information is still relevant; you can often do this by cross-checking the facts on another website.
- **Know your sources.** In the wide world of the World Wide Web, you may be hard-pressed to know exactly where the stuff you read comes from. If you read a rave review of a new business-software program, and the review comes from a respected business source, you can put your faith in it (and just as true, a blatantly negative one might be from a paid troll). If it appears without a source, be suspicious. Similarly, if the grammar and spelling of the review seems odd — or clearly wrong — be on guard.

» **Double-check key facts and statistics.** If you use specific pieces of information — about business trends, markets, competitors, technology, and so on — as the central building blocks of your business plan, make doubly sure that they're correct. If you build your financial projections on a forecast that the market for digital widgets will grow at 40 percent a year, for example, you better make sure that information is true and not some widget inventor's private fantasy. And if the data is absolutely crucial to your plan, follow the advice of the old sage: *If still in doubt, throw it out.*

Purchasing business-planning software

Business-planning software allows you to automatically assemble all the components of a business plan, turning them into a printer-ready, spiffy-looking document. The best programs also make easy work of the financial parts of business planning — creating income statements and cash-flow statements, for example, or making financial projections. Some software programs add graphics, such as tables and charts, which provide an easy way for your audience to see what you describe in the written document.

WARNING

Business-planning software programs can sometimes make the job of business planning *too* easy. With all their bells and whistles, they may trick you into skipping the serious (that is, difficult) work of creating and writing an effective plan. Keep in mind that the best software-planning tools guide you through the important aspects of business planning and then keep track of your words, sentences, and paragraphs. But they don't think for you. You still need to do the serious mental work yourself.

TIP

Investors, and bankers who make a living reviewing and funding business plans, are all too familiar with the look and feel of the most popular software-generated business-planning documents. If you use one of these programs, make sure you customize your plan to make it unique. The last thing you want is for your business plan to look exactly like a hundred others that cross a VC's (venture capitalist) desk every month.

Seeking professional help

No one knows the ins and outs of planning and running a business better than people who have done it. And most businesspeople are happy to share their experience and expertise, as long as you don't plan on becoming a competitor! Many are even willing to mentor first-time entrepreneurs. Don't be afraid to turn to a seasoned veteran for advice if you run into questions you can't answer or run out of ideas to get your business off the ground.

TIP

Finding expert advice is surprisingly easy. The first place to look is in your own contact list. You may have an easier time getting help from someone you already know on a personal level. Ask your friends and colleagues for suggestions. Other good places to look for help are the local Chamber of Commerce, a nearby college or university (the local junior college might have an evening course on business start-ups), or the business section of your favorite news source. And don't forget one other invaluable location that we should all hope never disappears: your friendly local library. The pros there can usually point you to a mass of relevant data specific to your inquiry. These sources are not limited to the United States; like nearly everything else, mentoring has gone global. For example, in the UK the British Library has excellent help for folks seeking start-up advice; see `www.bl.uk/business-and-ip-centre/about`.

Of course, you may end up paying for expert advice. Nothing odd about that — in fact, there's a whole industry out there ready and willing to help. When you really need a lifeline, the advice could be well worth it. Later on, your advisers may pay you back by becoming your mentors or advocates, cheering on your business as you search for funding or those elusive first customers.

REMEMBER

Choose experts with experience in a business similar to the one you're planning. After you identify a person, decide exactly what kind of assistance you need. You can't ask someone to plan your whole business for you, after all. But you can ask them to fine-tune the look of your web page, for example, or review and critique your financial projections.

TIP

Retired businesspeople represent a rich — and underused — source of expertise. By default, they have more experience than almost anyone else, and they often look for ways to use their experiences to help others. Contact the Service Corps of Retired Executives (SCORE), a nationwide organization that works with the Small Business Administration (SBA) to provide help to business owners. SCORE (`www.score.org`) has a free online newsletter and provides free email counseling. The group also has local chapters around the country, with retired businesspeople ready and willing to help.

Finding friendly advice

Many local communities have organizations of businesspeople who convene to share ideas, exchange contacts, help each other out, and just plain socialize. Lots of research shows that Americans especially seem to love this sort of clubbiness, but it's definitely not limited to one demographic. Some groups consist of folks who've worked in the same industry or firm in the past or share mutual interests, and other organizations focus on helping specific groups like women, recent immigrants, people of color, LGBTQ people, or freelancers. Thanks to the Internet, you can find business groups that regularly schedule either online or in-person support meetings.

TIP

Business networking organizations are an invaluable resource for help in planning and running your business. For information about what's available in your community, check with your local Chamber of Commerce. There's nothing better than talking to someone who's been there, done that, so you don't fall into avoidable traps. Ask whether they have a mentoring program. Because websites change so fast, the best way to find a networking organization is through a detailed and thorough search using keywords.

Assembling Your Planning Team

REMEMBER

The first step in creating a business plan is realizing that creating a plan is vital (see Chapter 2 if you're still wavering). The first question you come across after your realization is this: Who's supposed to put the darn thing together? In some sense, the answer depends on how big your company is — a new start-up or small and medium enterprise, or an established larger organization:

- **A new start-up:** If your business is just out of the blocks or about to launch, then there's no question that the key founder(s) has to do the work. That means you. But don't fret: Who better to create a view of the future and set business goals and objectives than the person responsible for reaching the goals and making the future happen?
- **Small businesses:** If your business is only yourself and a couple of other colleagues, making a plan for the company is your responsibility. You might have one or more trusted insiders or external mentors who can offer wisdom, but in reality, something as critical as a business plan can't be outsourced. Own it.
- **Medium-size companies:** If your company is a bit bigger, the process of creating your written plan requires more organization — and more people. Putting together a plan is a big job, and involving all your key people has a certain advantage: Everyone involved in the plan has a stake in making sure that your company succeeds. And they will appreciate the inclusion.
- **Large corporations:** If you're part of a big company, you may need to bring in people who work on business planning full-time, if they're not already there. Make certain, however, that you don't create an independent planning staff: You don't want your plan to take on a life of its own and get completely divorced from what's happening with your business and those who make the day-to-day decisions. You have to make sure that your planners don't create the plan all by themselves. Your planning staff should always work alongside the managers and owners who actually have to execute the business plan. (See Chapters 16 and 17 for details on implementation.)

Setting the ground rules

REMEMBER

Putting together a business plan resembles any project that involves teamwork, from building a house to running a relay race. The clearer the ground rules, the smoother the process — and the happier your team. Make sure that your ground rules do three things:

- **Identify key steps.** Typically, the process of writing a business plan includes five distinct steps: research, first draft, review, revised draft, and final review. You can specify as many or as few of these steps as you think you need. Just make sure that you spell them out up front.
- **Clearly assign duties.** Everyone involved needs to know exactly what you expect from them. You can use the key steps you identify to create separate sets of tasks, and then you assign each task to members of your team (see the next section).
- **Establish a schedule.** Although writing up a business plan is a big job, the process doesn't need to be a long and drawn-out affair. A business plan has to be timely, responding to the current business environment — not the way it looked six months ago. After you complete the preliminary research, the rest of the steps are fairly straightforward. To keep your project on track, set specific due dates for each component of the plan and each step in the process. Assign the members of your team as much time as they reasonably need, but no more, and be fair but forceful in having them meet deadlines.

Delegating responsibility

If your company is large enough to boast a management team, you should divvy up the work involved in putting together your written business plan. We're not suggesting that you delegate responsibility just to make your job easier (although it certainly does). Different people bring different insights to your plan. With a team in place, you have a wider array of people and perspectives ready to read and review drafts, offer suggestions, and fine-tune the document to make it as good as you possibly can.

REMEMBER

We can't give you a simple formula for putting together your team. Every business is different. We can't even tell you the ideal number of people to choose — that depends on the size of your company and the complexity of your plan. But here are a few tips that can help you create an efficient and effective team:

- **Keep your team lean and mean.** Too many planners are like too many chefs in the kitchen — they get in each other's way. A bloated team can mean endless meetings and too many points of view. Involve only the number of people you think you really need to get the job done.

- **Appoint people who want the job.** Sure, you may have trouble finding volunteers who jump up and down at the chance to work on a business plan. But you need to make sure that whoever you choose is at least willing and able to complete the task. To spark your people's enthusiasm, take time to explain why creating a written business plan is so important. See Chapter 2 if you need help convincing your team of the importance of a plan.
- **Organize your team around the plan.** By accomplishing this, you make sure that your people know the purpose of their task and how their work fits into the larger picture. Some of the assignments are straightforward. Your financial person takes charge of the financial review. Your marketing head puts together the customer segmentation section. However, if certain pieces of the plan are more complex than others or require tight coordination among units, think about assigning a small group to work on them.
- **Put one person in charge.** Keeping track of the whole process can be a job in itself, especially if you have a large team or a complicated plan. Name one person as the project director to manage the team and ensure that employees complete tasks on schedule. Make sure every person on the team understands that the person you choose has the ultimate authority.
- **Appoint a wordsmith.** A business plan is a written document. If you're lucky, you have someone on your team who enjoys writing — or at least has the talent to put words down on paper with clarity. Pick a lucky person to be in charge of writing key sections of your plan, such as the executive summary. They can also serve as senior plan editor, checking grammar and spelling and making sure that the writing style is clear and consistent throughout the plan.

Putting Your Plan on Paper or in Cyberspace

When you first set out to create a business plan, the task seems overwhelming. Right off the bat, you need to answer fundamental and sometimes difficult questions about your company and what you see for the future. You have to decide what targets to aim for as you look ahead and set specific business goals and objectives. To succeed, you have to take the time to know your

- Industry
- Customers
- Competitors

- Company resources
- Company's unique qualities
- Company's advantages
- Basic financial condition
- Financial forecast and a budget

You also have to prepare for changes you will make to this list down the road. That means thinking through other options and alternatives and being on the lookout for new ways to make your company prosper. Few business plans ever pan out according to the first cut, so the more you can build flexibility into it, the better.

WARNING

You don't want to scare people — yourself included — with a giant written plan. The longer your plan is, in fact, the less likely people are to read it. Ideally, your written plan should be 15 or 20 pages maximum. You might even consider putting the whole thing into a PowerPoint format, knowing you can support the main bullet points with all the exhibits, appendixes, and references that you think it needs, along with a brief written summary if desired. If you want to glance at a sample business plan, check out the Appendix.

WARNING

Some of your colleagues might want a hard-copy print version of the plan (and why are we thinking of the age-challenged here?), but you will likely choose to commit it to a soft format version. That way, you can add or delete pages and swap entire sections in or out as your business plan changes — and it *will* change. Fortunately, however, the table of contents you use — all the major sections of a business plan — stays the same. If you do choose the soft-copy route, and it's up and available on your internal website, be sure you have all the required security walls in place beforehand. Breaking into your business plan might not be equal to cracking the corporate safe, but it can still result in serious damage; the last thing you want is to find that the plan is for sale on the Dark Web. So be prepared; the hackers out there — may their pitiful little souls burn in you-know-where — are dangerous.

To avoid becoming overwhelmed, and to keep the business-planning process in perspective, break up the plan into the basic sections that every good business plan needs to include. This should apply to both a written plan as well as a PowerPoint presentation. Take a moment to review the sections of a business plan.

Executive summary

Your executive summary touches on every important part of your business plan. It's more than just a simple introduction; it's the whole plan, only shorter. In

many cases, the people who read your plan don't need to go any further than the executive summary; if they do, however, the summary points them to the right place.

The executive summary isn't much longer than a page or two, and you can wait until you complete the rest of the business plan before you compose it; that way, all you have to do is review the plan to identify the key ideas you want to cover.

REMEMBER

If you want to make sure that people remember what you tell them, follow the Public Speaker's Rule of Three: You have to summarize what you're going to say, say it, and then reiterate what you've just said. The executive summary is the place where you summarize what your business plan says.

The preceding little note might be helpful to recall if you deliver a summary of your business plan as a verbal plea to a VC (venture capitalist) or some comparable funding source. The *senseis* of Silicon Valley are known for requiring their acolytes to make the Big Ask as succinctly as possible, which has become known as "the elevator pitch." (The idea being that these gurus' time is so valuable that all you've got is the minute or so it takes to ride up the elevator with them to their palatial office digs.) But aside from the personal indignity involved, it's actually not a bad idea. See whether you can boil down your concept to as simplified a version as possible — say, two or three sentences at most (but please, don't take James Joyce as a model here). Chapter 4 gives you more on this topic.

Company overview

The company overview provides a place to make general observations about the nature of your business. In the overview, you highlight the most important aspects of your industry, your customers, and the products and services you offer or plan to develop. Although you should touch on your company's business history and major activities in the overview (if you're an ongoing enterprise), you can leave many of the details for the later sections.

To put together a general company overview, you need to draw on several key planning documents, including the following:

- **Values statement:** The set of beliefs and principles that guide your company's actions and activities
- **Vision statement:** A phrase that announces where your company wants to go or paints a broad picture of what you want your company to become

- **Mission statement:** A statement of your company's purpose; establishes what it is and what it does as a business entity — and succinctly demonstrates its relationship to your vision
- **Goals and objectives:** A list of all the major goals that you set for your company, along with the objectives that you have to meet to achieve those goals

To begin constructing these statements, turn to Chapters 3 and 4.

Business environment

Your business environment section covers all the major aspects of your company's situation that are beyond your immediate control, including the nature of your industry, the direction of the marketplace, and the intensity of your competition. Look at each of these areas in detail to come up with lists of both the opportunities that your business environment offers and the threats that your company faces. Based on your observations, you can describe what it takes to be a successful company.

REMEMBER

Pay special attention to how your industry operates. Describe the primary business forces that you see, as well as the key industry relationships that determine how business gets done. For example, has the digital revolution occurred there yet, and if not, when will it? Talk about your marketplace and your customers in more detail, perhaps even dividing the market into segments that represent the kinds of customers you plan to serve. Finally, spend some time describing your competition: their characteristics, how they work, and what you think you may see from them in the future.

For more information on how to explore your business circumstances and the overall environment that your company competes in, check out Part 2.

Company description

This section should go into much more detail about what your company has to offer. The description includes information about your management, the organization, new technology, your products and services, company operations, your marketing potential — in short, anything special that you bring to your industry.

In particular, look carefully and objectively at the long list of your company's capabilities and resources. Sort out the capabilities that represent strengths from

the ones that show weaknesses. In the process, try to point out where you have real advantages over your competitors.

Examining your company through your customers' eyes helps. Today many interested observers of business organizations want to know your plans for dealing with issues of environmental sustainability, social responsibility, and creating staff inclusiveness policies. Be sure you address these. With a consumer viewpoint, you can sometimes discover customer value that you didn't know you provide, and as a result, you can come up with additional long-term ways to compete in the market.

To start to put together all the things that your company brings to the table, flip to Chapters 9 and 10.

Company strategy

Company strategy brings together everything that you know about your business environment and your company to come up with future projections.

REMEMBER

Map out your basic strategies for dealing with the major parts of your business, including the industry, your markets, and competition. Talk about why your strategy is the right one, given your business situation. Describe how the strategy is likely to play out in the future. Finally, point out specifically what your company needs to do to ensure that the strategy succeeds. Inquisitors of business plans often like to ask, "What is the one worst thing that might throw you off track?" so be sure you've got a reassuring answer if the question comes up.

Everybody knows that the future is uncertain, so you need to talk about the ways your business world may be different in the future. List alternative possibilities for action, and in each case, describe what your company is doing to anticipate the changes and take advantage of new opportunities. Explain how your current resources might be rapidly transformed to meet new possibilities and what critical signals you will monitor to determine if and when such a pivot is necessary.

To prepare for change in your business world and to get info on how to think strategically about your company's future, turn to Part 4.

Financial review

Your financial review covers both where you stand today and where you expect to be in the future.

Describe your current financial situation by using several standard financial statements. True, these statements don't make for the liveliest reading, but the people who are interested in the financial part of your business plan expect to see them, and some of these folks will have a magnifying glass in their hands. For everyone else, make certain that your financial statements are referenced and support the assumptions and arguments that you make in the other sections of the business plan. The basic financial statements include the following:

- **Income statement:** A list of numbers that adds up all the revenue that your company brings in over a month, a quarter, or a year and then subtracts the total costs involved in running your business. The total is your *bottom line* — the net profit that you make during the period.
- **Balance sheet:** A snapshot of your financial condition at a particular moment, showing exactly what assets your company owns, liabilities that exist including money it owes, and its net worth.
- **Cash-flow statement:** A record that traces the flow of cash in and out of your company over a given period, tracking where the money comes from and where it ends up. The cash-flow statement only tracks money when you actually receive it or spend it. Potential investors are particularly interested in when you plan to achieve "positive cash flow" status — that is, cash inflows become greater than outflow and you are not reliant on outside injections of cash to pay bills and stay solvent.

Your projections about your future financial situation use exactly the same kind of financial statements. But for projections, you estimate all the numbers in the statements based on your understanding of what may happen. These are called *pro forma* statements. Make sure to include all the assumptions you made to come up with your estimates in the first place.

To get a head start on your financial planning, flip to Chapters 11 and 12.

Action plan

Your action plan lays out how you intend to carry out your business plan. It points out proposed changes in management or the organization, for example, as well as new policies or procedures that you expect to put in place. Also include any additional skills that you, your managers, and your employees may need to make the plan work. Finally, you want to talk about how you will generate excitement for your business plan inside your company, creating a culture that supports what you want to accomplish. Only then can you have real confidence that your business plan is going to succeed.

TIP

If your plan is for a new venture or start-up, potential investors are especially interested in two key issues: Who are you (the specific individuals to whom they will give their money), and how will they get it back with a decent multiple (that is, the "exit strategy")? They want assurances that you and your team have the chops to make the plan work, and that they will receive a financial reward that the risk of a new venture necessarily entails. This latter point means having a clear plan of when and how to monetize the new venture to the satisfaction of those providing the risk capital. Be sure you've considered these questions beforehand.

For more background on how to make your business plan work, head to Chapters 16 and 17.

IN THIS CHAPTER

- Drilling down on your business idea
- Planning for the past, present, and future
- Understanding the difference between strategy and tactics
- Identifying your audience
- Discovering the basics about potential investors

Chapter 2

Understanding the Importance of a Business Plan

A famous shoe company once proclaimed, "Just do it!" That sounds like good advice, so why waste time overthinking about what it is you need to do to accomplish your objectives? Just start moving and *git 'er done*, right?

No. Not good advice. Definitely not. Why? We will be the first to admit that planning is not a predictive science; indeed, far from it. But when you really drill down, you begin to realize that the point of planning (business or otherwise) is not to predict the future. The point is to better inform yourself and your associates about your goals and the levers that you can pull to move up and impediments that can thwart achievement. That is, planning is about the willful pursuit of *knowledge*, about thoughtful and rational consideration of all the elements involved in your defined quest, and how you can best navigate the surest path forward.

But aren't there "unknowns" out there (even unknown unknowns) that can't possibly be unearthed through any systematic approach to planning? Time, after

all, is fleeting, especially in today's hyper-charged global business environment — you linger, you lose; the race goes to the swiftest; and all that. And if so, then ditto — why not just put your head down and plow forward (and indeed save the money you just spent for this book)?

The answer, of course, is that yes, there are unknowns, greater today than perhaps ever before, and yes, it is often better to be first. But to reiterate, *planning is about process* as much as (if not more than) outcomes. This business-planning process, when done systematically and conscientiously as we describe it in the pages that follow, will greatly improve your chances of success by forcing you to consider, in sometimes excruciating detail, just what it is you're up against — and how to leverage the advantages and circumvent the pitfalls that emerge.

A "good idea" is not a passport to success — lots of people have good ideas every day. In fact, the business terrain out there is littered with the desiccated remains of what once sounded like a "good idea" but never got beyond that point (anyone recall Pets.com?). Meanwhile, a good idea hitched to a sound plan for moving ahead is something that both experience and history have shown to be a highly positive factor — take a look at Amazon.com for just one example. Your purchase of this book is not an expense. Rather, it is an *investment* — and one that will yield dividends to those who take the process seriously. We don't, and can't, guarantee success with our suggestions for how to plan your business venture, but we do believe that the odds will improve substantially by following the guidelines we offer. So, OK, *just do it* — but first do your homework (and also eat your spinach); you won't regret it. And as for that need for speed, just ask the second mouse at the cheese trap what it thinks of being first. . . .

In this chapter, we look at why having a plan is so important and how you can use your business plan in different ways. We talk about your business plan as a guide to your company's future and a record of where you've been and how you've done. We help you take the first steps in describing what you actually plan to do and how you plan to do it. Finally, we look a little closer at two important groups: investors who may want to own a piece of your business and lenders who provide funds to help you grow.

Bringing Your Ideas into Focus

The concept of a plan originated with the early builders of, well, buildings, not businesses. If you've had a house built or have remodeled one recently, you know that this kind of plan is still around (and is expensive). Over the centuries, however, the meaning of the word *plan* has expanded to include time as well as space. A *plan* in the modern sense also refers to a view of the future, as seen from the

present. You make plans for a business trip next month or a holiday next summer (*holiday*, you ask; what's that? Is it an Italian word?).

REMEMBER

A *business plan* is a particular view of your company both today and into the future, planning for the following things:

- What your industry will look like
- What markets you want to compete in
- What competition you'll be up against
- What products and services you want to offer
- What value you can provide customers
- What long-term advantages you think you'll have
- How big and profitable your company can become

To create this detailed view of the future, you have to make a whole bunch of predictions about what's going to happen down the road. If your company manufactures crystal balls, of course, you're in luck. If not, you have to find other ways to make some basic business assumptions about the future.

REMEMBER

In the end, your business plan is only as good as all the assumptions you put into it. To make sure that your assumptions make sense, much of your planning should involve trying to understand your surroundings today — what goes on right now in your industry and marketplace. By making these assumptions, you can better predict the future of your business. Will your predictions actually come true? Only time can tell. Fortunately, the planning process better prepares you for what lies ahead.

Looking forward

A business plan provides a view of the future. Whether your company is large or small, whether you're just starting a business or you're a part of a seasoned company, you still need some sort of planning process to point you in the right direction and guide you along the way:

- A brand-new company makes a business plan to get its bearings and often uses the plan to get funding.
- An up-and-running company uses a plan to prepare for the inevitable changes in the marketplace.
- A large company needs a plan so everybody sees the same view ahead.
- A small company constructs a plan to make sure it has the necessary resources to survive year-in and year-out.

In fact, a small company needs a business plan most of all; unfortunately, small businesses are often the *last* to prepare a formal business plan. If you own or manage a small business, you already know that you're the jack-or-jill-of-all-trades. You hardly have enough time to get your daily business chores done, much less plan for next week, next month, or next year. But because you run a small business, you simply can't afford *not* to plan.

WARNING

When a giant corporation stumbles, it usually has the financial reserves to break the fall and get back on its feet. General Motors, for example, filed for bankruptcy not that long ago, but it's still churning out millions of cars a year. If your resources are limited, however, a single mistake — such as exaggerating the demand for your product or underestimating how long you have to wait to get paid — can spell the end of everything you've invested in and worked so hard to achieve. A business plan points out many dangers, alerting you to the hazards and obstacles that lie ahead, so that you can plan to avoid such pitfalls.

REMEMBER

Three-quarters of all new businesses fail within two or three years. And untold numbers never even make it off the ground. Smart business planning up front can reduce these dismal casualty rates.

Looking back

REMEMBER

A business plan paints a picture of where your company has been and how it has changed over the years. By reviewing your past performance or the track records of your newly discovered competitors, you can use your plan to figure out what worked and what didn't. In effect, your business plan offers you an opportunity to keep score, allowing you to set goals for your company and then keep track of your achievements. For example:

- **Your plan creates a view of the future.** In years to come, you can use old copies of your plan to look back and determine just how well you predicted the future.
- **Your plan maps out a direction in which to go and the route to take.** You can use it to gauge how skillfully you accomplish what you set out to do.
- **Your plan forecasts where you want to be.** You can use it to check out how close you come to your targets for the industry, your market, and your finances.

WARNING

Your history, as described in your business plan, teaches you important lessons about the business you're in — so you aren't doomed to make the same mistakes over and over. If you can't remember exactly where your company has been, you probably can't see where you're headed.

Looking around

You can use your business plan to tell the world (or at least anyone out there who displays an interest) meaningful information about your company. No matter who you deal with or why, your plan has a ready-made description to back up the claims you make. Your plan comes in handy when you deal with the following constituencies:

- People you want to recruit to join your organization as staff associates
- Suppliers you want to work with on a regular basis
- Distributors interested in carrying your product or service
- Customers you want to establish long-term relationships with
- The board of directors or other advisers who want to offer their support
- Outside consultants you hire to help out with specific issues
- Bankers who decide to lend you money or shut you out
- Investors who show interest in taking a stake in your company
- The general public in your community who might have an interest in your activities

All these constituents have their own special reasons for wanting more information about you. Each group is probably interested in a different part of your plan. A well-written business plan satisfies all these groups and makes your company stronger in the process.

Taking the first step

With so many people to keep in mind and issues to think about, you may be feeling a little overwhelmed. Well, we're not going to sugarcoat this: Business planning does take time and effort. But if you're excited about the business you're putting together, the process can be a lot of fun. In fact, maintaining your sense of excitement and enthusiasm and making sure you reflect it in your business plan is important.

TIP

Now's the time for you to capture that can-do enthusiasm and take the first step: Get your big ideas captured either in a Word doc or on paper. Don't worry about writing beautiful prose. Get right to the point. Devoting no more than a sentence to each of these items, explain

- What you want to do
- How you plan to do it

- Who your customers will be
- Why they should come to you and not the competition
- The number one reason you're convinced that this business will succeed

After you finish, be sure to drop the doc into several different files so you don't accidentally delete it. For more information on describing your business in 50 words or less, check out Chapter 4.

Understanding the Planning behind the Plan

Some companies think that planning is a total waste of time. They would never think of using the term in the context of their own organizations. These companies still move forward; they just don't talk much about it ahead of time. So why does planning have such a bad reputation in certain quarters? One reason is that far too many organizations simply go through the motions rather than taking the exercise seriously: Someone high up read somewhere that having a plan looks good to an external audience, so the firm commissions one and then promptly forgets about it. More than likely, the companies that don't plan don't understand what it really means to plan. Planning has become such a buzzword in today's business world that its real meaning has been lost.

Is planning an art or science?

Planning is both an art and a science. Putting together a serious business plan requires you to gather data, analyze the information, and then turn it into knowledge about your situation. A serious business plan requires that you think *strategically.* What do we mean by that? The word *strategy* comes to us from the ancient Greeks and translates literally as *the art of generalship.* So it shouldn't be surprising that when you start thinking strategically about your business, you feel that you're suiting up for battle and jousting with your competitors for the hearts and minds of customers (to say nothing of their wallets and purses).

REMEMBER

Modern definitions of the word *strategy* have become a bit fuzzy. But what matters isn't so much how the term is defined, but what it *does.* When you think strategically about business plans, you do the following:

- You clearly describe how to reach the goals and objectives that you set for your company (see Chapter 4 for more info).

- You take into account the social values that surround your company and drive your staff, you included (see Chapter 3).
- You think about how to allocate and deploy your human and financial resources (see Chapters 12 and 16).
- You create an advantage in the marketplace that you can sustain, despite intense and determined competition (see Chapters 10 and 14).

Don't misunderstand us here: Planning is not always rational science, and business success sometimes can be an inspired outcome of "art." Some people are intuitive by nature and "go by their gut" more than engaging in a lengthy planning process such as we encourage in these pages. The late Steve Jobs of Apple, Inc., was supposedly one of these creatures. Good for him and them. But let's be honest: People like Steve Jobs don't come along often, and the probability that you are one of them is negligible at best. In fact, now that we think about it, Mr. Jobs — one of the most remarkable and admirable business leaders of modern history — could have saved himself a decade of time and boatloads of money if he had devoted a bit more effort to understanding the threat of competition for his original Apple I and II machines. So when that Blinding Flash of Brilliance strikes, grab it and thank your lucky stars. But please don't run with it until you've finished our book. You and all your involved associates will be thankful not too far down the road.

WARNING

Make sure you don't forget the strategy behind your business planning. Without strategic thinking, business plans often turn into those neatly bound fantasies that begin and end with numbers — revenue projections, cash flows, expense allocations, and the like — that alone don't help you figure out what to do. This is what we call the "SPOTS Syndrome": *Strategic Plans On Top Shelves*, where the document ends up gathering dust and little more. Trust us, we've seen this. They don't represent planning; they represent a waste of time.

What can you do to make sure your business plan includes a strategy? When it comes to strategic thinking, a healthy dose of plain old common sense and logic works wonders as you pull all the pieces of your plan together. Experience in your industry and some smarts are advantages, too. Unfortunately, we can't give you any of these gifts. But we can offer you some solid advice to keep you on track. Go to Chapter 14 for more on strategy.

Why planning matters

Planning doesn't guarantee success, but it does go a long way toward bettering your chances. We've seen it with our own eyes. And a recent survey of close to 1,000 small businesses backs up the claim. The survey found that companies that have business plans enjoy 50 percent more revenue and profit growth than companies that fail to plan. It's that simple.

REMEMBER

Planning works best when your company integrates strategic thinking into every aspect of your business, every day of the week, and every week of the year. An ongoing process means that you do the following things:

- Always question what makes your company successful — it's more than mere luck.
- Observe customers and markets, tracking their wants and needs.
- Relentlessly examine the competition and what progress it makes.
- Steadily work at maintaining your competitive edge.
- Optimize the organization to rapidly transform if and when change occurs.
- Continue to search for ways to take better advantage of what you do best.

Some managers may follow all these tips automatically and intuitively. But if you want to make sure that strategic thinking extends into all parts of your company, you have to create a framework to ensure that it happens. When you make planning a basic responsibility for the whole enterprise, you get the added benefit of including all levels of employees in the process. Employees — especially those closest to the customer — often have different and equally valuable viewpoints about shaping strategy. Having a planning framework ensures that you hear their voices.

Satisfying Your Audience

Whether you write your business plan on your own or do it by committee, always keep in mind *who* reads the written document. A business plan is meant to communicate your vision and strategy — what you plan to do and how you intend to do it. The best way to convey your message is to consider your audience. You don't speak French to someone who only speaks Italian, right? (Well, maybe the French do.) For the same reason, you don't want to fill your business plan with all kinds of techno-jargon if your audience is made up of people who don't know the first thing about the cool new technology you work with.

What if your whole business idea is based on something brand-new? Don't you need to describe it in detail? Sure you do. But you can address different audiences within the same document. For example, your plan may include an overview of the new technology that anyone who reads it can understand, and if necessary the techno-speak can go into an appendix. Before you can really think about how to address different audiences, however, you have to know your readers.

For the sake of simplicity, we lump them all together and call them your *stakeholders* — as in everyone who has a possible stake in what your company does or how it operates. Some of these people may have direct stakes: They rely on you for their income, for example, or they own a piece of your business. Others may have less tangible interests: government watchdogs who occasionally survey you to ensure that you're complying with legal standards or civic organizations who want to make sure that you remain a good corporate citizen.

Whatever the interest group, your business plan is one of the most important tools you have to communicate with them. But there is a catch: Each of these groups is likely to look at your plan in a different light. So take a closer look at two very important types of stakeholders: investors and lenders.

Venture capital

If you need money to fund your business and you want to minimize your financial risk, one place to turn to is the venture capital (VC) marketplace. Venture capital firms are in the business of raising money and then putting it in the hands of businesses that make their money grow. They usually invest capital in new ventures, hence their name. So for start-up companies, venture capitalists can be a very important (and discerning) audience when it comes to the business plan. You can bet that they will read your plan very carefully before handing over any cash.

WARNING

Sounds simple, right? Well, lining up venture capital funding isn't easy. Would-be entrepreneurs have been led to think that a great idea and plenty of enthusiasm are enough to shake the money tree. You need both, of course, but now you're only at the beginning. According to a recent survey, venture capitalists fund less than 1 out of every 500 business pitches (proposals) they hear.

What do you need to succeed in the venture capital sweepstakes? First, it helps to know about the nature of VCs. Venture capitalists come in all sizes, from small, independent operators to large national or even global VC firms that evaluate thousands of new business proposals every year. Some VCs specialize in certain industries — biotechnology or e-commerce services, for example. Others tend to stay close to home, funding companies in their own geographic area so that they can keep close tabs on their investments. Some VC firms prefer to invest in companies working in the early stages of development. Others look for companies that need a final push into the big leagues.

Now comes the $64,000 question — or if you're lucky, make that $64 million: What's the best way to get your business idea and plan in front of real, live investors? We wish we could give you a sure-fire, one-size-fits-all answer. There isn't one. Still, entrepreneurs who've been successful before can provide you with valuable knowledge. The following sections provide a few tips that should help you distinguish yourself.

FANCY FINANCING LINGO

As you may expect, the world of venture capitalists has a language all its own. Most of it has to do with the various types of financing available — which in turn is closely tied to the different stages of a company's development. Here's what you need to know:

- **Seed financing:** The money you need to prove that your basic business concept is a rock-solid one that can generate streams of additional funding. Seed financing may go into building a prototype of your very cool new technology; this is called "proof of concept." Or it can be used to conduct market research to show that customers really want what you have to offer.
- **Start-up financing:** The initial level of investment required to get your business off the ground. You can use the funds for everything from assembling your business team to developing your product or service, testing it, and bringing it to market.
- **First-stage financing:** Additional money that comes in after your initial start-up funds run out. You often use the funds to support further growth by ramping up new product development, production, marketing, or your sales efforts.
- **Second-stage financing:** Money raised further down the road after your business has initially proven itself. You typically use the funds to allow the company to expand even more by supporting growth in all areas of the company's operations.
- **Mezzanine financing:** We're not talking about buying theater tickets here. *Mezzanine* means in between. In a theater, the mezzanine level is between the orchestra and the first balcony. In the business arena, mezzanine financing falls between an equity investment and a standard bank loan. The money allows your company to expand in a particular direction without necessarily having to give up additional ownership in the business.
- **Bridge financing:** Like a bridge over troubled waters, this kind of financing can help your company over temporary rough spots. For example, you sometimes use short-term bridge loans before an Initial Public Offering (IPO) to smooth out any working capital needs that may occur before the IPO is completed. When the latter occurs, the bridge loan is paid off with the proceeds.

Making connections

As almost all successful entrepreneurs can tell you, it's not just what you have, it's who you know. The more networking you do — those people who can say nice things about you, your business idea, and your plan — the better your odds of actually getting onto some venture capitalist's radar screen.

Doing your homework

Venture capitalists have been to the rodeo before, many times in fact. And although they love to see excitement and enthusiasm in the entrepreneurs they talk to, they absolutely need to know that you've also done all your homework — everything from scoping out the competition and sizing up the market to crunching the numbers and identifying the strengths, weaknesses, and uncertainties inherent in your business model (see the earlier section "Bringing Your Ideas into Focus" for tips on finding this info). You need to be enthusiastic, definitely; who goes into business without a strong dose of optimism? In short, your investors assume the happy talk . . . but they want an ironclad business plan.

Perfecting your pitch

TIP

What do successful entrepreneurs have in common with hotshot Hollywood show runners and baseball Cy Young award winners? They know how to throw a good pitch. And knowing how to pitch your idea is absolutely critical in all of these fast-moving worlds. Like movie producers, venture capitalists have crowded schedules and short attention spans. You have to wow them quickly and keep them listening. For more help, turn to Chapter 4.

Bankers, backers, and bootstrappers

Before you jump on the venture-capital bandwagon, here's something else to remember: VCs are definitely not philanthropists. They take a big chunk of your company in return for the cold cash they provide. And they often demand a role in directing or even running your business, taking seats on your board of directors, or even naming the CEO. You'd probably do the same if it was your money.

On the other hand, you can fund your start-up the old-fashioned way — from pay-as-you go bootstrapping, family and friends, or via a formal business loan. There are even crowdfunding sites that can provide you a platform to source online equity financing. One key advantage of this route is that you get to keep all the voting equity (legal ownership) in the company. And you get to run your business any way you please — you're the top dog and no questions asked.

Stop for a moment here to consider just what kind of new business you're contemplating. If it's a software-based venture — such as an online dating service, a YouTube.com video sharing site, or an educational tutoring site — you might not need much to get started other than a computer connection, your own ability to code, and the time to do so. If this is the case, perhaps clearing out some space in your room and draining your pitiful little so-called savings account is all that's needed, since "sweat equity" is your major contribution as you bootstrap your way to riches. But on the other hand, if your new venture requires raw materials,

HELP FROM YOUR UNCLE SAM

The U.S. Small Business Administration (SBA) has a mandate from Congress to help small businesses with their financial needs. So if you're a small company, the SBA may be an important source of funding. The SBA does its good deeds through several specific programs:

- **The 7(a) program:** Providing financing for a variety of general purposes, this is the most flexible and popular loan program the government offers to small businesses. You can use the money to acquire a business, to start a business, or to meet special financing needs such as a specific contractual obligation or mandatory export financing requirements.
- **The CDC/504 program:** Also known as the Certified Development Company, this program has been established to help finance the purchase of big-ticket asset items by small businesses, such as equipment or real estate, by using fixed interest loans in combination with additional outside financing and equity.
- **The MicroLoan Program:** This is where you go to get very small loans, with the average running about $13,000. The SBA provides funds to an outside micro lender, who makes the actual loan to a small business.
- **Disaster Loan Programs:** The SBA offers a number of programs to assist business firms to recover from disasters, such as floods, viral pandemics, and the like. These are usually transitory in nature and are established for a specific incident, with given time deadlines for both application and payback.
- **The Small Business Investment Company (SBIC):** The SBIC program supports the creation of independent investment companies that provide both equity capital to invest in small businesses and long-term loan financing when required.

Finally, the agency also has a program to guarantee payment of surety bonds issued to small business firms from surety firm lenders. To find out more about any of the Small Business Administration programs, check out the agency's website at `www.sba.gov/funding-programs`.

dedicated manufacturing space, machinery, and trained personnel, it's going to cost you up front before a penny of revenue comes in. Is that little piggy bank account up for this level of drainage? If you do have large start-up costs, another option is to take the route that many businesses follow and pay your way forward with either donations from close relatives or a more formalized business loan.

Family and friends

Hitting up the family or friends can be one way to start that many have used. One recent survey found that nearly 40 percent of small business owners turned to family for funding needs. Fred Smith, for example, the founder of the enormously successful FedEx overnight delivery service, started the firm in 1971 with the help of a whopping $4 million from his family. Obviously, however, this isn't something that everyone can do — in a world of growing income and wealth disparity, a lot of worthy would-be-entrepreneurs are getting left out, and that's neither fair nor good for the economy. But if you think there is some spare cash sloshing around out there in your network, give it a try. If your idea for wealth creation is as good as you believe, then why not circulate it among loved ones first? (But on the other hand, don't forget that money obligations are something that can separate friends faster than a sneeze in a packed elevator.)

Credit cards and crowdfunding

Another tactic that some start-up founders pursue is to max out their credit cards. The co-founder of SellMax, a nationwide used-car buying service started in San Diego, California, used his business card to pay for critical media advertising as no other funds were available; this was a lifesaver, and the firm is thriving today some 25 years after launch. Additionally, the fraud protection benefit offered by many credit card suppliers gives a safeguard to business newbies who might otherwise fall prey to the many scammers out there offering (false) help. And don't forget those points that accumulate when you use a credit card for purchases; they can be converted into payment for travel expenses such as airfare, hotel stays, and meals needed to get the business up and running when cash is short.

WARNING

But keep in mind that credit card financing terms are typically some of the most onerous on the planet, short of funds from organized criminal syndicates — and even some of the latter look good by comparison! If you need to leverage your wallet plastic in order to fund your start-up, it should be a desperate last resort when you are absolutely and unequivocally convinced of the soundness of your plan; you have exhausted all other means of funding; and you — and your dependents — can take the financial hit if your great new business idea dies in the cradle. So be forewarned, and not excessively foolish.

How you get funded today through more formal means has become interesting, to say the least. Like so many other sectors of the economy, deregulation and modern technology have transformed the banking business into a kind of Wild West with the emergence of cryptocurrencies and their disruptive variants (many originating from new venture firms that could benefit from reading this book). In the past your friendly local banker was the go-to source — and you had to go through many ritual genuflections to come away happy. But, for good or bad, not today: Available funds can be no more than a computer click away and available in a flash

through a so-called "De-Fi" lender (decentralized finance). If you have even minimal assets — and sometimes even if your only advantage is that you're breathing — there's likely some place out there that will consider or grant funds if your idea is solid and your business plan coherent.

TIP

These new kids on the block are increasingly online in nature, from subsidiaries of established lenders such as big banks to go-fund-me and crowdsourcing sites that have sprung up like lilies after a hard rain. It's likely worth your time to investigate some of that terrain if you think your chances with a more traditional lender look shaky. You might want to create a fundraising page on the web (one current how-to-do-this site: `www.spotfund.com`). Conversely, just Google "crowdsourcing" on your laptop, and you'll instantly find numerous hits. Here are a few you might consult (chosen randomly with no endorsement implied or intended):

- `www.askforfunding.com`
- `www.ideapros.com`
- `www.kickstarter.com`
- `www.startengine.com`

Traditional banks

If you do choose a traditional bank loan route (from so-called "Ce-Fi" or centralized finance firms), most of them are more than willing to lend money to local businesses, provided that they can present convincing business plans. The simplest arrangement: a standard commercial loan. In this case, the bank loans you the money, and you pay it back, usually in monthly installments and with interest. But you can find all sorts of variations on this theme, from real estate loans on commercial property to loans secured by your inventory or accounts receivable and even to your personal assets such as a home (see Chapter 11 for more info). If business assets secure the loan, you usually pay a lower interest rate.

If you don't intend to use all the money at one time, consider applying for a commercial line of credit. A credit line allows you to draw on the funds when you happen to need the cash. Given a firm's circumstances, banks don't usually require collateral to secure small lines of credit. Larger lines (some banks loan up to $10 million or more) are typically secured against accounts receivable, inventory, machinery and equipment, or real estate.

TIP

A quick note for our global fans: Many other nations have comparable lending programs for small business owners or entrepreneurs in their own countries, especially in emerging markets. Quite a few of them have developed impressive micro-lending facilities designed specifically for small, even tiny, businesses. See, for but one example, a program offered by FNB Bank, a leading financial institution in South Africa: `www.fnb.co.za` (and then click on "For My Business" on the top line menu bar). For a more comprehensive list of such opportunities, see `www.kiva.org`; this is a Silicon Valley–based nonprofit organization that connects worthy small-business entrepreneurs with lending resources both domestically and internationally.

WARNING

Regardless of the source, by securing an external loan to fund your company, you get to use one of the greatest things ever invented: *OPM* — that is, Other People's Money! Using this channel to build up your business means you get to keep all the growth and profits for yourself — at least in theory. But it doesn't mean that borrowing money is without risk. Somebody has to pay back the loan, after all, and that somebody is you and/or your business entity. To minimize your risk, make sure that the business idea is fundamentally sound and that you have a solid business plan in place. Rest assured, your lenders will also do the same. And those papers you need to sign? They are legal documents that can impose significant penalties for noncompliance with terms. Be sure to read the small print before giving your John Henry, or your next job might be making license plates.

WARNING

And it's always worth asking one further question: If you put up your own funds to get the business going, can you afford to take the loss if it fails? See our comments about credit-card borrowing in the previous section. We don't want to be the ones who yank out the punch bowl just as the party's getting started, but we also don't want you to have to run for cover whenever you encounter that former family member or friend who you haven't been able to re-pay (or worse, end up in some modern version of debtors' prison).

IN THIS CHAPTER

- Discovering the importance of values
- Identifying your company's current beliefs and core principles
- Declaring your company's vision

Chapter 3

Setting Off in the Right Direction

You may ask yourself why on earth you're reading a chapter on vision and values in a book on business planning. But if you are wondering, perhaps it's only a reflection of the era in which you were born. Why is this? Because today we must acknowledge that the business firm is an entity that needs to be acutely aware of its societal surroundings if it wants to attract both loyal customers and skilled employees. As such, how an organization positions itself in its larger social domain is critical to not only the bottom line but also to its very survival. People the world over are realizing the need to hold firms accountable if we are to improve both the physical and human condition, and they are taking action to do just that — especially younger people who, let's admit it, have a stronger stake in the future than some of us old fogeys. Lesson learned for the business planner: Today, social values count as much as an economic valuation of the enterprise.

Now, don't get us wrong here — we have no quarrel either with profit or the economic system that encourages its accumulation. We devoutly believe in a consensual relationship with both, engaged with eyes wide open, of course, and we hope that you, too, dear reader, will earn your fair share of greenback gratification over time. But short-term profits aren't the measure of business success. Truth be told, even the oldest tomes on business planning have noted that long-term profit is the best success metric of the capitalist firm.

Yet while all of this is true, we've also come to another realization as our complex new century unspools before us: The blind pursuit of profit only for its own sake is a death wish. It results not only in the depletion of the planet's scarce resources but has also shown an unfortunate tendency to deepen the chasm between the haves and have nots (to say nothing of the haves and have yachts). This is not good, indeed it's bad, and though it might take another book to explain why, suffice it to say that even a casual look around should prompt all of us to re-examine the role of the business firm in contemporary society.

REMEMBER

Cynicism abounds here, but we're nevertheless still convinced that a successful business plan must start with a statement of company values as well as a vision for the future. Values and a vision — the Double Vs — give your business a moral compass that guides you should you encounter trouble along the way. They also keep everybody in your company on course and heading in the same direction. What if you're a company of one? Taking time to establish your values and vision still guides you as your business grows, and it might even reveal a whole new side of your personality that will bring both surprise and delight.

In this chapter, we point out why values are so important in the first place. We help you identify your company's values by evaluating the beliefs and business principles that you already hold. We show you how to put together a values statement along with a set of rules to work by. Finally, we encourage you to create a vision statement for your company that will inspire everyone who encounters it. (And by the way, we haven't forgotten that "mission statement" we mention in Chapter 1; we get to it in detail in Chapter 4.)

Understanding Why Values Matter

Your company faces all sorts of options, alternatives, and decisions every day. There's an old saying that perhaps you've heard: "If you don't stand for anything, you'll probably fall for everything." If you take the time to define your company's values, your principles and beliefs can guide your managers, employees, or just you (if you're in business for yourself) as your company wades through complicated issues that sometimes don't have easy answers. When the unexpected happens, you can react quickly, consistently, and decisively, based on a clear sense of what's important. Even when your company is in smooth waters and sailing along just fine, a strong sense of value helps motivate you and your employees.

Facing tough choices

There is growing evidence that financial investors favor the good guys over the ethically challenged. Government regulators around the world are beginning to

impose ESG (environmental, social, and governance) mandates on publicly traded firms in their jurisdiction, with appropriate penalties for violators of social norms. Investment funds, which constitute the majority of stock holding in public firms, are also jumping on the bandwagon and restricting purchases of shares in firms that cross the line. In short, doing good is increasingly a route to doing well financially.

WARNING

Having no fundamental guidelines to follow — or, worse yet, being told "don't rock the boat" and play it safe — means that businesspeople are forced to choose the easy path paved by profit opportunity. But the easiest path isn't always the best. When profits are the only guide, you may find it easier to cut corners or even bend the law — and that has spelled serious legal trouble for many companies in recent years, bringing some very high flyers crashing down.

Weighing utilitarianism and other philosophies

Unfortunately, the philosophers haven't provided us with any surefire tool to resolve the dilemmas of profit versus purpose. Some approaches take a black-or-white line that right is right, wrong is wrong, and never the twain shall meet. Period. But the messy and complex world in which we live today renders this as much too simplistic, especially for a business firm that is trying to balance the competing demands of multiple stakeholders, each of whom might have starkly different objectives. There's a lot of gray out there. Consider the case of child labor. It is clearly abhorrent and should be opposed by anyone who possesses an ounce of moral fiber. But suppose that your firm is sourcing some component from a supplier in a low-income nation where investigation shows underage children to be working. The families are poor; government resources are lacking; and given existing economic opportunities, everyone needs to pitch in for the family to have a roof over its head and sufficient food on the table — survival itself may be at risk. Do you terminate your supplier? Tough call.

Another approach advocated by philosophers, one that has found more favor with businesspeople, is the so-called "utilitarian" school. In this, the decision-maker has to define the costs and benefits associated with the options, weigh them appropriately, and then calculate an outcome. The alternative that delivers the highest return — benefits less costs — is the preferred choice. But for the example of outsourcing to a supplier in a low-income nation, the trade-offs are multiple and involve calculations that could be wildly off-base depending on who's doing the judging. (For example, how important is it to keep costs down and the firm's share price elevated by turning to offshore low-wage suppliers? Perhaps some shareholders are counting on stock returns for their well-deserved retirement.) Again, tough choice, squared.

Utilitarianism does have a certain attractiveness, no doubt: It quantifies the problem and allows for a seemingly rational outcome devoid of emotion and bias. And that's good. But the question as you've no doubt guessed is how to weigh the choices. In the starkest cases, this necessitates a valuation of human life, or a calculation of long-term damages that are almost impossible to do with any sense of fairness or accuracy. The poster child example of the difficulties that arise in these instances can be seen in the notorious case of the Ford Pinto automobile.

Some years ago the Ford Motor Company introduced a small, compact automobile, the Pinto, in an effort to compete better with Asian imports that were flooding the United States. To meet pricing and fuel efficiency demands, company executives adopted a policy of "2000/2000" — that is, the car had to weigh less than 2,000 pounds and retail for no more than $2,000 (we did say this was an example from some time ago . . .). But after a series of accidents that resulted in not only serious injuries but also fatalities, it was determined that an engineering flaw — resulting from the mandate to keep cost and weight down — caused the fuel tank to rupture and explode even when hit from behind by a very slow-moving vehicle. Subsequent economic analysis yielded results showing the cost to recall and repair all the Pintos on the road would exceed Ford's expected payout in death and injury benefits to those who were statistically likely to suffer or perish from such accidents. Given this cost-benefit analysis, the firm chose to do nothing. Of course, when this rationale was revealed in subsequent legal proceedings, the public outrage was such that Ford's reputation was seriously damaged, and soon thereafter, Pinto sales dropped by more than half and never recovered. Did Ford's decision-makers make the right call? The economic logic might have been impeccable, but the ethical basis for using such an approach — utilitarianism — was questionable. You be the judge.

REMEMBER

But when you put all the ethics puzzle pieces together, there is at least one positive that should stand out: It's better to acknowledge the moral issues involved and at least try to muddle through them, rather than sweeping them under the rug and adopting a business-as-usual posture. Ignorance is not always bliss. Both you and your organization will be better off for making the effort to sort through the data and find your bearings — as reflected in a statement of values.

Applying ethics and the law

REMEMBER

A *values statement* is a set of core beliefs and principles that guides the activities and operations of your company, no matter what its size. To make the statement mean anything, the people at the top of your company must constantly exemplify your stated values, and your company's incentive and reward systems should direct all employees to act in ways that support your company's values.

Having a values statement also can keep you and your colleagues on the right side of the law. For decades now the United States, as well as numerous other nations, has legislated statutes regarding product and workplace safety, financial transparency, and environmental issues, to name just a few. In the more recent past, a number of new laws and regulations have been enacted to ensure fairness and equity toward women and minorities in the workplace. Failing to comply can cost you your job. No longer can top-level executives say they don't really know what's going on in the companies they run. Now they can be personally held responsible.

REMEMBER

Well, you ask, if there are so many laws and ordinances out there to channel the right behavior by the business firm, then what's the big deal about a values statement? Fair question, as even a cursory review of the legal environment surrounding business would reveal the "grayness" and terminological haze of so many of these statutes. All too often, it seems, our laws are written to allow clever lawyers the wiggle room to slide the perps out of harm's way (perhaps Shakespeare was right on this issue . . .). Given this reality, the truly ethical firm shouldn't seek exoneration under the cover of law, but rather should institutionalize best-practice behavior through its observed actions, especially those taken by the folks at the top of the organizational pyramid. Trust us, lower-down employees will see right through any attempts to sidestep responsibility, and the news will race through their social media accounts faster than answers in a *Jeopardy!* episode.

Getting caught lost and unprepared, if not naked and afraid

You probably remember some headline-grabbing stories of companies suddenly faced with crisis. Companies that have come under fire in recent times include the following (and we don't mean to purposely shame these ones, as the list could be lengthened almost exponentially):

- **Volkswagen and diesel engine emissions:** The German-based automaker was caught altering emission-control devices to reduce pollution on millions of its diesel-powered products so they would "defeat" legally required standards and increase power and MPG fuel consumption — all the while touting its green credentials and deep respect for the environment. Top executives ultimately were terminated, and billions in fines were imposed.
- **Target Roofing & Sheet Metal and COVID-19 relief funds:** It's not just the big dogs who do this stuff, though they do get the most media attention. The owner of this small business in Fort Myers, Florida, was charged with fraudulently diverting $2 million in government funds intended to provide relief for his company's employees hurt by the COVID-19 pandemic and buying himself a flashy new $700,000 40-foot boat, among other purchases.

The Hall of Shame Fame list could include episodes involving companies of every size in all industries in all countries, from day-care centers to giant investment firms. Faced with unexpected events, unprepared companies often react as though they're in total disarray, the classic deer caught in the headlights. When a company lacks stated values that everybody subscribes to, the interpretation of important issues is left up to anyone and everyone. The company is likely to find itself speaking with many voices and going in several directions, resulting in confused employees, unhappy customers, an angry public, disappointed investors, and sharp-eyed law enforcement officials.

REMEMBER

As you begin to think about your own business values, remember the following:

- A values statement is a summary of the beliefs and principles that guide your company's activities.
- Clearly stated values can help your company react quickly and decisively when the unexpected strikes.
- Everybody in your company must understand and embrace your company values.

Understanding the value of having values

A clear values statement can be most important when the unexpected happens.

Here are two current examples of firms, one who saw the light and reaped the rewards by focusing on issues beyond short-term bottom-line numbers . . . and one that was apparently blinded by the light:

- San Francisco-based Salesforce.com, founded in 1999, is the global leader in the customer relationship management (CRM) software industry. Under the guidance of its founder Marc Benioff, in 2000 the firm established a model for philanthropy it called "1-1-1." This stands for the company's giving of 1 percent of its products, 1 percent of its equity, and 1 percent of its employees' time annually to communities and nonprofit organizations far and wide. Given the size of Salesforce, this has been significant (the firm has more than 65,000 employees and a market capitalization of more than $250 billion — 2021 figures). Its staff has donated more than five million hours of volunteer work, and nearly half a billion dollars in grants have gone to more than 40,000 organizational beneficiaries. The `www.greatplacetowork.com` site shows that more than 90 percent of the firm's employees rate it highly, compared to

a national average of 59 percent. Given the competition for talent in this industry, this is a significant competitive advantage for Salesforce and its leadership team.

- Equifax is one of the world's largest credit reporting agencies, with more than 10,000 employees and more than $3 billion in annual revenue. Chances are your credit worthiness was scored and reported on by the firm when you last applied for a credit card, a mortgage, or some other form of financial debt. But in September 2017, it had a problem: Equifax reported that nearly 143 million Americans had their personal data exposed in a massive cybersecurity hack by some unknown miscreants. A month later, it announced the number of compromised accounts was even larger. And then the following March, it increased that number yet again — data that included names, Social Security numbers, birth dates, addresses, even driver's license identifiers. The firm's CEO said, "Equifax will not be defined by this incident, but rather by how we respond." Shortly thereafter, the firm had to acknowledge it had known about the breach months prior to its initial public reporting, and several of its executives had sold shares in the firm during the interval.

  Trying to repair the damage, Equifax offered no-fee credit monitoring — but only if victims waived their right to sue and submitted a complicated form. Under pressure from outraged customers, it also offered a free credit freeze — but valid for only one month. Soon thereafter its CEO of 12 years, claiming he was "deeply sorry," was terminated along with other top officials responsible for security measures. Obviously no clear disaster recovery plan was in place, and the top C-suite folks in charge seemed befuddled if not outrightly negligent in their collective responsibilities. In April 2018, the firm's chief transformation officer declared, "We should have been quicker, more frequent and more transparent in our customer communications immediately following the incident. . . . We are committed to being as proactive as possible in the way that we communicate and rebuild trust." Duh. The management of this fiasco was not good, not even close. In fact, it was abysmal. This proves the case that when disaster strikes, firms typically are judged not on the root cause of the problem itself, but on how they respond. Value-driven planning counts.

REMEMBER

Firms like Salesforce.com work so well because each employee takes seriously the concept of responsibility beyond the bottom line. With the active encouragement and involvement of top management, from the chairperson on down, its values and commitments are invoked, praised, and communicated throughout the company. Old-timers and new hires alike are reminded of the importance of the message. Salesforce.com remains at the top of its industry — an indication of why the company is so well regarded by so many people.

Clarifying Your Company Values

Values statements often address several audiences. Salesforce.com's vision statement notes employees, customers, partners, communities, and the environment — a rather broad array, to be sure. Should there be a priority ranking here, as well as for your own organization's statement? We think so, and in fact one reason we like Salesforce's pecking order is because it recognizes that a vision is only as good as it will be lived by its exemplars — that is, employees (or if you operate a business alone, yourself).

But your company's values have an obvious impact on all your stakeholders, including the owners, investors, bankers, customers, suppliers, regulators — and heck, even crazy Uncle Ernie if he's the one who loaned you the $10K to start your business. (See Chapter 2 for more info on stakeholders.) As you start to identify your company's most important values, you have to consider different viewpoints, including the following:

- The demands of your investors (if you have any)
- The interests and expectations of all your stakeholders
- The beliefs and principles that you and your company already hold

When you come up with a preliminary list of company values that you feel are most important, you're in a good position to create your values statement.

Putting together your values statement

Drawing up a list of beliefs and principles is one thing; putting those beliefs to the test is another. Tough choices are bound to come along, and they force you to examine your beliefs closely. If you run a one-person company, you already know something about what you stand for. In a bigger company, certain beliefs and values are inherent in the ways the company does business. The best way to get to the heart of your company's beliefs and principles is to imagine how you'd respond to tough dilemmas.

Your company's values statement represents more than a quick to-do list. The description of your values reaches beyond quarterly goals or even yearly targets. Your values should guide you through tough decisions as you build a sustainable business that lasts and grows over years and decades.

Maybe your company has some sort of values credo already in place but tucked away into a file that hasn't been accessed in ages. If so, at least you're a step ahead

of the game. (You lose points, however, if you have to glance at a dusty bronzed plaque on the office wall to remember it — even more if you don't remember where the plaque hangs.)

You may not have the luxury of spending weeks or months developing a values statement, so we show you a quick way to create one that sets your company on the right track. If your company is small, you can follow the steps yourself or with one or two of your colleagues — no need for long meetings and careful review. If you're part of a larger company, however, you may have to wade through a bit more debate to get a consensus.

REMEMBER

You can't and shouldn't create a values statement too quickly, but you *can* quickly begin a process to help capture and articulate the values intrinsic in the behaviors of leadership and employees of your business. Follow these steps to start creating a values statement:

1. **Gather your company's chief decision-makers to talk about the general company values that should (and do) guide employee behavior.**

   Come prepared with an agenda and your own observations and take careful notes. Use good meeting management protocols to ensure all voices are heard and hierarchical or seniority battles don't arise (for example, ensure the meeting facilitator never dismisses a suggestion out of hand no matter whom it's from). One useful trick is to bring in a relatively new employee and ask that person the single most important thing that attracted them to the firm.

2. **Prepare a first-draft list of all the values discussed in the meeting and circulate copies for review.**

3. **Schedule one or two follow-up meetings with senior managers to clarify and confirm a final set of values.**

4. **Create a values statement that captures the agreed-upon values clearly and concisely, and get it approved by the board or other such advisory body if that's necessary.**

5. **Meet with managers at all levels to make sure that they understand the importance of, and the reasoning behind, the company values statement.**

   Another useful exercise is to select one value from the statement and start off your next management meeting with some discussion around it; solicit examples, positive and negative, about its deployment, and try to come up with some suggestions for better communicating the value if it appears there's a problem. Rotate the value under discussion at the next meeting until all have been covered.

6. **See that every employee gets a copy of the statement.**

   If you're in business for yourself, place a hard copy of the values statement near your workspace or at your home office if that's what you use. Don't let it gather dust. For a bigger company, print the values statement on wallet-size cards and don't forget to include it in the annual report. Post it on the company website and make sure it reaches all the stakeholders.

Following through with your values

A values statement can sometimes turn out to be a bit too simplistic, with words that sound good on paper but that are difficult to put to practical use. Worse, some firms simply outsource the creation exercise to an external wordsmith and then smugly declare they are woke. We recently came across a research report by Booz Allen Hamilton, a large consulting firm, and the Aspen Institute that found that a majority of the vision statements they examined used five similar terms: *Integrity, Teamwork, Authenticity, Sense of fun, Customer orientation.* They urged that these be expunged from any such statement, as they smacked of simple follow-the-leader regimentation rather than any sincere effort to unearth and institutionalize the firm's real values.

To make your values statement really useful, you need to take the next step and link your values to basic, sensible rules that employees at all levels in your company can follow. You may want to create an anonymous "online hotline" where employees can express to senior management their own ideas about values and about how your company is fulfilling its stated values, without fear of retribution. You may even get some unanticipated great new insights this way.

TIP

When the time comes to conduct those annual employee performance reviews (you know, the ones that everyone loves to hate), use them as an opportunity to promote your company's values. Bring out a copy of the values statement and ask each employee how well their individual activities reflect the company's values. At the same time, ask yourself whether the incentives and reward systems in your company work toward supporting those values. In fact, if you're really an evangelist, you will tie a portion of that person's compensation to some metric that measures compliance with firm values. Bet that gets attention fast.

Creating Your Company's Vision Statement

REMEMBER

Your company's *vision statement* should be a precise, well-crafted document announcing where your company wants to go and painting a picture of what your company wants to become. To people on the inside and outside of your company, your vision statement is a compass, showing the whole world the direction in which your company is heading.

A vision statement not only points the way to the future, but also makes you want to get up and go there. It represents your company's best hopes and brightest dreams. An insightful corporate vision is much more likely to develop out of a diverse team of hard-working women and men than to spring mysteriously from an inspired moment in the life of a leader.

REMEMBER

The best way to create a meaningful vision statement resembles the best way to create a values statement. Just follow these steps:

1. **Select a small group of dedicated employees from various levels across your company.**

   If your company is small, get the whole gang together. If you're the chief cook and bottle washer all in one, you can represent yourself, perhaps recruiting your significant other (or maybe even Mom . . . OK, not). The more people you involve, the broader the perspective you receive and the better the chances of creating a vision statement that truly reflects your company's future.

2. **Have the group re-read your company's values statement and review the list of stakeholders, both internal and external, who have an interest in your company.**

3. **Begin a verbal free-for-all.**

   Allow everybody to volunteer personal opinions and ideas about the company's future, form, and direction. Start taking down a list and forming it into a cohesive statement.

4. **When the vision team feels comfortable with the results, add the finishing touches to get your vision ready for prime time.**

Although it may be only a couple of sentences or even just a phrase, the vision statement is the compass that provides your company's direction into the future. Spend enough time with your statement to make sure that the north on your company compass truly is north — that it does indeed point in the direction in which you want to go.

REMEMBER

Brush, rinse, repeat? No. As a rule of thumb, you should assume that your vision statement could serve the company for the next decade. But does this mean that you can never change the statement? Again, no; the disruptive times in which we currently exist has put just about everything in flux. But vision statements are not like your underclothes: you should change it only if business conditions truly warrant a new course of action. Keep in mind that the ideas you capture in your company's vision statement aren't meant to be crossed out or rewritten on a whim; they represent the lasting themes that guide your company at any time and under any circumstance.

But only diamonds last forever. If a changing environment throws you an unexpected curve, by all means alter your vision to reflect the new reality. You should craft your statement in such a way that it's flexible to respond to a changing environment. If the words no longer have meaning for your company, they become useless. Again, the company's vision statement is useful only to the extent that it has the power to move your people into the future, and words alone rarely do that. So don't just talk the talk — you also gotta walk the walk.

Money categorizes you. Values define you.

IN THIS CHAPTER

- Putting together a mission statement
- Tying strategic goals to your mission
- Setting goals and objectives that make good business sense

Chapter 4

Charting the Proper Course

In Chapter 3 we show you how to create your vision statement. That exercise is focused on the aspirational aspects of your business. When done right, it allows you to define a future that comes from the heart, inspiring your co-workers as well as customers, suppliers, and just about everyone else in your stakeholder network to act in a manner that reflects the core values of your organization. Now it's time to fire up those brain cells and get down to the specifics of just what you plan to do in the here and now that will bring in the customers and light up the cash register.

This is done through your mission statement. You probably already have a pretty good idea of what you want your business to become. But how do you make your idea a reality? You start by defining the business activities that your company plans to engage in, the goals that you expect to meet, and the ways in which you're going to measure success.

In this chapter, we help you create a basic overview of your company and its activities, and we guide you as you shape your expectations into a mission statement. We introduce business goals and objectives and show you how to use them to measure the results that you expect to achieve. And we help you prepare to set your company's goals and objectives and look at how you can use them to improve the overall efficiency and effectiveness of your future business.

Creating Your Company's Mission Statement

Mission statements originally were associated with religious or military organizations, but they began to catch on with business types when the U.S. government declared a mission to the moon in the 1960s. *Mission Impossible* became a big TV hit around the same time, and viewers began to understand how an explicit description of what an organization did would benefit everyone involved. The public sometimes was (and is) not quite sure of just what a firm does ("Dad. . . is General Dynamics some military guy in Greece?"). Perhaps even company insiders needed a better explanation of just why they were there and what they were expected to do.

More and more companies, in fact, post their mission statements for everyone to see. Some companies put mission statements in their brochures and even on their letterheads. Almost all now include them prominently on company websites. In fact, you can do an online search for the name of almost any business, large or small, using terms like "mission statement," and you're likely to find what you're looking for.

What many companies are finding out is that a mission statement can be a powerful tool to communicate the economic purpose of the business to people both inside and outside the organization. It establishes who you are and what you do.

REMEMBER

To be effective, your mission statement must

- Highlight your company's business activities, including the markets that you serve, the geographic areas you cover, and the products and services you offer.
- Emphasize what your company does that sets it apart from every other business out there.
- Include the major accomplishments that you anticipate achieving over the next few years.
- Convey what you have to say in a clear, concise, informative, and interesting manner (a little inspiration doesn't hurt, either).

Getting started

A mission statement doesn't need to be long. In fact, the shorter it is, the better. Even so, the task of creating one can seem impossibly daunting — the Mount

Everest of business-planning chores, right up there with that vision thing we encounter in Chapter 3. One reason is that a mission statement has to sum up some pretty grand ideas in a few sentences. Another is that writing a mission statement requires business planners to ask themselves some fundamental questions — and come up with solid answers. And don't forget, your mission statement should closely reflect the values and vision you set for your company.

In other words, a mission statement answers the basic questions first posed long ago by the famed business guru Peter Drucker:

> *What business are you in? Who is your customer?*

When you conscientiously create a mission statement, you'll find yourself drilling into the core of your business. Take this example: Home construction toolmaker firms like DeWalt or Makita offer drill bit products to the DIYers who finally gets around to fixing that creaking railing on the back deck. They're the customers, and the business purpose is the manufacture of metal alloy bits for electric drills — right? Nope. What do these weekend warriors really want? A hole! The drill bit itself is merely a means to an end. Perhaps there's a looming new laser technology out there that might get the hole-creation task done more efficiently. And the real customer might be the person demanding that the fix-it job finally gets done. If you see yourself only as a shaper and twister of metal for those with lots of nasty little cuts and scrapes on their hands and arms, you'll likely miss potential competitive threats and focus your marketing efforts on the wrong target.

By understanding the business you're really in and the customer who truly drives the purchase decision, the firm can address its markets and their needs in a way that better informs the realities they face and decisions they make. A good mission statement will capture this.

REMEMBER

A little preparation up front can make the process a bit easier. Ask yourself some background questions as you get ready to work on your company's mission statement. Don't worry if the answers are fairly general at this point, because you're only interested in the basics right now. Research your goals and the practices of the competition and then answer these questions:

- Which customers or groups of customers do you plan to serve?
- What products or services do you plan to provide?
- What needs do you want to satisfy?

- How will your company's products differ from competing offerings?
- What extra value or benefits will customers receive when they choose your company over the competition?

TIP

Need some help? You should enlist managers who are familiar with all the aspects of your business, or if you're a start-up, call in those advisors who've been there before. Follow these steps to begin the process:

1. **Get together a small group of people whose responsibilities cover all the major functions and activities of the company.**

   If you run a small company, include trusted friends, former co-workers, and perhaps even your significant other in this group.

2. **Ask the group members to prepare for the meeting by coming up with their own answers to the background questions we list earlier in this section.**
3. **Review the reasons for having a company mission in the first place, and go over what the mission statement should include.**
4. **Schedule several informal meetings in which group members can present their own perspectives, brainstorm a bit, and begin to form a consensus.**
5. **Create, revise, and review the company's mission statement over as many formal meetings as it takes for everyone to be satisfied with the final product.**

A well-crafted mission statement is clear, concise, and easily understood. You should also make it distinctive (from the competition) and up-to-date (given the company's situation and market dynamics).

WARNING

One rock in the road you have to watch out for is "mission creep." This can occur when the decision-makers forget to stick to the script and get overzealous about what the organization is trying to do, or what they think it can do. As a result, they tack on a little something here, work in a new objective there, and before you know it, end up with a dog's mess of conflicting goals and underfunded initiatives. It's worth installing practices and procedures in your own organization that allow for a systematic review of your mission and whether (or not) it's still guiding your direction. As firms grow and rewards get objectified, some folks in the organization will see opportunities for personal benefit in the scramble for access to scarce resources, no matter how distant the supposed opportunity is from the firm's core. One good opportunity to call out mission creep is at the annual strategic review session (see Chapter 17).

Capturing your business (*in* 50 words or less)

Your company's mission statement has to draw a compelling picture of what your business is all about. We often refer to this picture as creating a *tangible image* of the company. We begin with a first stab at a mission statement:

> *Our [fill-in your product or service] brings unique value to people, wherever they may be.*

Not a bad start. This statement says a little something about geography and a bit about being different. But you're far from done. To work toward communicating the company's activities, accomplishments, and capabilities with more clarity and punch, we suggest expanding the statement as follows:

> *We provide the highest quality [name your product/service] with unmatched value to the global [your product/service] industry, which allows our customers to be leaders in their own fields.*

This statement conveys what the company does (provides the highest-quality products or services), who it serves (the relevant global industry), and what sets it apart from its competitors (unmatched value, which allows customers to lead their own fields). This is a far more compelling mission statement than the earlier version.

TIP

How do real companies go about capturing their purpose clearly and concisely, in 50 words more or less? The following examples provide useful insights. If you want more, just key in "mission statement" after naming an organization, and chances are your search engine will crank it out pronto. We may not agree with the composition of each of these. But after reading this chapter up to here, dear reader, and drawing on your own knowledge of the statements under the microscope, we'll leave it up to you to draw your own conclusions. You even might want to give each a grade, say from one to five with five being the best, and then try to explain to yourself why you awarded that score. Give it a go.

> **American Red Cross** (an international humanitarian organization): *The American Red Cross prevents and alleviates human suffering in the face of emergencies by mobilizing the power of volunteers and the generosity of donors.*
>
> **Google** (leading online search engine firm): *Our company mission is to organize the world's information and make it universally accessible and useful. That's why Search makes it easy to discover a broad range of information from a wide variety of sources. Some information is purely factual, like the height of the Eiffel Tower. For more complex topics, Search is a tool to explore many angles so you can form your own understanding of the world.*

Haas School of Business, University of California-Berkeley: *Our mission is to help extraordinary people achieve great things. At Haas, we live our distinctive culture out loud by embracing our four Defining Leadership Principles: Question the Status Quo, Confidence Without Attitude, Students Always, and Beyond Yourself.*

John Wiley & Sons, Inc. (large international book publisher): *Wiley empowers researchers, learners, universities, and corporations to achieve their goals in an ever-changing world.*

Tesla (global manufacturer of electric vehicles): *Tesla's mission is to the accelerate the world's transition to sustainable energy.*

Walt Disney (diversified entertainment company): *The mission of the Walt Disney Co. is to be one of the world's leading producers and providers of entertainment and information. Using our portfolio of brands to differentiate our content, services, and consumer products, we seek to develop the most creative, innovative, and profitable entertainment experiences and related products in the world.*

MINI MISSION ACCOMPLISHED

You may think that mission statements only represent businesses. But you also can use them for product categories (maybe coming up with one for yourself would be a good way to clarify your personal journey). The best statements not only describe the purpose of the product and what it offers, but they also capture something about the brand image that the product hopes to convey. Consider this statement from MINI Cooper USA — a division of BMW and distributors of one of the cutest cars on the road. It's a tad bit on the wordy side, but it neatly includes both a mission and a message:

> *At MINI, we believe in the short cut, the long cut, and the just because cut. We believe a white contrasting roof makes an ideal canvas for whatever you can imagine. We believe in test drives that cross state lines, giving people a reason to smile when they see us coming, and the grace of being small and mighty. But, perhaps most importantly, we believe that although the distinctive personality of a MINI may not be for everyone — a MINI should be within the financial reach of anyone who has been smitten by it. Which is the reason we've made the price of both the MINI Cooper and MINI Cooper S so accommodating.*
>
> *Rooted in our heritage, our mission is to deliver cars and mobility solutions that heighten city life for customers today and tomorrow. Core to all MINI cars is our unique go-kart feeling, our iconic design, and our creative use of space.*

Nice! Where do we sign?

Introducing Goals and Objectives

Your mission statement is a giant step forward; in it, you articulate the purpose of your company by defining the business that you're in. But the definition is just the beginning. When the world was recently consumed with the COVID-19 pandemic and the need for an effective vaccine was paramount, stating the nature of the mission was the easy part. But actually figuring out, step by step, how to get there and then get the jab into billions of arms was the real trick. It involved carefully formulated goals and objectives by the multitude of actors involved in the effort.

You don't have to be planning how to fight a pandemic to know that goals and objectives are important. If you've ever planned a vacation trip by car, you know that choosing the destination is essential (and often painful, especially if the kids want to go to Disney World, and you want to refresh your knowledge of the bar scene in Key West). But the real work starts when you begin to work out an itinerary, carefully setting up mileage goals and sightseeing objectives so that your summer getaway doesn't turn into another *National Lampoon* sequel. Goals and objectives are vital to successful business planning.

We know you're eager to get going with your business plan. But spare us a few moments up front to introduce some important ideas that you can take advantage of when you begin setting your own goals and objectives.

Why bother?

Who needs goals, anyway? You may be the type who plans a trip by filling the SUV with gas, stopping at the ATM for cash, and flipping a coin as you head out of town and reach the first intersection. Ah, life, adventure, the thrill of the unknown! Why waste time trying to decipher a map when you're just out for the ride? Maybe your approach is fine for a quick getaway break, but for a company, failing to set business goals can lead to more serious consequences — real serious.

WARNING

If your business opportunities are so obvious and so overwhelming that you don't need to define a particular course of action to reach your ultimate destination, you've won the business planner's lottery. Be like the first-in folks with Bitcoin: just get out there and scoop the loot as fast as you can. Such opportunities are relatively rare, however. You're more likely to run into one hazardous crossroad after another in your quest for gold, and a lack of careful planning can be dangerous indeed. Note the following examples:

- Planning blunders have been partly blamed for fiascoes involving certain infamous product introductions, including the Ford Edsel in the 1950s, New Coke in the 1980s, and the Apple Newton PDA in the '90s.

- Motorola ultimately lost more than $5 billion on Iridium, its ill-planned low Earth orbit mobile telephone satellite system. By 2000 the venture was bankrupt.
- In 2004 Google launched Orkut and in 2011 it introduced Google +. These online services were designed to give this innovative firm entry into the highly lucrative social media platform market. But by 2014 Orkut was gone, and in 2019 Google + was pulled, unable to compete against established incumbents like Facebook, Instagram, and Twitter.

REMEMBER

Even the biggest can fail when they don't do the heavy lifting required in business planning. Moreover, just because a company is successful in one sandbox doesn't give it a free pass to play in another. Clearly defined goals and objectives can keep you from deviating down those deceptive rabbit holes, no matter how intriguing they may appear at first glance. Watch where you stray as you might stumble instead. Ouch!

TIP

Setting business goals and objectives provides an important insurance policy for your business: the opportunity to plan a successful course of action and then keep track of your progress. One way to focus your thinking when it comes to goal definition is to use the "SMART" approach. That is, your goals should be *Specific*, *Measurable*, *Attainable*, *Relevant*, and *Time-bound.* This is a nifty little guideline to keep you from running off the track with goal statements that are too broad or so over the top that no one believes in them. Good goal-setting is not simply box-checking by the business planner. It's providing direction for your future.

Goals versus objectives

After you complete a mission statement, your business goals lay out a basic itinerary for achieving your mission. *Goals* are broad business results that your company absolutely commits to attaining.

Goals are typically stated in terms of general business intentions. You may define your company's goals by using phrases such as "becoming the market leader" or "being the low-cost provider of choice." These aims clearly focus the company's activities without being so narrowly defined that they stifle creativity or limit flexibility.

In working toward set goals, your company must be willing to come up with the resources — the money and the people — required to attain the intended results. The goals that you set for your company should ultimately dictate your business

choices throughout your organization and may take years to achieve. Goals should forge an unbreakable link between your company's actions and its mission.

REMEMBER

Simply setting a general goal for your company isn't the end of the story; you also need to spend time thinking about how to get there. So, your company must follow up its goal with a series of *objectives:* operational statements that specify exactly what you must do to reach the goal. You should attach numbers and dates to objectives, which may involve weeks, months, or sometimes even years of effort. Example: *We will achieve sales revenue of $10 million by 2024.* They help you realize when you reach a given objective.

Objectives never stand alone. They flow directly from your mission and your values and vision (see Chapter 3), and outside the context of their larger goals, they have little meaning. In fact, objectives can be downright confusing.

The goal "Improve employee morale," for example, is much too general without specific objectives to back it up. And you can misinterpret the objective "Reduce employee grievances by 35 percent over the coming year" if you state it by itself. (One way to achieve this objective is to terminate some employees and terrorize the rest of the workforce.) When you take the goal and objective together, however, their meanings become clear.

TIP

Want an easy way to keep the difference between goals and objectives straight? Remember the acronym *GOWN:* G for goals, O for objectives, W for words, and N for numbers. For goals, we use words — sketching in the broad picture. For objectives, we use numbers — filling in the specific details. For example, your firm might set a goal of becoming "the perceived quality leader" in its space. But to get there, it might want to define an objective of "reducing errors in the shipping department to less than 1 percent during the next six months." The latter gives specificity to the generic statement of the prior and, as such, provides a concrete guide for action to those charged with getting the job done.

REMEMBER

If you already use different definitions for goals and objectives, don't worry; you're not going crazy. What we do find crazy is the lack of any standard definition of terms when it comes to business planning in all its areas and topics (some firms out there are still trying to differentiate between vision, values, and mission). The important task is to settle on the definitions that you want to use and stick with them in a consistent manner, communicating these clearly to everyone in the organization. You may even want to add in a glossary at the end of your business plan that specifies the key terms used. That way you prevent any unnecessary confusion within your company.

Efficiency versus effectiveness

Talking about goals and objectives provides us with the perfect opportunity to bring up another pair of business terms that people have bandied back and forth for years: *efficiency* and *effectiveness.* The terms were first thrown together in an absolutely captivating business classic, *Functions of the Executive,* written by Chester Barnard back in 1939 (why are you snoring?). Old Chester was president of the New York Telephone Company, and perhaps he had a bit too much time on his hands (monopolies, you know, can lead to that). But he did come up with one useful notion for working with your company's goals and objectives: efficiency versus effectiveness.

We all strive to be both efficient and effective in our individual work, of course. *Effectiveness* is often described as "doing the right thing," whereas *efficiency* is described as "doing things right." President Barnard came up with the idea that you can apply these concepts to a company and its activities.

In this context, effectiveness — doing the right thing — has a great deal to do with choosing the right goals to pursue. For example, consider an imaginary company we'll call Global Gadgets. Its mission statement may emphasize becoming customer-focused and market-driven in all product areas. If Global Gadgets is to be effective, management must set goals that encourage product designers and engineers to be in touch with their customers *first* and to be aware of market demands *before* they start designing and creating new products.

Efficiency — doing things right — is concerned more with how well the company applies resources in pursuit of its goals. To be efficient, Global Gadgets' employees must have objectives that ensure the company can achieve its goals of becoming customer-focused and market-driven. Among other results, these objectives should lead to a proper allocation of the research budget among design, product development, and market testing. Resources are always scarce, and Global Gadgets can't afford to squander them.

REMEMBER

Successful organizations aren't just effective or just efficient. The best companies are both efficient and effective on a consistent basis. They achieve both efficiency and effectiveness by taking goal-setting and the development of clear, measurable objectives seriously in the relentless pursuit of the company's mission. Achieving one without the other is like wearing an attention-getting gorgeous new designer outfit to the company's annual New Year's bash while keeping your bathroom slippers on: The shoes might have been an efficiently quick-and-easy way to dress, but . . . OMG, what?

Minding Your Own Business: Setting Goals and Objectives

Your company's goals and objectives reflect your primary business intentions, and they determine both the itinerary and timetable for getting you there. In other words, your goals and objectives focus the company on the important work at hand and provide a mechanism for measuring your progress.

Goals and objectives are ultimately meant to make your company more efficient and effective. How can you see to it that setting them is also as efficient and effective as it can be? Here are some guidelines to get you started.

Creating your business goals

REMEMBER

Goals serve as the broad business results that your company commits to achieving. To jump-start the process of setting your company's goals, follow this useful set of guidelines:

- Determine who to involve in setting your company's goals. Because goals are the core of your company's business, the group members should include the people who are responsible for all your major business activities. If you're going it alone in business, try to develop a core group of advisers who can meet with you periodically to confirm your goals.
- Develop a procedure for monitoring your company's goals on a routine basis, revising or reworking them as business circumstances change.
- Create individual goals that clarify your company's business activities without limiting flexibility and creativity.
- Confirm that your company's goals, taken together, provide an effective blueprint for achieving your broad business intentions.
- Make sure that your company's stated goals closely comport with your company's mission and vision statements (see both Chapter 3 and the earlier section "Creating Your Company's Mission Statement" for more info). If you spot a contradiction, it's time to revisit one or the other and undertake appropriate action.

Laying out your objectives

Objectives are the statements that fill in the details, specifying exactly how you plan to reach each of your company's goals. As much as possible, you should tie your objectives to cold, hard numbers: the market share percentage you want to achieve or number of new customers you want to serve, the quantified volume of products you want to sell, or the number of revenue dollars you want to generate.

REMEMBER

This set of guidelines provides a useful template when your company starts to develop business objectives:

- Determine who should set business objectives in your company. While overall firm profit objectives might best be reserved for senior management to make, you don't want these same folks alone determining the optimal level of product quality metrics on the shop floor.
- Develop a system for reviewing and managing business objectives throughout your company.
- Make sure that objectives are achievable and verifiable by including numbers and dates where appropriate.
- Create business objectives that can clearly advance and achieve larger company goals.
- Confirm that your company's objectives, taken together, result in an efficient use of resources — money and people — in pursuit of broader business intentions.
- Consider using a formal method, such as management by objectives (MBO), to involve everyone in your company in the continuous process of setting, reviewing, and meeting business objectives. (For more on the ins and outs of MBO, see the nearby sidebar "Management by objectives.")

Matching goals and objectives with your mission

REMEMBER

Repetition builds muscle memory for athletes, which is advantageous when decisions must be instantaneous and wrong ones can result in defeat. Accordingly, we might be saying this over and over, but it's so important that it deserves repeating one more time: Your company's goals and objectives must be intimately bound to your mission and vision statements.

MANAGEMENT BY OBJECTIVES

In 1954, management guru Peter Drucker came up with a novel way to generate and communicate a company's intentions (its mission, goals, and objectives): You simply involve all the employees who have to actually carry them out, giving each her or his own specific list. Not surprisingly, he also coined a term for his method, calling it *management by objectives* (MBO).

MBO turned out to be a wildly successful idea when it was introduced. By the mid-1970s, more than half of the U.S. Fortune 500 companies were using the technique. Granted, not everybody was happy with the process. Some companies balked at the time and effort that it took to set MBO goals and related objectives. Other companies failed to carry out the paperwork that the system requires. Still other companies, basking in an authoritarian regime lodged at the top, found the entire concept of shared decision-making to be just plain weird and the new culture to be too alien. Pity them.

For companies that commit to using it correctly, however, MBO has proven to be a valuable management tool — a process capable of generating new ideas, communicating business intentions, and focusing the company's energy on an agreed-upon set of goals and objectives. Management by objectives works because it involves people themselves fashioning the company's future. Employees commit more to that future because they have a greater stake in the process that gets them there. As you begin to work on your company's goals and objectives, invest some well-spent hours in figuring out ways to bring the spirit of MBO into your collaborative process.

Too many companies simply forget their broad business intentions when they go about the detailed work of setting goals and tying them to measurable objectives. Managers start with what's close at hand. They look at employee activities and behavior, and they come up with incentives and rewards that seem to do the right thing at the time, motivating workers toward specific objectives. But these types of goals and objectives tend to be nearsighted and may be totally out of sync with the larger aims of the company. So yet again, don't let the trees shield the forest in which they reside.

Timing is everything

What's the proper time frame for you to reach your goals and objectives? How far out should your planning horizon be — one year, three years, maybe five? The answer is . . . it depends on the pace and dynamics of your industry. We live today in a world of constant change and disruption; definitely, it can be confusing out there, so do your homework before blindly setting a timeframe for goal achievement.

HOW GOALS CAN KEEP A MISSION ON TRACK

A recent poll by Gallup found that 74 percent of company employees felt they weren't getting enough information and news about their firms, and 40 percent couldn't explain just what it was that their organization did (and as far as we can tell, no spooks from the CIA were surveyed). This is clearly not a good thing — except within our clandestine corps, of course. If your employees feel they're operating in the dark, then there's a good chance that their day-to-day work routines can veer from the broader goals that the firm is pursuing. Let's go back in history for a moment and revisit Cisco Systems in the first decade of this century. As a provider of switches and routers, the network software and hardware "plumbing" used for the booming Internet industry, Cisco rose to the top of the pack and raked in nearly $20 billion in annual revenues by 2000, making it one of the biggest and most successful companies in the world. But in spite of several major advantages, including proprietary products, success was not a slam dunk. In the huge downturn following the dot-com crash in the spring of 2000, Cisco saw many of the customers it served simply disappear. The company managed to stay afloat through rough times by keeping its goals and objectives closely aligned to the company mission statement. Back then Cisco described its mission this way:

> *To shape the future of the Internet by creating unprecedented value and opportunity for our customers, employees, investors, and ecosystem partners.*

Fine words, of course. The challenge, however, was in making progress when budgets tightened and markets shrunk. So to keep everyone's eyes on the prize, the company's CEO offered specifics in the form of strategic business goals:

- To seek out profitable growth opportunities with a target of 20 percent pro forma profit after tax
- To improve productivity, as measured in terms of operating expense as a percentage of revenue
- To maintain a healthy and conservative balance sheet

The language of these goals and objectives may not be as stirring as the mission statement phrases. But they represent the nuts and bolts that made the company's mission a reality. By 2010 Cisco's revenue more than doubled to just a shade less than $40 billion and head count expanded to nearly 70,000. By 2020 the top line was $50 billion and the mission now read:

> *To inspire new possibilities for our customers by reimagining their applications, securing their data, transforming their infrastructure, and empowering their teams.*

While the heady growth trajectory of the past slowed as the industry matured and powerful new competitors like the China-based Huawei began to poach customers away (by using pirated Cisco product source code in some cases), Cisco didn't just fade away as market turbulence grew. It stuck to its guns. In its most recent (2020) Annual Report, the CEO said:

> *"In fiscal 2017, we set a three-year goal for 30% of our revenue to come from software, and while we achieved 29% in fiscal 2020, we did achieve 31% in the fourth quarter. In fiscal 2020, 74% of our software revenue was sold as subscription, exceeding our target of 66%. We also delivered 51% of our revenue from software and services in fiscal 2020, exceeding our target of 50%."*

The firm continues to set specific performance goals that link to purpose, and it conveys results with a transparency visible to all. To Cisco we say, *Bravo!*

Certain industries seem to remain tortoise-like in their pace, at least at some level of analysis. Small boutique furniture makers in the United States, for example, still operate today much the same as they did 50 years ago, with perhaps the addition of an Internet address. Technological change was minimal at best. Consumer tastes for these products have also changed slowly, and the types of materials used and levels of craftsmanship required have stayed pretty much the same. But while the internal dynamics of furniture making might not have shifted too dramatically, the globalization of markets has utterly and totally disrupted the domestic American industry. Reduced transoceanic shipping costs combined with the communications revolution wrought by the Internet upended the industry, as suppliers from Asia entered the market with look-alike products offered at considerably lower price. High Point, North Carolina, was proudly referred to as "the furniture capital of the world," but today many of the large, branded firms that operated there no longer exist; next time you're out shopping for a new sofa or coffee table, try to find something that says "Made in the USA." In the case of this industry, incumbents might be most comfortable devising a business plan for three years or so at most.

Change, however, is perhaps a daily constant for many other industries. Take traditional "bricks-and-mortar" retailing — that is, a physical store where the customer walks in, wanders the aisles and browses the shelves, and is served by a live salesperson. But then came the advent of online suppliers like Amazon.com. At first they took root slowly (the sorcerer from Seattle first entered into the retail book selling industry way back in 1994). But today almost anyone who sells something in a physical store is subject to disruption. In the past, retailers were judged on four key variables: *breadth of available product line*; *convenience of purchasing*; *trust* (which encompassed perceptions of the firm's customer service such as returns policy); and *price.* E-commerce suppliers quickly overtook traditional stores on

three of the four, and when they began to build trust through brand recognition, customer-centric policies like no-hassle free return of goods, and ready access to instant chat with a real person, the traditional businesses were doomed. Clearly, you snooze, you lose in this industry today. Perhaps a one-year time frame for planning, which in fact is little more than the annual budgetary exercise, is appropriate for firms in the retail space who have not yet gone digital — and even that might be too long.

REMEMBER

When dealing with change, business planners have to maintain a balancing act between moving too quickly and not quickly enough. You have to set business goals and follow them up with verifiable objectives, basing time frames on your comfort level with what you expect to happen down the road. Build in some flexibility so you can revisit your goals and objectives and account for the changes you see; perhaps lease equipment rather than make an outright purchase or hire temps until you get your footings. Stay agile. And stay tuned. We discuss this topic more thoroughly in Chapter 13.

2 Describing Your Marketplace

IN THIS PART . . .

We help you scan the business environment and determine the best fit for your business. We take a hard look at your industry to see what it takes for you to be successful, and we get you prepared for business opportunities and threats that come your way.

We look at how you can divide your customers into groups with similar needs and wants so that you find it easier to identify and communicate with them.

We spend time talking about ways to get better acquainted with your customers — figuring out what motivates them, how they make choices, and what makes them keep coming back.

Finally, we talk about your competitors — who they are, what they're up to, and how you can plan to compete against them and win.

IN THIS CHAPTER

- Defining the business that you're in
- Taking a closer look at your industry
- Finding out where to turn for information
- Knowing the keys to success
- Watching out for business opportunities and threats

Chapter 5

Examining the Business Environment

One of the most important questions you can ask yourself as you prepare to create a business plan is "What business am I really in?" The question may sound simple, even trivial, which is precisely the reason why businesspeople too often ignore it. However, if you can answer this basic question correctly, you take the first giant step toward creating an effective business plan.

Remember when crisscrossing the United States on trains, with their elegant dining cars, two-level Pullman cars, and smoking lounges, was commonplace? Probably not. But you can still catch an old movie and become a bit nostalgic for a long-lost era (except for that smoking part). Railroad companies in the 1930s, '40s, and '50s thought that they knew exactly what business they were in: the railroad business, duh. The question was a no-brainer. As it turned out, however, passengers thought in more general terms: effective and efficient transportation. Railroad companies soon found competition in the form of interstate highways, General Motors and the Ford Motor Company, American Airlines, and airports. The forces that drove the choo-choo business extended well beyond rails. The railroad companies didn't see the big picture — one business guru cleverly termed their problem "marketing myopia" — and they never regained their former glory.

The market, like the house in Las Vegas (or for that matter Atlantic City, Macao, or Monte Carlo), always wins. Always. So defog those glasses. In this chapter, we show you how to begin a systematic analysis of just how your market and chosen industry works. We analyze your industry, search for critical success factors, and then give you some pointers on preparing for the opportunities and threats that loom on the horizon. You're not going to be able to predict the future, but we bet you'll be much better prepared to deal with your hand no matter how the cards play out.

Understanding Your Business

REMEMBER

Okay, so what business are you *really* in? Don't say that you're in the widget business, if widgets are what you produce; go beyond the easy answer you base simply on what you do or what you make. You have to dig a bit deeper and ask yourself what makes your marketplace tick:

- What basic needs do you fulfill?
- What underlying forces are at work?
- What role does your company play?

We say more about the shortsightedness of leadership in Chapter 17 and frame some ways to prevent you from falling into similar traps. First, though, we want to make sure that your company isn't like the railroads by understanding the underlying forces that shape your business environment. Start by analyzing your industry. (For a closer look at your customers, check out Chapters 6 and 7. The competition gets the once-over in Chapter 8. And — just love those new specs — we have you take a closer look at your company in Chapters 9 and 10.)

EASTMAN KODAK: A TEARDROP TRIP DOWN MEMORY LANE

The Kodak story is old by now, but its lessons are timeless — especially if you want to avoid disaster. Founded in Rochester, New York, way back in 1880 by the entrepreneur George Eastman, Eastman Kodak quickly established itself as the leader in amateur still photography, selling cameras and film to the world and developing the prints that you stuffed into albums, drawers, boxes, and entire closets. Where did the company make its money? Cameras were only marginally profitable, but Kodak wanted people to have cameras so that it could make money on film and even more money on developing that film.

In fact, Kodak had always reaped huge profits from the processing of film. The company manufactured all its own photographic chemicals and coated papers, and it owned the processing labs. Eventually, Kodak came to think of itself as being in the *chemical imaging* business — they announced this to their stock analysts and anyone else who would listen. While Kodak's executives and managers were busy patting one another on the back and cashing bonus checks, new competitors — and new technologies — began to enter the picture.

As it turned out, customers weren't exactly interested in chemical images for their own sake. Nobody had a deep-seated desire for chemically coated paper or clamored for the bulk photographic chemicals that Kodak produced so well. People wanted *memories*, nothing more. They wanted to capture special moments and save them forever. Kodak was really in the memories business. And new ways of saving memories were just around the corner.

Weirdly, an engineer at Kodak's world-class labs came up with the first digital still camera, in 1975. But this wasn't a chemistry-based product, and the powers that be in Rochester passed. More prescient firms saw the future.

First, in 1981 Sony introduced the Mavica (magnetic video camera) to the world. Suddenly, memories were made of electrons, not chemicals. The digital camera revolution soon went viral. By 2004, Kodak finally recognized the full impact of the train wreck overtaking them. They abandoned their traditional camera markets in North America and Europe to concentrate on digital technology. But alas, too little, too late. Kodak filed for bankruptcy in 2012, abandoned the camera business, and today provides packaging, functional printing, graphic communications, and professional services to the world. Memories? Perhaps nightmares are more like it.

Analyzing Your Industry

No business operates alone. No matter what kind of business you're in, you're affected by forces around you that you must recognize, plan for, and deal with to be successful over the long haul. Ivory-tower types often call this process *industry analysis.* You may have the urge to run the other way when the word *analysis* pops up (or perhaps think about your mother). We don't want to sugarcoat this step, but we try to make the process as painless as possible.

How much do you already know? Take a moment to complete the Industry Analysis Questionnaire (see Figure 5-1). If you're unsure about an answer, check the ? box.

Industry Analysis Questionnaire

Number of competitors in your industry:	☐ Many	☐ Some	☐ Few	☐ ?
Your industry is dominated by several large firms:	☐ Yes	☐ No		☐ ?
The combined market share of the three largest companies in your industry is:	☐ <40%	☐ In between	☐ >80%	☐ ?
Digital technologies have become routine in your industry:	☐ 1 year	☐ 3 years	☐ 5+ years	☐ ?
New technologies change the way your industry does business every:	☐ 1 year	☐ 3 years	☐ 5+ years	☐ ?
The barriers that stop new competitors from entering your industry are:	☐ High	☐ Medium	☐ Low	☐ ?
The barriers that prevent competitors from getting out of your industry are:	☐ High	☐ Medium	☐ Low	☐ ?
Overall market demand in your industry is:	☐ Growing	☐ Stable	☐ Declining	☐ ?
There's a large, untapped market that your industry can take advantage of:	☐ Yes	☐ Maybe	☐ No	☐ ?
There are foreign firms who currently compete in your industry:	☐ Yes	☐ Maybe	☐ No	☐ ?
Your industry offers a selection of features and options in its product lines that is:	☐ Extensive	☐ Average	☐ Limited	☐ ?
Customers buy products in your industry based almost entirely on price:	☐ Yes	☐ No		☐ ?
Customers can find other alternatives to take the place of your industry's products:	☐ Easily	☐ With difficulty	☐ No	☐ ?
Suppliers to your industry have a lot of influence when it comes to setting terms:	☐ Yes	☐ No		☐ ?
Customers have a lot of bargaining power when buying your industry's products:	☐ Yes	☐ No		☐ ?
Distributors have a lot of power and play a major role in your industry:	☐ Yes	☐ No		☐ ?
Overall costs in your industry have been:	☐ Declining	☐ Stable	☐ Rising	☐ ?
Profit margins in your industry are:	☐ Strong	☐ Average	☐ Weak	☐ ?

FIGURE 5-1: The Industry Analysis Questionnaire.

Your answers provide a snapshot of what you think you know. The question boxes that you check highlight the areas that need a closer look. In any case, now you can roll up your sleeves and take a serious poke at completing your industry analysis.

The good news is that many smart people have already worked hard at analyzing all sorts of industries. Although no two businesses are exactly the same, basic forces seem to be at work across many industries (see Figure 5-2).

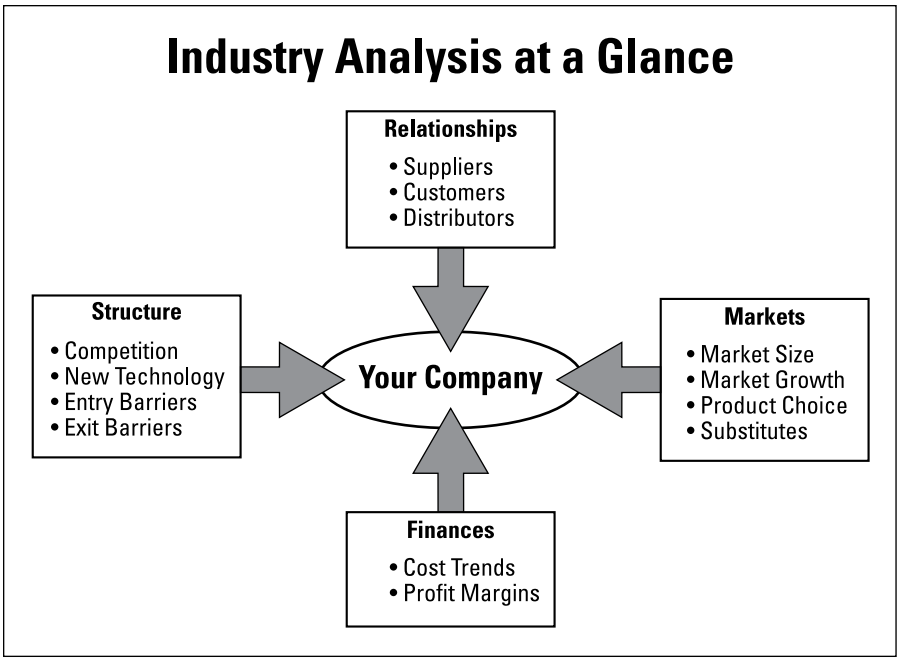

FIGURE 5-2: The four major components of analyzing an industry.

The following sections describe the most important of these forces — those factors in your industry — and provide some hints on how you can think about these forces in terms of your business planning.

Configuring the structure

Every industry, from auto manufacturers to zucchini farmers and everything in between, has a unique shape and structure. Here are a few tips on how to recognize the particular structure of your industry.

Taking stock of your rivals

The number of competitors, taken by itself, has a major impact on the shape of an industry. This is referred to as *industry structure.* An industry can be a *monopoly* (one monster company with no significant competitors), an *oligopoly* (a small number of strong competitors who collectively dominate), a *monopsony* (many competitors but only one buyer), or a *polyopoly* (many viable competitors with no one overly dominant). This last term is rarely invoked, but we figure that you could use a word to represent the vast majority of industries out there, probably yours as well (and besides, it'll make you look that much smarter to your colleagues, who are admiring how well you create your business plan). In addition to

the number of competitors, you should check out how many of the companies are big and how many are small, as well as how they carve up the various markets that they compete in.

TIP

Make a list of all the major competitors in your industry, sometimes referred to as *incumbents* by the pointy-head crowd. Find out their sizes, based on revenue, profits, active users, production capacity, or some other readily available measure, and estimate their relative market shares for the markets that you want to explore. Try to get beyond just revenue numbers, as most industries have some telling metric specific to the industry that is more indicative of performance. For example, brick-and-mortar retailers are measured by sales per square foot, because in the end all they're offering is space. Carefully choose keywords to take advantage of the extraordinary range of information on the Internet to gather as much data as you can find.

Examining technology

Changing technology drives many industries. Just consider digital to start with. Look both at how much and how fast things change in your own business. Although you don't need to become a rocket scientist, you should feel comfortable with the underlying technological issues that fuel the change around you. You should also find out who owns or controls the technologies, especially IT, and how easily you can obtain them in a legal and ethical manner.

TIP

Identify current technology, obsolete technologies, and potential future technology in your industry. How long were old technologies around before they were replaced? Try to predict when new technology may become important to your business, keeping in mind that globalization and the communications revolution have put everything on hyper speed. At the same time, try to keep track of any copyrights, patent protection, or special expertise that could influence the adoption of a new technology. A little digging around in the web, business magazines and journals, or specialized information sources can be a big help here. Don't forget to tap into your advisory friends either; they can be lifesavers.

Overcoming barriers

The "table fees" that make it more or less difficult for new competitors to join the game are referred to as *entry barriers.* Some of these barriers are obvious — high capital costs (a lot of money needed up front), for example, to build *economies of scale.* In this case, the bigger you are, the lower your costs and, thus, more attractive to customers — all of which can discourage brand-new competitors by pricing them out. Other barriers are easy to miss, such as complex distribution systems that make it hard to reach customers without going through expensive gatekeepers. Try writing the Great New American Novel and getting it turned into a real

book easily available to readers, without having to go through agents and their contacts (but wait, isn't Amazon . . .?). Strong customer loyalty, long-term contracts, or a buyer's costs associated with switching suppliers can also create formidable barriers for the new kids on the block.

As you think about your business, list the entry barriers that you think stand in the way of new competitors: for example, deeply entrenched incumbents in the industry, capital costs, distribution, access to raw materials, new technology, scale economies, regulation, patents, and switching costs. (Whew! Still with us?) Rank these barriers based on how impenetrable you find them. On which side of each barrier do you stand? Be realistic, but keep in mind that there were many obstacles that entrepreneurs like Steve Jobs, Elon Musk, and Jeff Bezos also encountered and overcame. Finish this book, and maybe you can, too!

Cashing out

Sometimes it can be hard to leave a casino, even when you really want to. How difficult is it for companies in an industry to get out of the market if they want to? The ties and attachments that keep competitors around are called *exit barriers.* Exit barriers can include everything from expensive factories or specialized equipment that companies can't easily unload, to labor contracts with unfunded pension obligations for terminated workers, extended customer leases, service agreements, and government regulations. The problem is that firms with high exit barriers often do anything to stay alive, even if that means cutting prices and, thus, decreasing profit margins for everyone else — including potential new entrants.

Find out how many companies have left your industry over the past five years or so. Try to figure out why they got out of the market and what sort of difficulties they ran into as they made their way to the exits. How many of them left voluntarily, and how many were shown the door, penniless and in tatters? Spend some time scrolling through the pages of business blogs, magazines, and journals — they offer plenty of useful insights.

Measuring the markets

Competition comes down to customers, and customers make up markets. Ideally, the customers you intend to target represent a market that you feel is ripe for new goods or services. Some call this your *addressable* market. The following tips help you judge for yourself.

Just how big is big?

The size of a market tells you a lot about what's likely to happen to it over time, especially when it comes to competition. Large markets, for example, are always

big news and can't help but attract the attention of strong competitors. Smaller markets don't get the same spotlight, however, and because competitors can easily overlook them, they often represent business opportunities for the little guy — giving you lead time to get up and running before someone's radar spots you. You hit the real jackpot if you can turn a small market into a bigger market by discovering a *usage gap* — finding a new use for your product or service that no other company has thought of before.

TIP

Try to work out some estimates of the overall size of your market based on current usage patterns. While you're on this subject, try your luck at coming up with novel approaches or applications that have the potential to redefine your market. This applies to more than WD-40 and baking soda, by the way. In the 1980s AM General Corporation was given a Pentagon contract to manufacture a new troop and cargo vehicle designated the High Mobility Multipurpose Wheeled Vehicle, HMMWV — or a "Humvee" as real people called it. After these vehicles were deployed in large volumes in the Gulf War of the early 1990s, some macho show-biz types took a shine to them and requested street-legal versions. Soon thereafter, AM was retailing Hummers to the public, and by 1999 General Motors had bought the brand and offered it through its vast dealership network. Other more sedate versions followed from competitors as the high-end SUV market took off; many were inspired by the look and feel of the Hummer.

Make some market projections based on the new uses that you're thinking about. You might also want to check out Chapter 15, where we explain the "product life cycle" concept and how demand shifts over time as market penetration evolves.

Growing or shrinking?

If large markets are good news, rapidly growing markets are great news, and competitors are going to circle like buzzards after the kill. A growing market offers the best odds for new players to gain a foothold and successfully join the existing competition. As for shrinking markets, you can bet that the old lions guarding the den will become leaner, meaner, and fiercer. (BTW, why would you want to chase declining demand?) As markets change size in either direction, the intensity of competition is likely to heat up.

Identify changes in the size of your market over the past three to five years, in terms of both units sold and revenue generated. If the market is changing rapidly in either direction, look for opportunities and try to predict the likely effect on both the numbers and the intensity of the competition. The Internet and other sources of business news are good places to start gathering data. Also try talking to customers, suppliers, and even other competitors in the market.

What choices do customers have?

A quick survey of the similarities and differences among products or services in a market measures something called *product differentiation.* If each product looks pretty much like every other product (think sugar or drywall), you can bet that price is important to customers in what's known as a *commodities marketplace.* On the other hand, if each product is different and offers customers something unique or special — from credit card terms and benefits to RVs — product features are likely to determine long-term success or failure in the market.

Take a hard look at the products or services that the top three competitors in your market offer. How similar are they? In what ways are they unique? Think about what you can do to differentiate your product — adding special features or offering value-added services — so you can compete in ways beyond simply raising or lowering your price. If price is your only differentiator, it's often a race to the bottom — any fool can come along and slide in under you, forcing you to match or walk.

Today you can "showroom" or "webroom" just about any product to obtain valuable competitor information:

- *Showrooming* means going into a physical store, using your smartphone to snap a picture of a product's ID or other details on the label, and then Googling this to see what comes up. Online retailers typically will show competing products ("maybe you will like these instead!").
- *Webrooming* is the opposite: first capturing the product details from the web and then marching off to the store to see what it's like in its physical rather than virtual configuration.

REMEMBER

Either way, the customer's going to know, so don't think you can hide something out there. You can't compete with deceit.

What about something altogether different?

Every once in a while, a completely new type of product or service suddenly makes a debut in a market, crashing the party so to speak. The product often comes out of another industry and may even be based on a different technology. The new product becomes an overnight rival for the affections of existing customers — the rise of email to challenge fax machines, for example, or the proliferation of digital cameras to overtake film-based versions, or the social media platform TikTok offering users an easy means to post 30-second videos on their site. The threat of *product substitution* — new products taking over existing ones — is real, especially in fast-changing, highly competitive markets that are vulnerable to disruption, and what market isn't today?

If you're on the receiving end of substitution effects, you'll want to consider how to hang on to those customers you already have. What barriers can you erect to keep them loyal? What new benefits might you offer? Look at what the legacy airline firms did when cheap low-frill competitors flew in: They came up with frequent flyer programs, with nontransferable miles, to raise the cost of switching airlines.

Think about what your customers did 5, 10, or maybe even 20 years ago (if you're a tad bit on the gray side of life). Did they use your product or a similar one back then, or did a completely different kind of service or product serve their needs? Think about sitting in a stuffy classroom taking notes — and then Zooming in on your laptop while sitting at home for an online educational experience. What about 1, 5, or 10 years from now? What types of products or services may satisfy your customers' needs then? How, for example, might artificial intelligence (AI) or augmented reality influence your business or market? Put on that thinking cap and let 'er rip; although you can't predict the future, you can envision possibilities.

Remembering the relationships

Business, like the Internet, is all about connections. Connections aren't just a matter of who you know — they involve who supplies your raw materials, distributes your product, and touts your services. Connections are about who your customers are and what kind of relationship you have with them. Social media influencers have realized this for years now, with the savvier ones bulking up their bank accounts as a result. A few tips can help you spot the key connections on which your business depends.

Recognizing supply and demand

One obvious way to think about products and services is how a company puts them together. Every company relies on outside suppliers at some stage of the assembly process, whether for basic supplies and raw materials or for entire finished components of the product itself. This applies even to such industries as online punditry. That brilliant gal whose newsletter you subscribe to seems to know everything going on in your industry. Is she really that omniscient, or does she have a really deep network of sources that keeps her up to date? When outside suppliers enter the picture, the nature of what they supply — the availability, complexity, and importance of that product or service to the company — often determines how much control they have over the terms of their relationship with a company. That means everything from prices and credit terms to delivery schedules.

The recent COVID-19 global pandemic made many firms acutely aware of their dependence on good supply chain management policies and procedures. The crisis shuttered factories and stopped output the world over. Lacking a component for installation at the assembly line meant that product couldn't be shipped. And for the final retailer, an unshipped product is one that's out of stock on the shelf — that is, a lost sale when the customer called.

It should be no surprise that many firms today are rethinking how they can build *resiliency* into their supply chains to overcome these potential bottleneck problems. Think about your own suppliers, be they insiders with intimate knowledge of industry events or providers of key components necessary for production. Are any of them in a position to limit your access or to raise prices on you? Might one suddenly disappear, and if so, can you turn to alternative sources? Can you form alliances with key suppliers or enter into long-term contracts that turn transactions into relationships? Are any of your suppliers capable of doing what you do, perhaps transforming themselves into competitors? How can you protect yourself?

Keeping customers happy

You've probably heard the expression "It's a buyers' market." As an industry becomes more competitive, the balance of power naturally tends to shift toward the customer. Because they have a growing number of products to choose among, customers can afford to be finicky. As they shop around, customers make demands that often pressure businesses to lower prices, expand service, and develop new product features. A few large customers have even greater leverage as they negotiate favorable terms.

The last time that you or your competitors adjusted prices, did you raise or lower them? If you lowered prices, competitive pressures no doubt are going to force you to lower them again at some point, especially if you're in one of those commodity-type markets. Think about other ways in which you can compete. Perhaps you can upgrade your customer-service policies, offering an on-time/every-time/in-full guarantee for delivery of orders. If you raised prices, how much resistance did you encounter? Given higher prices, did you inadvertently tempt customers to do what you do for themselves, eliminating the need for your product or service altogether?

REMEMBER

A penny saved is a penny earned. But a penny lost is a penny burned. Don't mistakenly give your customer the match book.

Delivering the sale

No matter how excited customers get about a product or service, they can't buy it unless they can find it on the Internet, in a store, through a catalog, or at their front doors. *Distribution systems* see to it that products get to the customers. A

distribution channel refers to the particular path that a product takes — including wholesalers and anyone else in the middle — before it arrives in the hands of the final customer. The longer the supply chain, the more power the channel has when it comes to controlling prices and terms. But those chains are now being twisted tighter and tighter, into much shorter lengths.

Collapsing the channel was made possible by the digital revolution. The companies at the end of the chain have the greatest control because they have direct access to the customer and the data associated with that person: contact information, specific product preferences, and a slew of ancillary knowledge that can be used for more accurate and cost-efficient marketing (see Chapter 6 for more on this). Think about what alternatives you have in distributing your product or service. What distribution channels seem to be most effective? Who has the power in these channels, and how is that power likely to shift? The D2C route — direct to consumer — has become not only popular with customers but also more profitable for the suppliers, because the midpoint handlers are eliminated and the supplier itself now owns customer data.

Try to think of some ways to snuggle up close to your customers so nothing will be lost in translation and the cost savings that come from eliminating the intermediate stops can be passed on as your gift to them. Don't abuse the knowledge that your newly minted customer data provides you. It's just not right. But when used conscientiously and skillfully, chances are that most customers will be thrilled.

Figuring out the finances

Successful business planning depends on you making sense of dollars-and-cents issues. What are the costs of doing business? What is the potential for profit? Understanding cost and profit behavior is fundamental to knowing how to compete in your industry. The following tips can help get you started.

The cost side

With a little effort, you can break down the overall cost of doing business into the various stages of producing a product or service, from raw material and fabrication costs to product assembly, distribution, marketing, and post-sale service expenses. This cost profile often is quite similar for companies competing in the same industry. You can get a handle on how one firm gains a cost advantage by identifying where the bulk of the costs occur in the business and then looking at ways to reduce those costs.

Economies of scale usually come into play when major costs are fixed up front (think of large manufacturing plants or expensive machinery, for example). Increasing the number of products sold automatically reduces the individual cost

of each unit, because you don't need to purchase a new machine each time you turn out a new product — that machine's cost is spread out over more and more products. *Experience curves* or *learning curves* refer to the potential for lower costs that result from the repetition of methods during the production process. The more you do, the more experienced and knowledgeable you become and the faster you get — that is, learning by doing.

Size matters in these kinds of industries, as the race often goes to the swiftest — that is, the firm that can get big before others and, thus, more efficient in its use of fixed cost inputs. This provides it a distinct competitive advantage and, in fact, is one major reason that anti-monopoly laws were put in place.

TIP

Separate your business into its various stages from A to Z, and ask yourself where the bulk of the costs occur in your company. Can you take any obvious actions to reduce these costs immediately or over time? How does the doubling of sales affect your unit costs? How are your competitors toying with new cost-saving ideas?

The profit drivers

Companies typically have their own rules of thumb when it comes to expected *profit margins* — how much money they expect to end up with after they subtract all the costs, divided by all the money that they expect to take in. In certain industries, these profit margins remain fairly constant year after year, as demand is more or less predictable. Consider a local power generating utility: Demand for electricity is a function of the number of households and businesses in the region, and the numbers of these typically go up or down in slow patterns of movement. A look at the history of other industries, however, points to more volatile profitability. These cycles often reflect highly fluctuating demand, such as the market for luxury goods like fine jewelry or high-end sports cars. Profit will depend on how much of a product or service an industry sells and delivers compared to the cost and available capacity of production that's been built up. You want to be able to predict demand as accurately as possible. (See Chapter 10 about profits and costs and how to get more of one and less of the other.)

Knowing where an industry stands along the cycles of consumer demand and cost, as well as the direction in which the industry is heading, tells you a lot about the competitive pressures that may lie ahead. Ideally, you want to find yourself in an industry with predictable demand and without much excess capacity — now or in the near future. Try to answer the following questions:

- Is your industry one that has well-known business cycles?
- Traditionally, how long are the business cycles?
- If you've been in business for a while, have your profit margins changed significantly in recent years?

- What direction do profits appear to be heading in?
- Do you think that these changes in profitability may affect the number of competitors you face or the intensity of the competition over the next one to three years?

Don't stop with our list here. No doubt we've missed some industry forces that may be important and perhaps unique to your business situation. Are labor costs spiraling upward due to a spike in demand and a shortage of qualified workers? Spend a little extra time and creative effort on coming up with other forces as you work on your own industry analysis.

After you give some thought to the many forces at work in your industry, put together a word portrait of your industry — you probably know a lot more than you imagine about what's going on but have never systematically put it down in writing.

TIP

A template that will be useful is the "Porter Five-Forces Model," named after the professor who first created it. The model provides a useful structure for putting together an industry analysis. Google it, and you'll be rewarded immediately with an abundance of sites that demonstrate its application (some in excruciating academic detail — avoid those, as in reality the model is a powerful but fairly simple concept). Here are a few websites to give you a sense of what the model is about (as well as the original article itself); enjoy!

- https://hbr.org/1979/03/how-competitive-forces-shape-strategy
- www.lucidchart.com/blog/what-is-strategy
- www.mindtools.com/pages/article/newTMC_08.htm

Coming up with supporting data

In most cases you'll likely need current data to support your take on how various industry forces shape your business environment. You may find it difficult, however, to get your hands on the right pieces of information to explain what makes your industry tick.

Sometimes you may come up empty-handed because your business proposition is so new that no one has collected the data you need, or perhaps companies aren't willing to part with it because they don't want outsiders (including potential competitors like you) to analyze the industry too carefully.

Most of the time, however, too much data is available, and the problem becomes knowing where to turn first for the information you need, so you don't have to invest a ton of effort separating wheat from chaff. Here are some details on how to shuck useful information about your industry without becoming overwhelmed.

TIP

The recent explosion of business- and industry-related data has given us a surfeit of riches. By taking advantage of web-based services designed to search for information that you can actually use, you'll shorten the time necessary to put together a suitable industry analysis. But don't overlook those old-fashioned tools like libraries either, or (as they're now called) SMEs — subject matter experts. Here are some starters to get you going, but keep in mind that the list changes faster than the weather in Chicago. (Whoops, just fact-checked this on the web — the Windy City didn't even rate in the top ten. Rapid City, South Dakota, actually has the most unpredictable weather. Wow, this web stuff is dope!) Start your search here:

- **Resources on the web:** The first place to start for most industry sleuthing is the Internet. Just key in the name of your industry, press Enter, and see what happens. The more specific your wording, the closer you'll get to what you need. Many searches will lead you to sites that collect data for a wide variety of businesses, allowing for a more detailed hunt. Just a couple of the many out there: `www.statista.com` and `www.numerator.com` are market research firms that track and report on many organizations. Most of these sources provide some free data but will want to charge for a deeper dive. For the latter, be sure you exhaust the *gratis* sites before taking the plunge.
- **Online data providers:** A growing number of companies specialize in providing proprietary business- and industry-related data at your fingertips. Standard & Poor's Industry Surveys (`www.loc.gov/rr/business//company/industry_surveys.html`), D&B Hoovers (`www.hoovers.com`), and Dun & Bradstreet Reports (`www.dnb.com`) are all available on the Internet. The information usually isn't free, but it may be worth the investment. To cut the cost, look for first-time user offers or special promotions.
- **Government sources:** Government agencies at all levels provide a wealth of data free for the asking, and you can find a good deal of it on the Internet. At the Federal level, check out the Securities & Exchange Commission (`www.sec.gov`), the Department of Commerce (`www.doc.gov`), the Federal Trade Commission (`www.ftc.gov`), the Justice Department (`www.usdoj.gov`), and other regulatory agencies. Don't forget that these larger departments have smaller, more focused units; Commerce, for example, houses the Census Bureau, which is a treasure trove of demographic data (`https://data.census.gov/cedsci/`). More locally, consult your state, county, or city website for business info closer to your backyard. (For just one example, the California State Association of Counties provides economic and related info at

no cost to users: `www.counties.org/data-and-research`.) Finally, data collection isn't limited to the United States. You may need to click the translate feature of your search engine, *oui,* but it can be worth the effort. (However, you better first brush up on those tricky meters and kilos.)

- **Trade associations:** Many industries support trade groups that keep track of what goes on in their world. General business organizations, such as the chamber of commerce in your area, can also be quite useful in providing relevant information.
- **Libraries:** Business-school libraries are the best source of info, but public libraries also house numerous business periodicals and books, as well as hard-to-find academic references, industry newsletters, and even the annual reports of large corporations. In particular, check out the *Dun & Bradstreet Industry Handbook,* the *Encyclopedia of Global Industries,* the *Handbook of North American Industry,* or the *Encyclopedia of Emerging Industries,* just to name a few useful resources. Those dedicated folks who work there will love to see a live person again.
- **Securities firms:** Every major securities company — Schwab, Morgan Stanley, Merrill Lynch, Wells Fargo, whatever — has a research arm devoted to tracking various industries and their incumbents. The trick is to get your hands on the information. You may have to become a client in order to have access to their information, but it's often incredibly detailed and forecasts prospects for the future. (Maybe ask old Gramps for the account password.)
- **Colleges and universities:** In addition to offering library resources, business schools often offer flesh-and-blood business experts. These people are paid to analyze, and every once in a while, they come up with a valuable insight or a really good idea. If you run across an expert in your industry, pay them a visit.
- **Direct industry data and contacts:** Go right to the source, if you can. All public companies in the United States are required to file comprehensive information on a timely basis with the SEC and other oversight agencies. Both annual and quarterly reports are in the public domain and freely accessible on the web. Start with the target firm's website, which usually has a link to required financial reports and a tab for "news" that's up to date. You can also find information at industry conventions and trade shows or through your advisory network, who might have insider knowledge of the firm. Finally, don't hesitate to make a direct contact to the company's PR department and see whether you can interview someone or take a factory tour. But probably best not to bring the camera.

Recognizing Critical Success Factors

Time spent doing careful industry analysis rewards you with a complete picture of the major forces at work in your business: the basic structure of your industry; your core markets; key relationships with suppliers, customers, and distributors; and profit margins and costs. The analysis can also point out trends in your industry and show you where your company is in terms of general industry and business cycles.

This information is all well and good. But how do you go about interpreting your industry landscape so that you can use it to improve your business planning? Just for fun, think about your industry as a great whitewater river. Imagine the many forces that you reviewed in the previous section as being the swift currents, dangerous rapids, haystacks, and even whirlpools in that river. You're in the company canoe. You have to do more than just point out these features and paddle merrily along; you have to navigate around the hazards. As any whitewater expert can tell you, this means figuring out what needs to be done at every turn — what special skills, resources, and lines of communication need to be in place for you to survive and conquer each stretch of river. And think of this book as your paddle.

REMEMBER

Once you're safely back on dry land, take a fresh look at your industry analysis. Ask yourself what your company must do to succeed in the face of each powerful force that you identify. Again, what special skills, organizational resources, and capabilities need to be in place for you to stay upright and survive? In the business world, these assets are known as *critical success factors* (CSFs), though some call them KPIs or *key performance indicators,* which are the specific metrics that define achievement of the CSFs. (They mean essentially the same thing, however.) Critical success factors are the fundamental conditions that you absolutely, positively have to satisfy if you want to win in the marketplace. These factors are different for every industry because they depend so directly on the particular forces that work in each industry.

The CSFs for your company should be rather specific — a one-of-a-kind set of conditions based on your industry analysis and the forces that you see shaping your business. You probably don't want to single out more than three or four CSFs at any one time. But no matter how many factors you believe are important, your CSFs are likely to fall into several general categories that you can identify ahead of time. In the following sections, we provide a starting point for creating your own CSF priorities.

Adopting new technologies, procedures, and policies

When digital commerce began to blossom in the early 2000s, it quickly became apparent that many retailers had to adopt this technology if they wanted to remain competitive. User-friendly digital capability became a CSF for industry incumbents. When reduced trade barriers led to the globalization of production, factories located in low-wage countries began to flood their products into advanced economies. If you couldn't shift your own manufacturing abroad ("offshoring") or get your workers to accept massive wage cuts (called "union busting"), you perished. These industry tectonics affected small businesses as well as large and challenged CSFs that had defined them in the past.

Getting a handle on what counts most

For manufactured commodity products such as steel or oil, large-scale mills or refineries are often the critical factors that lead to low-cost production and the capability to compete on price due to economies of scale. (For more information on economies of scale, refer to the earlier section "Overcoming barriers.") Employees are becoming little more than appendages to automated machines in factories. In high-tech industries, on the other hand, victory in the "talent wars" may be the critical ingredient that allows for the creation of hot new products that keep the cash register ringing. Ditto for firms in investment banking or management consulting. Different industries have different CSF priorities. It's usually a lot more complicated than "buy low, sell high." Do you know yours? Keep reading for clues on how to find out.

Determining what drives your business

The long-term success of entertainment companies that consistently produce big (or these days little) screen hits and make money often hinges on organizational capabilities — the know-how to evaluate, organize, and manage site scouts, set designers and workers, production companies, as well as the media and distribution outlets that exhibit the last cut. And this says nothing of handling the fragile egos of the on- and off-screen creative talent.

In the health-care financing industry — a major subset of the nation's largest business sector — goal achievement often stems from excelling in data management, efficiently steering hospitals and clinics, doctors, patients, medical suppliers, drugs, and insurance claims through a dysfunctional travesty masquerading as the health-care billing and reimbursement system.

Been to a casino lately? How do they make money? Not from the poker tables or that big spinning Wheel of Fortune. Those are for show. Profit comes primarily from keeping customers glued to their seats in front of the slots, where the odds are decidedly in the house's favor. Come up with a trick to keep 'em glued down, such as having an hourly big prize paid to one randomly selected machine, and they'll sit for hours in fear that the moment they move someone else will jump in and hit the jackpot on "their" seat. Seriously.

Looking for a great location

Supermarkets, retail drug stores, gas stations (remember when they were called "service" stations?) — it's often the location of the business that spells success. Wonder why Pittsburgh was once the "steel capital" of America? Its location on rivers and roads provided ready and reasonably cheap access to the key raw materials that had to be hauled to the mills for conversion into iron and steel. If you're interested in starting an outdoor entertainment venue, you might want to look into property around Orlando before trekking off to Buffalo. We think you see the drift here.

Dealing with distribution

Packaged foods, household products, snacks, and beverages often sink or swim depending on how much shelf space the supermarkets or local grocery stores allot to them. A successful packaged-goods company works hard to create incentives for everyone in the delivery chain, from the driver to the grocer, to make sure that store shelves have plenty of room for their brands, even squeezing out competing products. Speed of delivery and logistics can also be critical success factors, especially when freshness matters. Unfortunately, these kinds of stores finally caught on to what they were really selling — scarce space — so they began to charge "slotting" fees for the privilege of placing your product onto their shelf.

Marketing mind games

Manufacturers of cosmetics, clothing, perfume, and even CSDs (carbonated soft drinks like Coke) all sell hype and hope as much as they do the physical products themselves. In these cases, CSFs depend on the capability of companies to create and maintain strong brands. A brand represents the image of a particular product or service in the marketplace and how it affects consumer psychology. Just as food products fight for scarce shelf space at the supermarket, branded products are

battling for the complex shelf space of your mind. In many markets, customers consider the name, the logo, or the label attached to a product before they buy the lipstick, jeans, or drinks that represent the brand.

TIP

If you're starting up a new business, pay special attention to the company name. In the past these were rather bland descriptions of the firm — National Biscuit, U.S. Tire, General Mills, American Broadcasting, and so on. Nothing wrong with these, just boring. Things began to change when that magician of disruption, Steve Jobs, incorporated Apple Computer in 1976. Say what . . . a firm named Apple makes computers? Look today what the master hath wrought: Tesla, Amazon, TikTok, Alibaba (two Chinese brands) — corporate names that are memorable. (Two of our favorites: a women's garment repair shop called Boulevard of Broken Seams in Toronto and a restaurant named The Edible Complex in Oakland, California.) "Brand equity" is for some companies their most valuable asset. Be sure you choose a good one.

Getting along with government regulation

Remember those weird words we use earlier in this chapter when discussing industry structure? Monopsony was one of them, and it refers to situations in which there is essentially only a single buyer for your offering. Governments are usually the target here (try selling your new ballistic missile system on Amazon; actually, please don't). Companies that contract directly with public agencies, such as waste-management firms and public infrastructure construction companies like road builders, often succeed because of their unique capability (ahem . . .) to deal directly with bureaucrats and elected officials. Government regulation plays a role in many industries, and the know-how to navigate a swirling regulatory sea is often the critical factor in a company's success. Pharmaceutical companies, for example, invest huge amounts of money in developing new drugs, and they stake all their potential profits and success on their skill in shepherding those "NCEs" (new chemical entities) through the Food and Drug Administration's complex regulatory approval process.

TIP

We could go on with more examples. But one last thing to remember before you start preparing your own CSF list: Critical success factors determine which companies are likely to succeed over the long haul in a given industry and marketplace. You absolutely need to know them. Unfortunately, your company's current capabilities may not always match those CSFs. Chapter 9 talks more about how you can unleash your company's specific capabilities and how you can make sure that they reflect the CSFs that you come up with here. What if they don't match up? In that case, you may find that you need to develop new capabilities; flip to Chapter 10 for guidance.

SWOT: Preparing for Opportunities and Threats

After you have a handle on the major market forces that shape your industry and you can point out the critical success factors that determine what kind of company has the best shot at coming out on top, you can begin to look ahead. Using everything that you've discovered about how your industry works (see the earlier section "Analyzing Your Industry" to get started), what possibilities do you see for leveraging the company forward, and where do the potholes lie?

These kinds of questions often fall under the umbrella of something called *situation analysis.* When you think about it, your company's situation depends partly on the structure of your organization and partly on things that happen outside, kind of a *yin* and *yang* in which you need to embrace the opposites and find ways to weave them both into your plans. These factors have long been in the playbook of business planners, located under the heading of "SWOT." This acronym stands for *strengths and weaknesses* (internal factors to your organization) and *opportunities and threats* (the external angels and devils).

For the moment, we want to concentrate on the opportunities and threats that you may face. (Turn to Chapter 9 to work on your company's strengths and weaknesses.) Opportunities and threats come from the forces, issues, trends, and events that exist beyond your control as a business planner and owner. They represent the challenges that your company has to tackle if you want to beat the competition. And today, in a world of historically high levels of disruption characterized by "VUCA" — volatility, uncertainty, complexity, and ambiguity — it's even doubly more difficult to read the tea leaves. But just because the task is daunting doesn't imply it should be avoided. It can't.

Finding warm and soothing waters

TIP

Opportunities don't always knock; sometimes they barely tap, and for others you have to find the door yourself and maybe pick the lock to get in. Consider the following situations. They can all lead to business opportunities, so see whether any of them can generate new possibilities in your industry:

- **Riding the wave of a new technology:** When technologies change, existing companies are often slow to pick up on what's new because they have so much invested in what's old. They wallow in fantasies of a static environment that we call ROI: *repression of innovation.* The potential of new business opportunities is often left to the brave young upstarts willing to take risk, like

Tesla in the EV (electric vehicle) space, usually because they have nothing to lose. What's on the techno horizon in your industry? If it looks promising, what are you doing about it?

- **Invention of new processes:** Opportunity is often cloaked in a challenge. Some time ago Japan possessed the most expensive real estate on the planet. Manufacturers located there like Toyota Motors found it increasingly costly to build and manage parts and supply depots. So, they began to work closely with their suppliers to develop just-in-time (JIT) parts delivery systems. The partner would make the component and then deliver it directly to the Toyota assembly line ready for installation, thus eliminating the need for warehouses and contributing to significant cost savings. Necessity is the mother of invention.
- **Finding new customer segments:** New market opportunities are born when you can identify groups of customers who have been underserved or perhaps totally ignored by industry incumbents. The entire LGBTQ community was long the subject of discrimination by too many firms, even though data showed that people in such relationships had demonstrably higher levels of disposable income than those in heterosexual relationships. But then came Subaru, the smallish Japanese maker of cultish cars. As a niche marketer, promoting to groups like the outdoorsy crowd, it discovered that lesbians loved their products and, in fact, favored them four times as much as any other surveyed groups. Subaru launched a daring new ad campaign specifically targeting this demographic and has enjoyed a success that its larger and more well-endowed competitors haven't.
- **New uses for old products:** Growth markets also spring up when firms find new uses for old products. We discuss earlier in this chapter how AM General repurposed its Humvee for civilians, but it was hardly the only one to spot a new opportunity. When medical researchers discovered that taking a small dose of acetylsalicylic acid a day could reduce the chance of a heart attack, aspirin became more than just an old-fashioned pain reliever. Pharmaceutical companies responded with new over-the-counter brands of "81" aspirin specifically designed for the new use and a new set of customers.
- **Access to new pools of workers:** Many industries have a shortage of human resources necessary to perform the available jobs. Business opportunities often arise when skilled workers become newly available, displacements from dying firms and industries or newly arrived immigrants fleeing catastrophe in their home nations or seeking new opportunities. Many of those who exit an industry are more strategic and resourceful than their cohorts; they are willing to take on new challenges and bring new ways of thinking into the game. In short, they open up opportunities for companies in need of a boost. Do you have the Hiring Now sign switched on and lighted — perhaps in a language besides English?

- **Nontraditional new locations:** Location means business opportunity. Starbucks used to be limited to its ubiquitous, green-starred locations around town. But then it convinced supermarket chains to free up a bit of space inside stores, which provided ready refreshment for current customers and drew in new ones seeking a quick brew. Customers love convenience. Where else can you spotlight your own products in addition to traditional locales?
- **Bottom-of-the-pyramid opportunity:** A number of years ago an influential academic researcher opened the eyes of businesspeople to the opportunities to be found "at the bottom of the pyramid" — that is, by reconfiguring products and services to better appeal to lower income and less advantaged groups in society. Collectively these folks represent an impressive amount of buying power, but traditional packing and distribution methods often overlooked their special needs. Is this an opportunity for you, too?
- **Fresh organization models:** New ways of doing business represent opportunities for the quick-witted. The pressure to downsize, for example, prompted firms to outsource all sorts of nonessential functions to other companies that do nothing but, say, manage IT, source and train staff, or undertake innovation and discovery projects. Can you offer your firm's skills and talents to those organizations that want them but don't see them as main jobs in their own operations — and, thus, might be willing to outsource the work to you? This is a win-win.
- **New distribution channels:** You rarely come across anything more exciting in the business world than finding a new way to connect with customers. We all now know by now how eBay's founder stumbled across this amazing opportunity by trying to satisfy his girlfriend's plea for an easier way to purchase flea market doodads. Think about how your own customers find your goods: Is there a better way?
- **Changing laws or regulations:** All levels of government (surprise, surprise) have a great deal to do with the way that companies operate in all sorts of industries. Have you taken your car in for its required smog check in California yet? Changing laws and regulation represent opportunities for firms to recalibrate how they grow sales and find new customers; track them and see what works.

TIP

Successful developments like the preceding often emerge from what are called *market pain points.* That is, what aspects of a product or service make for irksome and unnecessary pains for users? By unearthing these and then creating a means to relieve the pain, the business planner can create opportunities. What sticks in your craw when you think about your own industry? A good way to start is by asking your customers what they don't like about your operations. What can you do to fix the hurt?

Scanning for clouds on the horizon, ice on the water, or worse

Is your glass half full or half empty? Yeah, Pollyanna felt the same way — but that was a kid's fantasy book, remember? We're not knocking optimism, as entrepreneurs thrive on it, and so should you. But you'd be a fool to think the coin will always flip your way. Business is risk. For every big opportunity in an industry, you find an equally powerful threat to challenge the way in which you currently do business.

Consider the following external forces, grouped by category: Do any of them apply to your industry's business environment? Do you have an escape hatch for the ifs and whens, or have you even thought about them? You might want to re-watch *Titanic*, mate. It's called planning.

Technology threats include

- The digitization of everything
- The spread of AI and robotics
- Cybersecurity threats and IT hacking

Political threats include

- Political chaos and new or amended legislation
- New international trade and tariff laws
- Shifting patterns of global politics and power

Social threats include

- Newly empowered consumers
- Changing consumer preferences due to demographic shifts
- Growing income and wealth inequality
- Newly empowered employees
- FD&H (fat, dumb, and happy) management culture

Economic threats include

- New and aggressive competition, both foreign and domestic
- Substitute products and services
- Shortages of raw materials
- Loss of patent protection
- Organized labor demands
- Exchange-rate volatility
- Unanticipated disasters, natural and otherwise
- Anticipated disasters, but with no clear response and remediation programs

You can probably extend the list. But the problem isn't how you check the box; these are forces usually beyond your control. It's how you spot the threats coming in and then manage them to minimize damage. We deal more with this in Chapter 13, but for now let's acknowledge that we're at the inflexion point of a brave new world for business. Problems exist — indeed, VUCA on steroids. Get over it and act.

REMEMBER

Some sage long ago noted that no crisis should go to waste. Industry transformation opens new doors. The firms that come out on top will be those that were willing to invest time and effort into anticipating change through sound situation analysis. They develop and implement business plans that acknowledge the uncertainty of the times but recognize the inherent opportunities that these represent, and they position themselves to pounce when that opportunity knocks. By reading this chapter, you seem to be one of those planners. Go get 'em, tiger!

IN THIS CHAPTER

- Grouping customers together through market segmentation
- Understanding who buys, what they buy, and why they buy
- Creating market segments that make sense
- Shaping your business around the key customers you serve

Chapter 6

Slicing and Dicing Markets

As you put together your business plan, it may seem good to view each of your customers — the Alexes, Aniyahs, and D'Andres who regularly walk through your doors — as individuals with unique personalities and distinct likes and dislikes. You may also be tempted to make things simple and lump everyone together and view all your customers in exactly the same way — after all, the whole world should want your products and services, right?

Unfortunately, neither of these tactics is very helpful when it comes to creating a business plan you can use. In an ideal world, you could address each customer individually. Walmart sees more than 200 million customers a week. Southwest Airlines averages more than 350,000 passengers per day. Starbucks's baristas serve well over a million worldwide caffeine addicts per hour. But is this one-by-one approach possible in today's marketplace? Not that long ago, the answer was clear as crystal: You couldn't personalize your marketing efforts with the customer, certainly not on a mass scale.

But we're not in Kansas anymore, Toto. The digital revolution has affected a firm's ability to reach out and touch customers through methods unheard of just a few

years back. It's turned the field of marketing almost upside down, and you, too, might be able to benefit from the revolution. Let's talk.

In this chapter, we show you how to create practical market strategies that you can use in your business plan. We explore various ways to identify market segments based on who is buying, what they buy, when they buy, and why and how they buy. Finally, we talk about things you can do to make sure that your business plans and practices reflect who your customers are and why they come to you in the first place.

Separating Customers into Groups

When you take a moment to think about who your customers really are, one of the first things you notice is that many of them have a great deal in common. That simple fact gives you a golden opportunity to divide customers into specific groups based on their similarities. Bingo! By planning your business around these customer groups, you can serve each group's particular needs almost as effectively as if they were individuals. This saves money — lots of it.

What makes a good customer? The best customers that any business can hope for have these traits in common:

- They bring in a lot of business — revenue!
- They maintain loyalty — they keep coming back!
- They make useful suggestions — they talk to you!
- They say nice things about you — to their friends and associates!

Good customers are more than satisfied; they're delighted. You provide them with exactly what they need and want. For their part, they keep you on your toes by making sure that you understand their changing needs and requirements.

To begin, we acknowledge that each individual customer is unique: You, dear reader, are you, and so far we're not cloning humans. But while you're an individual, you also share some characteristics with others, maybe lots of others. Are you right-handed? Welcome to that intimate little club of 90-plus percent of the world's population. By identifying those commonalities, we can group customers together into baskets that make it a lot easier and less expensive to serve them.

When you make sense of your marketplace by grouping customers together, you create *market segments.* To be of any real use in your business planning, however,

market segments should describe groups of customers that you can readily identify and that respond to your products and services in similar ways — ways that appear distinct from those of other customer groups. An accurately defined market segment allows you to satisfy the particular needs and wants of an entire group of customers as if they are one — a more cost-efficient approach.

REMEMBER

Heck, smart segmentation might even enable you to pick out those underhanded baddies so you can steer clear of them. A good marketing strategy not only identifies what you are and who you serve, but also what you are *not* trying to be or do. Accurate market segmentation allows you to find those that are *not* a good fit with your business before spending your scarce resources on a fruitless quest.

You may remember a time when "sneakers" were simple, rubber-soled canvas shoes that kids played in and maybe used for school sports. But that was back then. Today the market for athletic footwear generates nearly $30 billion in yearly revenue. The difference is phenomenal. Now everyone seems to wear them — kids still wear the shoes, of course, but so do toddlers, tweens, teens, serious runners, amateur wannabes, senior citizens, and just about all other categories of consumers — each demanding choices in various shapes and colors, with different features and options, and in a wide range of prices. Just ask Nike and Michael Jordan. Today the athleisure segment (not a typo) has niches for walking, running, skateboarding, the fashion runway, whatever and wherever. You can even find ones with little lights in the heels that flash when you walk. Cool.

Literally dozens of athletic-shoe segments exist now, each defined in unique ways. For Nike, Adidas, or Puma to attempt to run the table today with one universal shoe would be sheer folly and a financial disaster. The athletic-shoe business and the market segments that shape it have changed beyond recognition during the past 30 years.

EXTRA! EXTRA! YOU NOW HAVE CAR OPTIONS!

In the early 1920s, Henry Ford and his famous Model T dominated the growing automobile industry in the United States. As Ford was fond of saying:

> *You can get the T in any color you like — as long as it's black.*

The key to the company's early success was its focus on just one product. Ford believed that if one size could fit all, standardized parts and mass production would lead to lower costs, lower prices, and satisfied customers. He was absolutely right . . . up to a point.

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The market reached that point when American shoppers began to have more income and developed a taste for options. Some buyers wanted to be sporty; others, classy. Some wanted more leg room; others, more room for the kids. Ford continued to improve his cars, of course. The chassis became sturdier, the engine quieter, and the ride smoother. But when customers visited a Ford showroom, all that they saw was the same old boxy Model T — still available in all shades of color, as long as it was black.

Along came Alfred P. Sloan, Jr., the legendary head of General Motors. Sloan's genius was in recognizing that car buyers weren't all looking for the same car. He captured this vision when he said:

> *GM will produce a car for every purpose and a car for every purse.*

Sloan soon hired a new kind of employee — the market researcher — to figure out what potential car buyers really looked for. Although he couldn't produce a unique car for each individual buyer, his market research identified five major groups of buyers with similar tastes and needs. In a bold move, he instructed his designers and engineers to come up with cars to meet those needs. The result was a new lineup of products tied directly to market segments:

- Chevrolet for entry-level buyers
- Pontiac for buyers who were moving up
- Oldsmobile for the growing middle class
- Buick for those who wanted something finer
- Cadillac for status-seekers

"Sloanism" won. GM cars soon began to outsell Fords; when the Model A was introduced in 1929, it was too late. Market segmentation took its rightful place as an important business-planning technique — not only for automobiles, but also for major industries across the nation and the world. In the United States alone, about 40 new car models are introduced annually — car buyers' heaven.

Identifying Market Segments

Despite what the marketing gurus may tell you, you rarely, if ever, can find a "right" way to carve up your market straight off the bat. You need to view your customers from various angles and describe them based on several factors. The

more you can apply your imagination and creativity in this area, the more successful you're likely to be in coming up with unique and effective market segments. *People who subscribe to my service have a computer. Maria and Marvin have computers. Track them down, team — they're prospects!* Ah, no. One dimension isn't enough.

REMEMBER

As Figure 6-1 shows, you can come up with ways to create market segments by asking three basic questions:

- Who buys your product or service?
- What do they buy?
- Why do they buy?

The first two are easier to answer; the third can be quite tricky indeed.

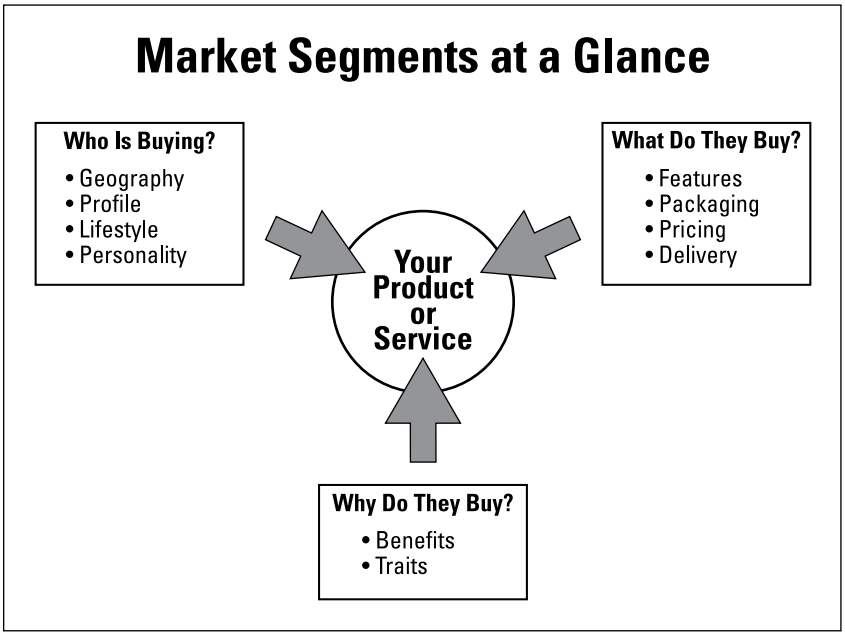

FIGURE 6-1: Define market segments by asking three basic questions and then answer those questions from different market viewpoints.

Who buys

The place to begin teasing out your market segments is by researching who buys your product or service. If you focus on individual consumers — the B2C market (business-to-consumer) — discover a bit about how they live their lives. If your

customers are other companies (the B2B "industrial" market of business-to-business), find out about their business operations. Think about your B2C customers in these terms:

- Demographic profile (age, gender identity, and so on)
- Geographic data (where they live: urban, suburban, rural, and so on)
- Economic status (income, wealth, education, and so on)
- Personality type (extrovert, introvert, and so on)

Where do they live?

Perhaps the simplest way to describe your customers is based on where they are, beginning with a simple geographic breakdown by these factors:

- Country and region
- State, county, and city
- Zip code and neighborhood

But geography can also lead to more specialized groups. For example, you may find it useful to describe customers based on factors such as

- Population density in the neighborhood, even length of the driveway
- Average precipitation and snow in the winter, or heat during the summers
- Available connectivity in the area (or not)

Dividing customers into groups based on geography is a good way to separate them according to local or regional taste — which often is a significant factor in the distribution and delivery of a product or service. Ethnic foods, for example, tend to sell better in certain regions of the United States. Hispanic foods are hottest in the Southwest; kosher products are most popular on the East Coast; and Asian food is everywhere on the West Coast. Per-capita wine consumption is far higher in San Francisco than it is in Milwaukee. And beer? Well, it made Milwaukee famous.

Speaking of the Midwest, instead of trying to sell heavy coats and sweaters throughout the country, you'd be better off concentrating marketing efforts in regions that have cold winters, taking advantage of customer preferences based on weather patterns. By looking at the geographic characteristics of consumers as they relate to your product or service, you begin to create market segments that

you can use. But keep in mind that personal identities are shifting quickly these days; don't get trapped into thinking yesterday's truths are the same as tomorrow's. You might want to read (or re-read) the end of Chapter 5 or jump ahead to all of Chapter 13 before you sketch out that new pattern. (Hey, future coat-makers out there, global warming is happening. Maybe they'll want bikinis in Buffalo next.)

What are they like?

A profile of your customers includes all the attributes that you may expect to find in a national census. Marketing gurus call these attributes *demographic data,* which includes the following:

- Age
- Gender identity
- Family size
- Education
- Occupation
- Income and wealth
- Ethnicity
- Nationality
- Religion

TIP

Your ability to identify, find, and connect to those with narrowly defined characteristics can give you a decided edge over competitors who don't. BTW, we give you a lot more on this topic in Chapter 7, where we review how understanding generational groupings like Boomers and Millennials can fine-tune your plan.

Company profiles, of course, are somewhat different. These profiles can include basic characteristics such as the following:

- Industry
- Size of company
- Number of employees
- Location of factories and stores
- Years in business

TIP

You can often use customer profiles to spot market trends and take advantage of potential opportunities. Why is the market for health-care products like vitamins and varicose vein remedies booming today? Because the fabled Baby Boom generation — those 76 million Americans who were born between 1946 and 1964 — has come face to face with its own mortality. And where can you find a growing market for housing and home loans? In regions of the country with plenty of sunshine where people can enjoy their retirement years. Got it. But keep a close eye on those Millennials, the 72 million or so born between 1981 and 1995. Many are in or rapidly entering their peak years for consumption, and they definitely don't buy like Mom and Dad did.

What do they do?

Lifestyle is an awfully tired word these days. People use it to describe anything and everything that you do in the modern world. If you're reading this book, you likely fall into the entrepreneurship lifestyle. When applied to your customers, lifestyle has a particular meaning; it captures characteristics that go deeper than what's available in plain old census data. Customer lifestyle factors include

- Hobbies
- Online usage habits
- Social activities
- Health-related choices such as foods and beverages

All this information is sometimes called *psychographic data,* because you can use it to map out the underlying psychology of the customer, which drives much of buying.

TIP

Ever wonder why some folks enjoy the DIY stuff around the house and yard? The psychologists tell us it's because there's a deeply seated need for the male species to create a warm and safe nest for the partner and kids. This need to be a protector can provide a clue as to how a seller of goods to this crowd might make the pitch. Don't just focus on the product — play to the underlying motivation. (More on this concept appears later.)

When applied to business firms rather than consumers, lifestyle identifiers might be their desire to be seen as "green," or socially responsive, or supportive of diversity and inclusion in employee hiring and promotion policies. And let's not stop there. Some firms want to be associated more with a Wild West, freedom-tinged image: smoking's allowed, concealed carry tolerated. Hey, it's America.

You can use these characteristics to understand how you may better serve a particular segment of your business market.

What customers buy

A description of your customers in terms of their geography, profiles, lifestyles, and personalities tells you a lot about them. To begin to understand how customers make choices in the marketplace you compete in, you need to consider not only who they are but also what they buy.

A description of customers based on what they buy enables you to view them from a perspective that you're very familiar with: your own products and services. After you come up with market segments based on what your customers purchase, you can address the needs of each group by making changes in the following aspects of your product or service:

- Features and add-ons
- Packaging
- Pricing
- Delivery options

TIP

A good way to start thinking about these things is to picture your firm's offering lined up in a labor hiring hall: What is it being "hired" to do for the buyer? Just what reason drives the buy decision, and what variables influence whether you or the other guy gets chosen?

What can your product do?

Features refer to all the specifications and characteristics of a product or service — things that you often find listed in a product brochure, a user manual, or the company website. When you group customers based on the product features they look for, the customers themselves turn out to have a great deal in common. Their similarities include

- How much they use the product (light, moderate, heavy)
- How well they use the product (novice, intermediate, expert)
- What they do with the product (recreation, education, business)
- What kind of customers they are (advisor, reseller, user)

Spirit Airlines is a player in the so-called *no-frills* segment of the airline business. The company caters to people who travel relatively short distances and who often have to pay for travel out of their own pockets — and are very conscience of price (the so-called leisure segment of the market). You can find rock-bottom ticket prices to fly Spirit, but don't expect a seat assignment in advance, free checked

luggage, early boarding privileges, or anything edible up there in the sky. You get what you pay for — not much, hopefully an on-time flight from here to there (even though that's dicey). But then Spirit's customers don't see the point of paying extra for things they don't want. That's who they are, and the airline's management knows it.

Spirit Airlines customers tend to be different from those of United Airlines, a global, full-service carrier at the opposite end of the airline spectrum. United offers service to most major airports around the globe. The company targets business customers, frequent flyers, and global travelers who expect a decent hot meal on a ten-hour flight, sufficient bubbly to ease the ride, superior in-flight service from experienced cabin attendants, help with their international connections, and their luggage to arrive when they do, no matter where they are in the world. And they (or their company's travel department) are willing to pay for it.

How do you sell the product?

When the Madison Avenue types talk about *packaging*, they refer to much more than cardboard, shrink wrap, and plastic. Packaging means everything that surrounds a product offering, including the following:

- Advertising (Internet, social media and blogs, radio/TV, magazines, billboards, T-shirts)
- Promotions (online contests, in-store sales, coupons, drawings)
- Marketing (social media influencers, product placement in movies, celebrity endorsements)
- Product service (warranties, help lines, website FAQs, service centers)

The market segments that you identify based on packaging criteria often reflect customer attributes similar to the ones based on product features (see the previous section): frequency of use, level of sophistication, product application, and the type of user.

What does your product cost?

The pricing of a particular kind of product or service creates different groups of customers. Price-sensitive customers make up one camp (remember the Spirit Airlines customer earlier in this chapter?); financially free customers who are willing to pay for a certain level of quality are in the other. If you've ever had to endure a course in microeconomics (yuck), you won't ever be able to forget two facts: Price is a major market variable, and the price/quality trade-off is a fundamental force in every marketplace. People who buy Timex watches at their local

drugstore tend to be price-sensitive, whereas shoppers acquiring a Rolex timepiece at a classy downtown jewelry emporium want luxury, craftsmanship, elegance, maybe even a flute of champagne from the elegantly attired sales associate while they browse, and the chance to make a personal statement.

Where can consumers find your product?

Distribution and delivery determine how customers actually receive your product or service. In this case, market segments are often based on where your customers shop. Here are some examples:

- Online platforms (Amazon, eBay, Etsy, or Alibaba and Rakuten in Asia)
- Big-box warehouses (Home Depot, Costco, Office Depot)
- Discount stores (Walmart, Target, T.J. Maxx)
- Traditional department stores (Macy's, Saks Fifth Avenue, Kohl's)
- Specialty stores (Dean and DeLuca, Tiffany & Co. [Hah! You knew this was coming])
- Boutiques (New York City Fifth Avenue or Beverly Hills Rodeo Drive shops)
- Catalogs (Frontgate, Omaha Steaks, Sundance)
- Street vendors (pirated DVDs and really good hot dogs or pretzels are both on Fifth Avenue)

Distribution is undergoing transformation these days, as the convenience of the Internet pulls more and more shoppers to this option (keep reading to find out why and how this happened). While the total volume of all online sales is in the low-to-mid double digits, the rate of growth has been spectacular compared to brick-and-mortar stores. Every week, it seems, a new category of products shows up online, and consumers — especially Millennials and Gen Zers — are choosing "buy now" on their laptops or phones more than ever. Heard of Carvana? Robinhood? Noémie? Check 'em out.

Moreover, unforeseen events like the COVID-19 pandemic gave a massive booster shot to indirect modes of shopping. You may want to peek at Chapter 13 to see how stress-testing your business plan for random events can make it more resilient in the face of unknowns.

REMEMBER

Not everything will go digital, of course. Markets based on physical delivery will likely stay viable for any number of products that can't be digitized or delivered easily to ultimate consumers. These will include personal services (dentists, manicurists), vehicle fueling stations, some forms of food, beverage, or medicinal products (cannabis, some prescription products, some age-regulated drinks), and

others, too. But don't undersell the power of technology and the resourcefulness of entrepreneurs — like yourself. Home delivery of food and meals is booming today; so is telemedicine. And in countries with a deeper penetration of online infrastructure and culture — and shall we say a more casual attitude about vehicular traffic on sidewalks and in buildings — almost everything can be brought to the door lickety-split. (If you're ever in Shanghai on the street, watch out; traffic signals are more likely regarded as suggestions than commands.)

THE DIGITAL REVOLUTION AND "MASS CUSTOMIZATION"

Segmentation was (and still is) an excellent means to understand your customers better and serve them efficiently without breaking the bank. After all, the cost of building a one-on-one relationship with each and every single customer is impossible except for a handful of firms in highly specialized markets. Maybe Boeing and Airbus can know precisely the needs of each member of the tight little community of buyers for wide-body jets, but for the 99.99 percent of other businesses, *fuhgeddaboudit.*

The holy grail of marketing remained, however, the search for intimacy, a means to turn a mere transaction into a deep and lasting relationship between buyer and seller. But nothing seemed possible to overcome the complexity and cost. Then along came Silicon Valley, and almost magically a tool to create that intimate bond appeared. Surprisingly, the discoverers kind of stumbled onto it rather than systematically pursued it. What they ended up creating was a whole new industry called *data analytics.*

Next time you sit down at your laptop to do a search or pull out the smartphone to dash off a quick message to someone, do you know what you're also doing? Digitally recording who you are. Say what? Yes, revealing yourself in ways that might be invisible to yourself, or even your shrink if that relates. This is because each and every stroke of the keyboard results in a digital code that gets stored on a server somewhere — and each and every laptop, PC, or phone has a unique identification to tie it to the user. It's like a license plate for cars; no two are alike. And it facilitates "mass customization."

When those nerdy kids out in Northern California began to come up with new ways to use computers and the networks that the bits and bytes traversed, there was little thought of data sweep devices. But just as search engines and social media sites morphed into advertising agencies, it became apparent that each use of this digital means of communication might also be saying something about the person doing the finger tapping. Searching for a book about beekeeping? Scrolling to determine the signs of pregnancy? "Hmmm," said the kindly site owner. "Wonder why my site visitor might be doing that? And guess what, I know precisely who you are and how to contact you." Cackle, cackle.

If your name is Google, Facebook, or Amazon, then you really struck gold: All that data can be mined through highly sophisticated data analytic software models that in many cases yield more insight about customers than they themselves are aware of. It's then packaged and sold to bidders who start contacting you directly, dear customer, with an offering suited to a T for just that gadget you've been thinking (or scrolling) about for the last few days or so.

Is this good? It's an incredibly cheap way to hoover up all sorts of valuable customer information, compared to the pre-digital means of collection, and makes it economically available to business planners. *Mass customization,* as it's called, is now a reality. And it's certainly convenient for us customers, too. What's not to like about having an algorithm instantaneously sift through all the variables out there and then recommend precisely the movies we want to watch, or those backyard tools that will turn the weed patch into the lovely garden that we've been dreaming about of late? And you don't even have to pay a personal concierge to do the sleuthing; the information just shows up free on your computer. Heck, the website even allows you to tap a few clicks, and presto! The product is on its way, perhaps for online viewing immediately or delivery the very next day — with no middleman channel to add to the cost. Netflix and Spotify have become market darlings by their skill in mass customization.

But then again, what else happens with all your private data out there? Remember that little sneak-a-peek at the rakish website your best friend quietly mentioned the other day (or you caught your 14 year old viewing)? Shhh, not so loud! We're collectively still trying to figure out the legal limits of privacy on the Internet, but for now keep this in mind as you do your business plan: Would you want your own personal data available for a price (paid to someone other than you) and then hung out there for all the world to see? Stay tuned on this issue as you consider how to ethically manage customer data.

Why customers buy

When it comes down to satisfying customers' needs over the long haul, you can't forget the basics. Perhaps the most difficult — and useful — questions that you can ask yourself about customers have to do with why they buy in the first place. These include questions such as these:

- What do customers look for?
- What's important to them?
- What motivates them?
- How do they perceive the world?
- How do they make choices?

When you group customers by using the answers to these questions, you create market segments based on the benefits that customers look for. Because these market segments describe your customers from *their* point of view, rather than your own, they provide the best opportunity for you to satisfy the particular needs of an entire customer group.

What do they get?

As you try to figure out exactly why customers buy products and services in your marketplace, start a list of the benefits that you think they look for. We discuss this a bit earlier in this chapter, urging you to look beyond the easy-to-see veneer and dig deeper for answers. Product benefits may sound an awful lot like product features, but in subtle yet crucial ways, product *benefits* and product *features* are really quite different.

REMEMBER

Features are defined in terms of products or services. A car, for example, may have a manual transmission (as opposed to automatic) and may come with power windows, anti-theft locks, or a dashboard screen with rear-view camera, route mapping, and other capabilities. *Benefits,* on the other hand, are defined by the customer. Depending on the customer, the benefits of a manual transmission may be in handling and responsiveness or in improved gas mileage. A dashboard screen may represent an added luxury for the weekend driver but could be an absolute necessity for the parent who wants to see what's behind them in the driveway with the embedded camera (or someone who insists maps are only for wimps). Again, the benefits are in the eyes of the customer.

Recall Spirit Airlines noted earlier in this chapter. The policies of the market leaders often create opportunities for the new little disrupter who has an ear closer to the ground for sensing customer desires. You need to understand the difference between benefits and features if you plan to use the market segments that you come up with to create an effective business plan. Take a moment to think about the business situations sketched out in Figure 6-2.

Which of the benefits listed represents genuine benefits to the customers of each company? A trick question, of course: *You* don't define benefits — only *customers* do.

How do they decide?

REMEMBER

Different customers approach your market in different ways, and you can often identify market segments based on certain customer traits as they relate to your product or service category. Some of the conditions that guide customer buying decisions include the following:

Choose the Customer Benefits

Situation	*Potential Customer Benefits*
A boutique offers upscale bath and beauty products imported from Europe, tasteful gift wrapping, and hassle-free delivery anywhere in the world.	• A nice place to go after lunch when there's extra time to kill • The opportunity to impress relatives back in Sweden • An alternative to divorce after discovering that today's an anniversary date • Aromatherapy after an ugly day at the office
A franchised quick-printing outlet provides self-service copy machines; sells custom stationery and business cards; and offers two-hour rush jobs on flyers, posters, and newsletters.	• The ability to look like a big company — at least on paper • A money-saving alternative to buying a copier • A threat used to keep the printing and graphics supplier in line • A job-saver when the printed brochures don't arrive at the trade show
A semiconductor manufacturer sells customized chips to high-tech companies for use in brand-name consumer products, including home electronics, computers, and games.	• An extension of the in-house research and development department • An easy way to expand the product line • A weapon in the cost/price wars • A way to reduce a new product's time to market

FIGURE 6-2: Consider these business situations.

- **Speed of the purchase decision:** The *decision-making process* (DMP) that customers go through before they purchase a product or service varies, depending on the product or service's complexity and price tag. People may buy chewing gum at the convenience store without much thought. But real estate agents or financial service advisors face a completely different DMP with their customers, resulting in a slower decision to buy. (For a basic primer on DMP, see Chapter 7.)
- **The actual decision-maker:** Families as a whole that buys various consumer goods represent a common *decision-making unit* (DMU). But who in the family has the final word? When deciding the location of the next vacation spot, for example, it makes a big difference whether the kids or the parent(s) have the final say. For B2B firms, does the IT guru select the hardware vendor, or the CFO who signs the check? Knowing the real decider-in-chief for the thumbs up or down on your goods should drive your marketing and sales planning efforts.
- **Customer loyalty:** The way that companies relate to their customers can easily define a set of market segments. Service industries, for example, go out of their way to identify and encourage customers based on their *loyalty* (that is, intent to repurchase from them). You've probably been asked to join more

than one frequent-flyer program or apply for endless credit cards that promise to reward you for being a member of a loyal customer group. (For more on customer loyalty, see Chapter 7.)

- **Level of product use:** In many industries, a small percentage of consumers account for a large percentage of sales. The so-called Pareto Rule says the top 20 percent of folks in most any universe account for 80 percent of the action. Recent research found that some 63 percent of Americans drink alcohol — but only 10 percent of that group consumes more than half of all alcoholic drinks. Now if you want to pour beer, you should note that consumers in Montana, Vermont, and New Hampshire down the most per capita, and Utahans imbibe the least. Overall, it's been estimated that only 5 percent of households account for a whopping 87 percent of total beer sales. Targeting this segment is the cap-popper for profit (though if you live in a college town, we'd suggest you steer clear of Fraternity Row after dark or anytime on the weekend).

Finding Useful Market Segments

A market segment is useful only if it allows you to deliver something of value to the customers you identify — and to do so profitably. Not all the market segments that you come up with are going to be practical ones. What should you look for if you want to find a really useful market segment? In general, you want to make sure that it has the following characteristics:

- A size that's large enough to support you, but small enough to be managed well
- Customers that you can identify by specific characteristics
- Customers that you can reach economically

Is the segment the right size?

REMEMBER

Identifying useful market segments requires finding the sweet spot between defining your markets so broadly that they don't offer you any guidance and planning and defining them so narrowly that you make them impractical and unprofitable. This often involves an exercise in *scaling* — that is, creating a business model that anticipates and allows for rapid and low-cost growth (see Chapter 15 for more on this). A useful market segment has to be manageable. The right size depends on your particular business situation, including your resources, the competition, and your customers' requirements — as well as your goals and objectives.

Choosing a manageable group of customers takes you back to efficiency and effectiveness issues (which we cover more extensively in Chapter 4). For a firm like Walmart or Procter & Gamble, manageable market segments are large and quite different from those of broadcasters like Fox or MSNBC, which cater to a more targeted audience. You want to be effective in serving your market segment — do the right thing. But you also have to be efficient — do it the right way. Clearly, the notion of manageable market segments has changed over the years. In general, they're shrinking as information technology provides new tools to slice markets into smaller and smaller pieces without sacrificing efficiency — the mass customization approach detailed in the earlier sidebar "The digital revolution and 'mass customization.'" It's like having your cake and getting to eat it, too — or cleaning the plate but not gaining weight.

Can you identify the customers?

REMEMBER

As you piece together a full portrait of your customers, take advantage of the many different ways to categorize them (see the earlier section "Identifying Market Segments" to check out the ways we describe them). Identifying demographic markers and the like is a good start, but to beat the competition, you want to probe further. In particular, market segments based on *why* customers buy are often the best, because they define groups of customers who have similar needs.

But then what? Unfortunately, you can't always detect intimate customer behavior — motives, wants, needs, and preferences — from the outside (unless you're a psychotherapist, of course, but can we really believe them these days?). You may know what these people are really like, but how do you go about tracking them down? If you want to recognize the customers in your market segment, you have to tie their behavior to characteristics that you can see.

Can you reach the market?

After you define a promising market segment based on customer wants and needs and including customers you can describe, you have to develop ways of communicating with those customers. You can't be satisfied just knowing that this group of customers exists somewhere out there in the consumer universe, even if you can describe and recognize them.

You need to set up affordable ways to contact the right customer through clever marketing, and then deliver your product or service in a timely manner. One approach is through what's called *direct marketing.* This means going direct to a prospective customer (duh) and avoiding any intermediaries. The great advantage of direct marketing is that you can target snail mail or email to potential buyers who have already demonstrated interest in what you want to sell. So how do you find out who these potential customers are?

There are folks out there called *list brokers.* They know where the lists of contacts can be found, which includes name-rank-and-serial-number details. They've been around forever. In the past the lists came primarily from magazine subscriptions; more than 7,000 different magazines are available in the United States, so chances are there's one whose readers are just the kind of customer you're looking for. This service isn't free, of course; you typically rent the list for a fee based on the number of prospects it contains. Just Google "list broker" and see what turns up.

The digital version of this approach comes from platforms that capture and store your every key tap on the Internet. If you engage in a search for, say, educational toys for that future little Einstein in the house, the information can be aggregated and your URL (your device's Internet address) sold to someone for use in a direct marketing campaign.

There's a relatively sizable group of folks out there who are often frustrated when searching for things suited just for them. They're called the left-handed. While you might be able to tailor something specific to their manual dexterity needs (golf clubs, for instance, or scissors), you also have to devise a marketing and distribution plan that ties into the common behavior of this group. Ideally, you want to get the full attention of left-handers without incurring the costs of reaching the 90 percent of folks in the right-handed world who couldn't care less.

This is called the "richness versus reach" dilemma. That is, to extend the reach of your message (the breadth of the market you can reach) at an affordable cost, you have to compromise the richness of the message (the level of detail you present). For example, your new product development team has devised a complex new financial investment product that yields above average returns with good tax advantages. To reach a sizable audience at a reasonable cost, you can place a print ad for the product in mass-circulation media that brings the cost of viewership way down; this is known as the cost-per-thousand (CPM) ratio — that is, what the fee is to reach each thousand viewers. But to do so at a reasonable cost, you end up with a rather abbreviated weak tea message: "Hey, investors! Try this, it'll save you a bundle!" Spelling out the benefits in granular form, which may be necessary given the circumstances of each potential customer and the complexities of your product, is hugely expensive and likely impossible through mass-media marketing. You end up having to use a financial advisor to explain in detail to each customer, one at a time, and that advisor gets a hefty fee for doing so.

Efficient, yes, but effective no. So how do you gain the attention of, and access to, the narrow slice of the product pie? For investment management firms with curated offerings, the customer has to pay a sizable fee as it is so expensive for that firm to find and identify you (ever notice how those folks are all driving the latest version of luxury cars and you're not?). As for the left-handed set, an easy

method would be to place ads in *Southpaw Press* and to make your products readily available at all Lefties Outlet stores. The catch is that not one of these companies exists.

Maybe it's too early to give up. The Internet continues to amaze with its endless opportunities for both disruption and invention. But if you can't come up with creative ways to reach out to, and communicate with, narrowly defined customer segments, the group isn't a useful market except when the customer is willing to pay whatever for your offering. In addition to having similar needs, common observable traits, and a manageable size, a useful market segment has to present realistic opportunities to be reached. (Perhaps that's why left-handers are always so frustrated.)

Becoming Market Driven

Remember back in school when you were told to check your homework before handing it in — especially if the teacher was going to grade it? Well, the marketplace is a difficult class to tackle (as difficult as, say, calculus or physics), and the stakes are high. Before you commit to a particular market segment scheme, make sure that you look back over your homework. Pose these review questions to yourself:

- What benefits are customers in the market segment looking for?
- Will product features, options, and packaging satisfy customers' needs?
- Is the size of the segment manageable?
- Can you describe, observe, and identify your customers?
- Can you reach your customers efficiently through advertising and marketing?
- Will distribution and product service be effective?

At some point, you may want to use a more sophisticated approach to answer some of the questions in the previous list. *Test marketing* gauges your ideas on a carefully selected sample of potential customers in your market segment. Using a test market, you can often judge how well your product plan is likely to work before you spend beaucoup bucks going forward. And guess what? The proliferation of online test market services has brought down considerably the price of this once expensive tool. (Key in Capterra.com, click on the survey software menu, and you'll see a gaggle of e-researchers just waiting for you to contact them; Capterra's not the only source for this service, either.) You also may want to start by just conducting some preliminary customer interviews on your own. Dial up some

folks who have some basic interest in your concept and see what they think. Not scientific, but their initial response might be a good way to kickstart the research process. It's also free.

TIP

Customer interviews produce a snapshot of who buys your product, as well as what they think they're buying. You can conduct interviews on an informal basis. Just follow these steps:

1. **Select customers, real or potential, in your market segment.**
2. **Arrange to meet with them individually or in small groups; an online meeting will work just fine.**
3. **Prod them to talk a bit about themselves.**

   You don't need to precisely categorize them at this point, but gathering some identifiers — gender, education, and so on — will help.
4. **Have them tell you what they like and don't like about your product.**

   Push hard on this; people often don't like to give bad news in person, especially if they know you.
5. **Ask them why they buy your product and what they would do without it — that is, where would they go to get an alternative that scratches their itch?**

WARNING

One word of caution: Use common sense. These interviews aren't meant to be rigorous pieces of market research, so you're going to have to be careful to confirm what you see when you start drawing conclusions about customer behavior from them.

IT firms have a special challenge when introducing new or upgraded software products: Any bugs can be disastrous for everyone involved, and even give the firm a serious black eye that's difficult to recover from. It can cost four to five times as much to repair flaws after product release, compared to doing the fix in the design stage. Back in 1993, the leading semiconductor firm Intel introduced its Pentium i486 processor that had a calculation bug; the damage cost the firm $475 million. Not only do product features have to be relevant and useful to users, but they also have to work as advertised. One way IT firms do this is a two-stage process: alpha and beta testing.

» *Alpha testing* is the final stage of internal review performed by the QA (quality assurance) staff to ensure the application is ready for limited release. It's referred to by some firms as "white box" testing, because presumably the developers know exactly how it should perform with no bugs that might make it unstable (it's no longer a "black box" full of mystery). It's like having Chuck

Yeager roar off into the wild blue yonder on the new craft's maiden flight — with a wing and prayer but also a really good parachute.

- *Beta testing,* on the other hand, involves release of the software to a limited number of real-world users before it's showtime with the paying market. Although prior market research might have generated great ideas in theory, and all seems well with QA, the proof is always in the pudding. Beta testing is typically focused on performance and scalability issues, which only the customer can judge. Apple, for example, will preview new iOS features before release to the world. When Google developed Gmail, it started beta tests in 2004 — but took until 2009 before the service was deemed ready for rollout, as test user experience kept revealing new insights. Real customer product demands, as well as those pesky little bugs, can often evade detection in the lab but will scurry out when the software is exposed to wider-scale usage.

REMEMBER

Successful business plans today are built around customer centricity. You need to get as close as you can to the ones you target, learn to segment them by relevant criteria, and then assess their needs and wants — beauty spots, warts, and all. Only then can you develop your market offering with confidence that it will hit the target on the bullseye.

IN THIS CHAPTER

- Taking a wide-angle view of markets
- Comparing good customers with bad customers
- Investigating your competitors' customers
- Looking closely at customer behavior
- Creating loyal customers

Chapter 7

Getting Up Close and Personal with Customers

Getting to know the neighbors is a fine way to make for a happier home life. And for business? More than almost anything else, how well you know your customers ultimately determines how successful you are in your business plans.

But we're the first to admit it: Not all neighbors can be ideal. In fact, some can be the proverbial ones from Hades. So how do you figure out what makes good or bad neighbors — or customers — tick? It can be downright frustrating. In your business plans, you may be tempted to throw up your hands and leave the entire mess to the so-called experts — marketing gurus, consultants, or perhaps astrologers. Don't. This chapter shows you how to acquaint yourself with your customers so that you can offer them more value and serve them more profitably than anyone else in your industry.

We compare good customers with difficult customers and try to help you gain some insights from your competitors' customers as well. We take a closer look at why customers buy your products and services. And we examine customer perceptions and decision-making processes. We consider ways to develop loyal customers by improving customer service, and we take a quick look at other businesses that invest in your products or services.

Keeping Track of the Big Picture

By now everyone knows about missing a forest because of too much attention to individual trees. When you first start to think about your customers, you don't want to fall into a similar trap. Focusing on a small number of individual customers and their personal habits, likes, and dislikes is both tempting and easy. But stop right there! Don't view your customers and your business activities too narrowly. Look instead at the larger forest, or at least that patch you've identified through market segmentation — the customer behaviors and basic needs that define your addressable market (see Chapter 6 for more info on defining market segments).

General Motors' Cadillac used to be *the* luxury car in America. Everyone knew you were the man if you were seen behind the wheel of one of these highway yachts. Forty years ago it outsold its nearest rival by a five-to-one margin. But nothing stands still forever. Buyers aged; a new generation of drivers hit the road; and foreign automakers began to target this emerging segment with styles and features more suited to the demands of this new generation of upscale customers. Lured by the intense loyalty of its customer base and the high margins they were willing to pay, Cadillac was frozen in the past; the inside joke was that its customers' average age was between 65 and death. In 2020 Cadillac's market share was barely 7 percent of the luxury market.

WARNING

If you think about your business only in terms of your existing customers and current products, you risk losing sight of broader customer needs — needs that a competitor is no doubt going to satisfy at some point if you don't. You also create a shortsighted view of your strategic choices that can result in missed market opportunities and woefully inadequate business plans.

REMEMBER

Do you want to know our favorite definition of a "customer"? *Someone who doesn't have a better alternative.* If you aren't the best alternative, you're toast.

TIP

Serve the steak . . . but sell the sizzle. Successful restaurants learned long ago that patrons wanted more than delicious and healthy edibles. That was a given, what you needed to compete. But with so many dining choices out there, you had to satisfy more than an empty stomach with good-tasting food. The smarter players realized that an appeal to the customer's other sensory perceptions could be a way to go. This included not only visual appeal — who wants to eat in a dump? — but also audio and olfactory receptors, like soothing background music and mouth-watering smells. Let 'em hear the sizzle of the pan, smell the savory sauce. You win when you understand your customers in all their dimensions, not just the one directly tied to your product or service. Mmmm, hand us that menu now.

Unfortunately, companies (and even entire industries) lose sight of the big picture all the time. Companies view markets too narrowly and neglect customer needs — a classic management blunder. Keep the big picture in mind, and chances are you'll recognize strategic market opportunities. Charles Revson did when he revolutionized the cosmetics industry. Revson famously quipped, "In the factory, we make cosmetics; in the store, we sell hope." As the founder of Revlon, he understood that he offered his customers something far more important than simple chemistry: the prospect of youth, beauty, and sex appeal. Boy, talk about sizzle!

Numerous firms in other industries also began to understand that they were selling what some called the "enhanced product." These included gas stations. Proprietors realized that they had a captive audience who actually didn't want to be there at all, but the demands of a fossil-fueled motor engine required the periodic stop. So why not sell them something in constant high demand, relatively small in size, and quick and easy to pick and purchase? Indeed, why not! Today almost 85 percent of gasoline vendors are, in fact, small convenience stores carrying a limited variety of FMCGs (fast-moving consumer goods) like packaged snack foods, beverages, tobacco products, and the like. Gasoline sales generate less than 3 cents per gallon profit to the store owner.

Winemakers reached a similar conclusion. The product itself is relatively complex with few, other than experts, understanding the science that differentiates bad or excellent from good. Some of the more astute winery proprietors realized there's more to wine than the juice itself: If managed right, it could become an "experience" product. Many people today, especially younger consumers, want some fun associated with the buy process. And that's what they began to get at the winery: facility tours, tastings, gift shops (some with goods actually related to wine), and access to the site for events such as weddings, anniversaries, or corporate meetings — all available for a fee.

REMEMBER

The key point here is simple: Customers are more than repositories for your products and services, and they love convenience. They often are seeking something beyond the obvious, and if you can show them how to realize this in an efficient and effective way, you can fulfill those needs and bank the rewards.

Categorizing Your Customers

Buyers of goods and services are influenced by many factors. These are internal in some instances — how people are raised, such as their exposure to powerful forces like religion or politics or education. The rising field of neuroscience is also finding evidence that genetics can determine personality traits, just as it does your physical appearance or eye color. ("Isn't it weird how Mariah is just like her

mom when it comes to being so considerate to others?") But external forces also have a strong influence on behavior, which is something you should be aware of when you consider your customers and their attitudes toward your firm and its products.

Comparing generations

When you were born, believe it or not, is often a major driver of customer behavioral attitudes. Market researchers have identified five demographic generations that define people, as follows:

- The Silent Generation — born 1928–1945
- Baby Boomers — born 1946–1964
- Generation X — born 1965–1980
- Millennials — born 1981–1996
- Generation Z — born 1997–2012

People born into these generations were exposed to different events that shaped their worldview, including attitudes toward technology, politics, social norms, and economic life, among other categories. They bring these views to their evaluation of what you offer in the marketplace today:

- The Silent Generation (increasingly silent as the clock ticks away) experienced the Great Depression as children or teenagers. Cataclysmic events had a profound influence on this group's attitudes toward economic security and social stability.
- The storied "Boomers" — more than 75 million of them — were raised in relative affluence compared to their parents, enjoyed educational opportunities unheard of before, and reflected a joyful optimism about the future. Can-do, by golly!
- The Gen Xers, however, about 65 million strong, came of age in a very different time as the American Dream began to unravel through tragic events like Vietnam, civil rights battles, and a growing political divide. Skepticism began to replace optimism. Try telling an Xer that they could go to the moon and their government could solve problems.
- Next are the 72 million Millennials — far more liberal in their social attitudes than prior generations, quick to embrace diversity and pluralism in the

workplace and society in general, but also burdened with school debt, deteriorating job prospects, and downward mobility for the first time ever in America. They're confused and questioning.

- Generation Z members — 67 million in number — were raised in a technological revolution and accepted it wholeheartedly. They were coddled by fawning parents and grandparents pushing them to succeed. They also saw the decline of the old dinosaur firms and the rise of the young disrupters — and have an entrepreneurial spirit that's challenging everything. And while they celebrate economic wealth and accomplishment, they've also retained the social liberalism of the Millennials; they want their suppliers to be intentional in their values. But they're overwhelmed, trying to do everything at once, and now beginning to question their work-life balance decisions.

REMEMBER

These are not perfect definitions. The generational time frames can overlap at the edges. Both Millennials and Gen Z folks, for example, love the experience of doing something as much as having a given physical product. And obviously, not everyone in such large groups behaves in the same way. But understanding how these groups respond in general to your market offerings — and how different groups respond differently — can ensure that you don't get caught in the time warp that drove Cadillac into a ditch (as we see earlier in this chapter). As you consider your current customer profile, where does it fit into the generational categories? And how will the next one, whatever name it's given, respond? It's never too late to start planning for change. In fact, it's the only thing we know will happen.

Defining your good customers

A fresh look at customers should start with the ones you enjoy seeing — those who regularly purchase goods or services from you. But sometimes, knowing what a customer is *not* can be just as important as knowing what a customer *is*. You can find out about your business and best customers by observing the other kinds of customers shopping your industry — the difficult customers, the former customers, and the nonexistent customers.

REMEMBER

Good customers are the ones who bring a smile to your face, the ones you like serving, the ones who appreciate you, the ones who fatten your wallet and keep you in business. You want these customers to keep coming back time and again. But how do you keep them all satisfied? Job One is to first know just who these customers are, gain an understanding of their characteristics, and figure out how to continuously fulfill their needs better than the competition.

Your business can measure and describe its customers in several ways:

- Track each customer's unit and revenue volume over relevant time frames.
- Figure out who your customers are, including demographic and psychographic data that you have available or can access.
- Learn what and who influences your customers.

If you want more details on how to separate your customers into appropriate groups (market segments), check out Chapter 6.

Handling your not-so-best customers

"Can there be such a thing as a 'bad' customer? Isn't that a contradiction?" you ask. Not at all. Bad customers — like the neighbor from hell — simply cause you more trouble than they're worth and don't fit into your company's values and strategies. Let them pollute some other neighborhood, not yours. Bad customers do the following:

- Ask you to serve them in ways that aren't practical or economic for your company.
- Distract you, causing you to veer away from your strategy and dilute your business plan.
- Purchase in such small quantities that the cost of doing business with them far outweighs any revenue that they generate.
- Require so much service and attention that you can't focus your efforts on more valuable (and profitable) customers.
- Remain dissatisfied with what you do, despite all your best efforts.

You need to consider two things here: (a) how to identify the less-than-ideal customers, and (b) how to de-market them without giving yourself a black eye that could be embarrassing or worse. Start by closely examining your current book of business.

TIP

Divide the total head count of customers into fifths, and then for each of these five groups, calculate the average revenue per customer (and nothing magic about five; use a divisor that provides the best snapshot for your business). Now take a look at the results for the tail-end group (and be sure to consider the time that a customer has worked with you, as some start out small to evaluate what you're supplying before stepping up the orders). Is the number for the bottom fifth considerably lower than for the other groups? Maybe your marketing and sales team

is devoting a disproportionate amount of time chasing tiny returns — is it worth it? If there's little, if any, prospect for customers in this group to up their sales, let go and redeploy resources to better prospects.

How you communicate the news to those you've cut off is critical, however. No one likes rejection. Be sure you manage the de-marketing plan with care and consideration, perhaps directing them to an alternative supplier.

REMEMBER

To handle bad customers, follow these steps:

1. **First figure out who they are.**

2a. **Try to convert them into good customers if you can.**

2b. **If they can't be prodded into increasing their purchase volume, then relegate them to a lower status by, for example, limiting their transactions with you to online-only or self-service.**

2c. **But if your best efforts still fail, wash your hands of them and move on.**

WARNING

A word of caution on the not-so-nice customer: You may think that some of your customers don't reflect the demographic or image that you've worked so hard to create, so you take measures to exclude them from your markets. You delete advertising in certain media, use not-so-subtle hints that they aren't welcome, or shut out or never enter certain geographic areas. This might seem prudent in the short term. But once again don't make the mistake of thinking life doesn't change. Perhaps today's troublemaker is tomorrow's big spender — people do reform; teenagers do finally mature! Moreover, in the world of instant communication via Instagram and other social media platforms, any bad move on your part can immediately go viral, probably accompanied by video, that forever besmirches your hard-won image and reputation. And it's always out there in the wide world of the Internet. Lesson: Be careful what you wish for when you dismiss your "bad" customers.

Scoping out the other guy's customers

You may think that when customers take their business elsewhere, it points to a failure on your part. On the contrary, these people present an opportunity. The fact that you haven't been able to serve this group gives you a challenge: Finding out what your market really thinks is important. Your competitors' customers tell you what you lack as a company. This information is extremely useful, especially when you work on the big picture in the early stages of business planning, defining who you are and who you want to serve.

TIP

Getting to know your competitors' customers is often difficult but not impossible. Follow these tips down the road of discovery:

- Spend some time where customers gather. Use trade shows, user groups, and industry conferences to make informal contacts and begin a dialogue with your non-customers. And don't forget that customer comment pages of vendor websites often are chock-full of valuable insights straight from the horse's mouth — both positive and negative.
- Ask pointed questions of people who choose competing products, perhaps through a focus group (a structured get-together of a curated group of consumers, led by an external facilitator who isn't perceived as biased or judgmental).
- Did they investigate what was available on the market? Are they even aware of you? If so, what are their impressions? What turns them off?

Listen to what these consumers have to say, even if it's painful. Don't get defensive if you hear negative things about your firm or its goods and services. Information about your customers is valuable, if not priceless.

It's like having a customer service representative or department in your own firm. By encouraging customers to comment, you learn things that otherwise you might find out only after sales slide and a paid consultant investigates and reports on free information available in real-time if only you had created an accessible channel. (And don't call it the "Complaint Department." No one wants to work there, and most customers are put off by the term. And think about it: A customer complaint is in fact a plea for help — it's free consulting. Are you listening?)

Discovering the Ways Customers Behave

Perhaps the most difficult — and useful — questions that you can answer about your customers have to do with their behavior: Why do they buy what they buy? What actually compels them to seek out products or services in the marketplace? What are they really looking for? Unfortunately, most people don't wear their hearts on their sleeves. They often conceal their true feelings, fearful they aren't mainstream enough and might raise the ire of others. Who wants that?

Because of this, market research surveys and questionnaires that seemingly ask straightforward questions can't always be trusted to reveal underlying attitudes and beliefs. You need to probe deeper to get at the rock-bottom truth about your customers before you can design-in the features they really seek and

communicate to them in words and symbols they get. In the past you might have needed a psychiatrist to do this work for you, but not today. Modern technology has given us modern tools to do the excavation in an affordable way — kind of like a digital Dr. Phil.

REMEMBER

But like many aspects of our brave new world of the 21st century, there are sometimes downsides to progress — and the new tools that are out there for customer inspection can be abused. We're talking about the collection of private data that is sent to a computer server whenever someone engages with one of their digital devices, be it purchasing something online or simply sending an email to a special other. When this happens, it leaves a digital trail of the user's particulars that some firms then scoop up, process, and make available for sale to others on the Internet (these are so-called "data analytics" providers). Firms that purchase this data can now customize down to the granular level to precisely fit people and their specific needs and desires to the product and services they offer. We should acknowledge and applaud this progress; understanding consumer behavior is critical to business success. But where does privacy begin and the public domain end? Would you want your own private life strung out there for all to see? Use some plain old low-tech common sense and be mindful in how you manage customer data that you gather. Use — but don't abuse.

Understanding customer needs

Why do people buy things in the first place? Psychologist types tell us that *needs fulfillment* is really at the heart of all consumer behavior (see Figure 7-1). Everybody has needs and wants. When a customer discovers a need, it creates the motivation that drives human activity:

- Survival, at the most basic level, results in the universal need for food, shelter, and clothing. In the modern world, these basic needs support grocery stores, carpenters, and the garment industry.
- The urge for safety, security, and stability generates the need for seat belts in cars, funds in a financial institution account, and all kinds of insurance products and even home alarm systems.
- The desire for belonging and acceptance creates the need for designer-label duds, members-only clubs, and beauty-enhancing aids.
- The urge to be recognized and held in esteem establishes the need for expensive private universities, ever bigger homes, and award plaques and trophies (the latter of various kinds).
- The desire for self-achievement results in the need for adventure vacations, quiz shows, and web-based educational courses.

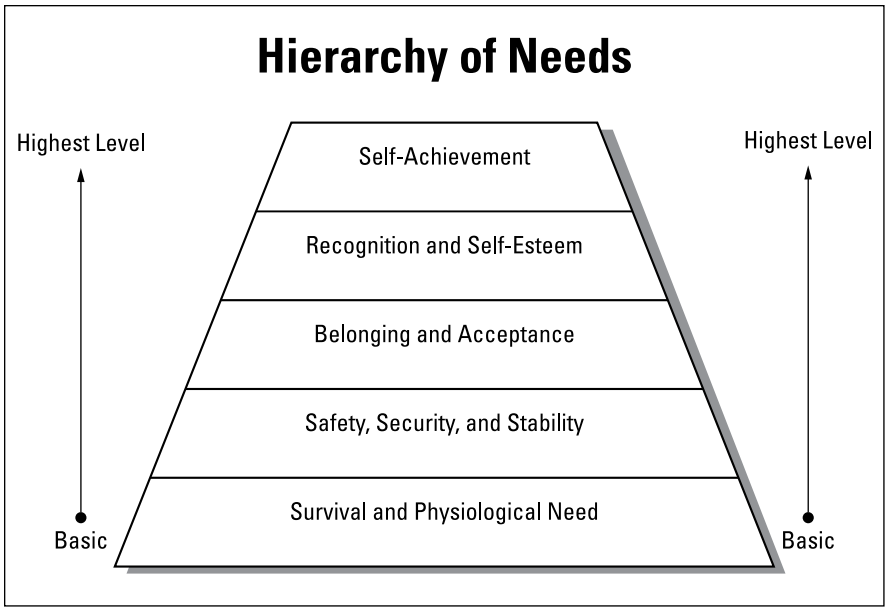

FIGURE 7-1: A basic overview of people's needs, as sketched out some 50 years ago by the social psychologist Abraham Maslow in his famous "Hierarchy of Needs" model.

Consider an example of understanding customer needs: Ever notice those ads where a shapely young female is paraded out in a red bikini to show off the latest round of drills, hammers, and saws? Let's be honest here, the idea of commoditizing a woman's body in order to sell products is more than tacky. So those who wallow in this gutter are simply despicable oinkers? Perhaps. But why would otherwise upstanding firms indulge in such sexist behavior? Primarily because it works.

At the end of the day we humans are the top dogs in the animal kingdom, and like all creatures large and small, we have a powerful innate drive to procreate the species and outsmart the daily sources of destruction — survival of the fittest as Dr. Darwin said. The DIY tool-buying segment tends to be overwhelmingly male, and many are in their prime child-rearing years. They're the target for brands like DeWalt and Craftsman found in Home Depot and Sears. But to get their attention amidst the barrage of shrieking advertising messages that bombard us almost everywhere we turn, something more alluring than a picture of a screwdriver is needed. Enter the hot model in the bikini. Psychology 101 — you figure out what primal instincts are aroused.

But why red? Because we humanoids respond visually to red and yellow more than other colors; they have the longest wavelengths on the visible spectrum. And if you can't attract and engage the buyer in the first place, you won't be able to sell them your product, be it computer games or garage tools.

REMEMBER

We aren't endorsing this approach to selling things. It's like adding too much sugar to foods aimed at kids. But we're showing you how a deeper understanding of human behavior can be useful in knowing how your market segment responds and what variables you can manipulate to pull the targeted buyers your way, rather than watch them hustle off somewhere else. So think about it. Maybe we aren't simply random wanderers in an unpredictable world; perhaps there is a reason for everything. What really floats peoples' boats? Sometimes you need to do a deeper dive beneath the waters to find out.

Determining customer motives

Motives are needs that have been awakened and activated (refer to Figure 7-1). They send people scurrying into the marketplace to search for products or services that can fulfill a particular need, although they aren't always what they seem to be:

- Greeting-card companies, for example, don't charge exorbitant prices just to sell cute little jingles (either online or in print). The prices are justified because they actually sell small insurance policies against their customers' fear of feeling guilty. And perhaps that fear of guilt (over a missed birthday or anniversary) is really what propels buyers into the greeting-card market.
- Most people have a need to be accepted and liked by others, and they enjoy having a certain amount of status in the eyes of others. This powerful motivation creates great market opportunities for beauty shops, aerobics studios, luxury goods, and breath-mint companies.

Although motives obviously apply to individual consumers, they work equally well in the context of business or corporate behavior. When a business sends out a post to employees or brings in a facilitator to explain to the troops why diversity in the workplace is good and gender or other forms of discrimination are bad, what's the motivation? We hope it's because organizational leadership believes that this message is important and should be heard and understood by everyone at the firm. But there might be another motivation. If for some reason an employee believes they were the victim of such reprehensible behavior by a supervisor or colleague, the firm can claim that it did what was legally necessary to inform staff that this behavior was definitely unacceptable at the firm and contrary to policy. If there was, in fact, a breach of the law, then it was the fault of the involved individuals, so sue them; the firm itself should not be held liable. What was the real motivation for the firm's nondiscrimination policies and training? You be the judge.

Figuring Out How Customers Make Choices

How do customers make choices in the marketplace? The most important thing to remember is that customers decide to buy things based on their view of the world — their perceptions of reality. Few customers buy without thinking; instead, they bring their perceptions of the world into a decision-making process that (ideally) leads them to purchase your product or service rather than your competitors'. (Remember our definition of a customer? *Someone who doesn't have a better alternative.*)

Realizing perceptions are reality

Customer perceptions represent the market's worldview and include not only what your customers think of your products and services, but also how they see your company and view your competitors.

As customers turn to the marketplace, they confront a mind-boggling array of choices. Many variables influence your customers as they evaluate their alternatives: advertising, endorsements, reviews, and salesmanship, not to mention their own gut reactions. It's been estimated that a typical urban or suburban American is exposed to between 4,000 and 10,000 advertising messages per day. Shopper paradise, or Dante's inferno? You need to know how customers respond to all these stimuli if you ultimately want to earn and keep their business.

Have you ever wondered, for example, why men's yellow sweaters are difficult to find or why women's clothes in black are everywhere? Well, it's not because your eyesight is failing: Market research consistently shows that a majority of men believe that the color yellow suggests weakness, and most women think black makes them look thin. Unfortunately, body shaming thrives in America.

REMEMBER

Marketing types have long known a critical truth about people: *Customers act on their perceptions of reality, not the reality itself.* People buy goods and services based on what they perceive to be true, not necessarily on what you know to be the facts. To be successful in the marketplace, you have to develop a clear insight into customers' perceptions, understanding how buyers react to products and services in your market before you complete your business plans — and be sure that you're not inadvertently sending out contrary signals.

Setting in motion the five steps to adoption

The decision-making process (DMP) that buyers go through often involves a series of well-defined steps leading up to the adoption of a product or service. (In this case, of course, *adoption* refers to a newly formed relationship with that product or service — not a child or a pet. But we're all for that, too, if it's your desire.)

REMEMBER

By understanding the five major steps we describe in Table 7-1, you're better able to take advantage of customers' behaviors and build strategies that help them complete the adoption process by choosing your product or service.

TABLE 7-1 The Buyer's Five-Step Adoption Process

Primary Steps	Description of Customer	Your Task
Awareness	Aware of a product or service but lacking detailed knowledge	Develop a strategy that educates and excites potential customers
Interest	Curious because of publicity and seeking more information	Provide more detailed product information and continue to build momentum
Evaluation	Deciding whether or not to test the product or service	Make the product-evaluation process as easy and rewarding as possible
Trial	Using the product or service on a test basis	Make the trial as simple and risk-free as you can
Adoption	Deciding to become a regular user	Develop strategies to retain good customers

Suppose that you own a software company with a brand-new business-productivity program or app. You fear, however, that customers will be reluctant to give the program a try, if they assume the software is difficult to figure out or incompatible with their computer systems. (Keep in mind that people act on their perceptions of reality rather than on the reality itself!) To move potential customers past the evaluation step of the adoption process, your CTA ("call to action" on your website) may want to consider access to a trial version of the program ("Click here for a trial!") — along with a simple purchase option after the trial period ends. Microsoft's Office 365 offers this, as do thousands of others like the movie streaming site Hulu or digital music app Spotify. Some software makers have gone even further by sponsoring hands-on workshops to demonstrate their hopefully cool new programs, which gives potential buyers a chance to evaluate, try out, and get comfortable with the product — all before they buy it.

Understanding the Global Customer

Powerful political forces began to converge in the ending decades of the 20th century to create conditions that opened up economic borders around the world. By the start of the 21st century, it was estimated that more than 3 billion new global citizens could participate in the grand dance of the capitalist market. The more adventurous large Western firms quickly grasped the opportunities for growth and made plans to push through the opening gates. At first the stampede was especially focused on the "BRICs" — that is, Brazil, Russia, India, and China, which between them held more than 2 billion people.

The hope, of course, was that the ways and habits of the so-called "advanced economies" would quickly take root in these newly "emerging economies." Unfortunately, the business pioneers had to learn a hard lesson before dreams of wealth actually materialized. This had to do with *culture,* both national and local: Not all customers throughout the world behaved alike. In fact, some of them were absolutely contrary to how the good folks back home shopped and bought. Read the nearby sidebar "The moral of the story: Know thy customer" before you disagree.

As this fact sank in, companies brought in the Indiana Jones types to get a better handle on how their products and services could be reshaped to meet international demands. Culture, we are told, does have similar foundations the world over. It seems that people, no matter where they live — the heavily populated places or the far-off Timbuktus (even Timbukthrees) — all have basic systems for the following: economic exchange, family formation, education, social norm and justice enforcement, and spiritual beliefs. But surely the forces of globalization, especially mass communication, would bring about a convergence of these cultural variables so that the global bazaar would be a one-size-fits-all paradise for the big firms moving in, right?

REMEMBER

Nope. Even though universal cultural markers exist like needs for food, shelter, and clothing, a quick poke beneath this outer layer reveals a world of difference underneath. In some product or service categories, the findings favor divergence rather than convergence. Food preferences are an easy choice. But many more exist, and this goes for business practices as well as actual services and products. For example, is your management style skewed to an objective analysis of cold facts and then a decision that says go with the winning option? You might be surprised that some cultures favor collaborative decision-making and agreement, even if the statistical "best" choice isn't the path selected. The devil, we know, is in the details — and you'd better get those right, or your goods will just rot away untouched on those offshore shelves. Or your best employees will quit, telling others how you just don't seem to get it when it comes to managing people.

So was globalization just a giant chase for fool's gold, to be shunned like the plague by the savvy business planner? No again. Not everyone benefitted from this trend, which was more evident in the advanced economies. And some products do appear to be universal in their appeal; who doesn't love Mickey Mouse, and a Big Mac and fries seem to whet the appetite worldwide. Overall we're fans of globalization, and we think you should be as well. If nothing else, population trends favor emerging market nations; these are the growth hot spots both today and in the future that will drive revenue, maybe for your firm, too.

More importantly, the opening of borders demonstrates that there's a lot of commonality in all the peoples of the world and that we really can find bonds of agreement when we get to know one another better. This is good — very good, in fact — when held up to the many atrocities of the past century. When approached carefully and conscientiously, the opportunities in foreign markets can be positive for all, real win-win situations. And this goes for the small and medium-sized enterprises as well as the big elephants that trek the commercial jungle. So when you're evaluating how to boost sales, don't neglect these international markets, even though they talk in many tongues and use currencies that might be only dimes to the dollar. Serious opportunity is out there if you're willing to make the effort to know how these global customers think and choose their suppliers.

THE MORAL OF THE STORY: KNOW THY CUSTOMER

The giant toymaker Mattel produced Barbie, the number-one selling doll in America where 90 percent of young girls had at least one. Company executives couldn't wait to get her into the hands of those millions of adorable little Chinese girls; after all, didn't they, too, deserve the chance to groom her hair and dress her up in those cute little outfits? Mattel opened House of Barbie in Shanghai, its largest store in the world.

Home Depot also spotted opportunity in this newly emerging market, as government relaxations on home ownership brought millions of families with rising incomes into play as potential customers. The retailer scooped up a local operator with 12 stores and quickly converted them to the familiar orange-themed big-box layout. Surely these customers, like American DIYers, would want to fix up the house a bit here and there, maybe add on a deck.

And then there was eBay, the wildly successful online auction platform for secondhand goods that allowed users to clean out the attic for a profit. After some success in Europe and elsewhere, China beckoned! The firm spent hundreds of millions to crack this huge market.

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But no pots of gold were found at the end of this population rainbow called China. In fact, only barrels of red ink for these three firms, along with many others:

- Mattel didn't understand that moms in China wanted their little darlings to be practicing the violin and solving calculus problems instead of fooling around with Barbies; if they were going to play with toys, they were educational or science-based. House of Barbie closed after only two years.
- Home Depot shut down its China operations after little more than five years; turns out that all those homeowners lived overwhelmingly in high-rise condo-like homes and didn't have much of a hankering to tear down walls and add on decks. If they did want to make some improvements, local labor was so cheap that it was the preferred method. China was a "do-it-for-me" market, not do-it-yourself.
- The demise of eBay was more complicated but stemmed from a similar source: a failure to understand local customs and behaviors. Moreover, its entry to China triggered a strong defensive response from Alibaba, the home-grown leading online retailer there, and this firm outwitted eBay at every turn. A mere three years after entering, and out some $300 million in investment, eBay pulled the plug and exited.

The Oracle of Delphi, we are told, said to "Know Thyself." But if you want to penetrate an international market, it might be better to first "Know Thy Customer."

Serving Your Customers Better

The more you discover about your customers, the better you can serve them. And in competitive markets, that can mean the difference between a successful business and a failure. Remember, your competitors can always try to copy the products you offer, and they will, but copying the services you provide to support those products is a lot more difficult.

Often, the difference between a customer and a *satisfied* customer is based entirely on the service you provide. Satisfied customers become loyal customers. And loyal customers are one of the keys to growth and profit.

TIP

You might consider those customers whose average spend on your product or service is miniscule to be unworthy of further consideration. Big mistake. A better way to evaluate customers is on their expenditures over time; it's called "customer lifetime value" or CLV. Take Starbucks, the ubiquitous coffee vendor. One

study found the average one-time spend to be $5.90. Now that's small potatoes. (Small potatoes? Please.) But that average customer made 4.2 transactions per week at Starbucks, or $24.30 per week. And that sums to $1,263.60 per year. And, during the 20-year average customer relationship, that pencils out to $25,272 of CLV. That's as much an eye-opener as your first cup of morning java.

REMEMBER

Think beyond an individual transaction. It pays to build lasting relationships with all your customers no matter how small. Do it right the first time, and they'll keep coming back. When profitable companies are asked to explain their success, they often take special care to mention their loyal customer base. This observation shouldn't surprise you: Loyal customers aren't only cost-effective, but they also tend to attract other loyal customers.

Take a look at the flip side of the coin: Lost customers are expensive. Research shows that most of your customers probably aren't profitable until they've been with you for several years. Why? Because in the beginning, you have to shoulder hidden costs, such as advertising, promotions, sales commissions, customer training, and what the bean counters call "SG&A" expenses. SG&A is sales, general, and administrative costs (also called "overhead," but be wary, or it can put you under water). Your firm likely needs to spend a fair amount of money just to open the door each morning, and it's difficult to accurately allocate these general costs to an individual product or service. To stay competitive, you will likely price your new offering based on the direct costs necessary to bring it to market and add in a fair profit margin for everything else.

OK, but what happens? If you did have a truly accurate cost allocation system, you'd likely find that your margin isn't covering all those "new customer acquisition" costs. In fact, as the research showed, that new customer was actually unprofitable for those first few years they purchased from you. It took time to pay off those initial acquisition costs. And worse: The same studies showed that a typical company loses 15 to 20 percent of its customer base annually. Many of these customers were long-timers — that is, their prior purchases had covered that hidden acquisition cost. Meanwhile, you're flogging the sales team to get out there and corral new customers to make up for the loss and meet the annual growth goals.

But what kind of customers come in? New ones, of course. Expensive ones. Customers who have yet to pay off their "acquisition" costs. And who left? To a large extent, customers who have already paid for themselves — the profitable ones. Studies across industries indicate that it costs about five times as much to attract a new customer as it does to keep an existing one. And it can cost up to 16 times as much to bring a new customer up to the level of profitability that a loyal customer represents.

TIP

Almost every firm today has a customer service unit. Often an FAQ (frequently asked questions) page is sufficient to satisfy customer inquiries. But for others, access to a real representative is critical to keeping customers happy. How can you improve this necessary resource? Here are some tips:

- The inflection of a customer service rep's voice can be off-putting to a customer, as it may sound hostile. One way to overcome that? One firm put mirrors on the wall facing its call-center workers, with a big sign over it: KEEP SMILING! Seems that when you smile, your voice turns down, and you sound more friendly to the caller.
- Another tactic is to use what's called "concreteness" in language. When an unhappy customer calls to ask what to do now that a flight's been cancelled, a typical response might be "Let me see what we can do." But a better one? "Let's see what might be available on a Chicago to Dallas connection going out this afternoon." This conveys an assurance to the customer that you have heard what they said and you are on it, pronto.

Looking at a Special Case: Business Customers

Many of the business examples we include in this book have to do with companies that sell products and services primarily to individual consumers. That's understandable, as they get a lot more attention by everybody and they are more interesting to discuss (we mean, can we talk industrial fasteners here?). But we don't want to neglect the other companies out there in the *business-to-business* or B2B markets, especially since there's more commerce done in this segment than in B2C markets. (Industrial fasteners actually account for about $90 billion in annual worldwide sales these days; got your attention now?)

There's another characteristic of industrial markets that also makes them highly competitive: Many products and services are commodities (see Chapter 5). Since individual incumbents in a particular industry offer very similar products, how can you compete on anything other than price? Throw in the tsunami of goods flowing across borders from abroad, where differing levels of economic development often mean lower costs for foreign suppliers, and the hurdle is raised even further for domestic suppliers in wealthy countries like the United States.

In this section, you find details on how companies, institutions, and government agencies behave when they act as the customers. What makes the business buyer different? Read on to find out.

Filling secondhand demand

Demand for goods and services in B2B markets is almost always *derived demand.* In other words, businesses purchase only the goods and services that they can use to better serve their own customers.

Steel is typically a product that most all individual consumers buy — but never shop for. Own a home or a car, have some appliances in the kitchen or tools in the garage? You have steel. But what you shopped for and then actually bought was a product containing the metal. Same goes for microprocessors: They're everywhere around you today — your phone, PC or laptop, in the car and other electronic devices. But your purchase of a semiconductor chip was an indirect one.

What are the implications for these derived demand product firms? If a steel maker cuts price across the board, for example, should it expect a huge increase in orders? Not necessarily. Steel users increase their purchases only if they think that they can sell more of their own product or service, and sales may be affected by many factors beyond the underlying price of steel. How many of us dashed out to buy a new Chrysler Jeep the last time US Steel (USX Corporation) reduced its steel prices by 10 percent?

REMEMBER

If you offer products or services in the B2B market, make sure you think through what your planning decisions mean to business buyers. This means considering the customers of your business customers, too:

- Will a price reduction on your part result in increased sales for your business customers — and your company?
- Will your customers (and their customers) benefit if you offer them additional product features that raise costs but don't add much value?
- Are your business customers looking for continuity and price stability so they can do adequate advance planning at their end?

Steel, as we note, is a classic commodity product. US Steel operated the nation's largest steel mill in Gary, Indiana, near many of its industrial customers. But these users had other choices available to them, so price was critical, and profit margins were always squeezed. The mill's general manager decided to try a different tactic: He instituted a new customer service policy. After an order was received and a delivery date set, then that's when the order would be sent. The order would be fulfilled on time, in full, every time. If it wasn't? The mill would pay a penalty to the customer. This proved to be a benefit that customers were willing to pay for, since their own production schedules and operations were highly dependent on having the steel order there precisely when needed. Higher sales were booked; more steel was rolled; capacity utilization went up (the key

metric in a mill's efficiency); and profits rose dramatically. The savvy general manager was promoted to HQ in Pittsburgh to oversee all steel operations for the firm (perhaps they read an early edition of this book).

Decision-making as a formal affair

Purchase decisions in the business-to-business marketplace tend to be more formal, rational, and professional than in most consumer markets. Many people from different parts of the target company may be involved in the *decision-making process* (DMP). One division in the company may recommend your product or service, another may acquire it, yet another may pay for it, and all the divisions do the work for a separate customer center that actually uses the product. Taken together, these groups form the *decision-making unit* (DMU).

Table 7-2 describes three ways in which a business DMU may behave when it thinks about buying a product or service. Businesses often change their buying behavior over time, so knowing where your business customers are in their DMP can help you plan when and how to make the sale.

TABLE 7-2 How Businesses Behave When They Buy

Buying Behavior	Description of the Customer's DMP
Business as usual	Continues to order more of the product or service, automating the process via EDI (electronic data interchange) software that communicates with suppliers to ensure that inventories don't fall below certain levels.
Yes, but . . .	Asks for changes in the existing sales arrangement, modifying one or more purchase terms (such as pricing, financing, quantities, and options), and including various people who are part of the DMU.
Opportunity knocks	Purchases a product or service for the first time, perhaps after putting out a request for proposal (RFP) to several possible suppliers and making a deliberate, complete decision involving all parties in the DMU.

Knowing the forces to be reckoned with

As you work with business customers, you have to deal with several powerful forces that you rarely encounter in consumer markets. It's usually a waste to create a "warm and fuzzy" ad campaign that plays on the emotions of the buyers to persuade them to bite. If you want your B2B strategies to succeed over time, you must factor these forces into your business plans.

REMEMBER

All the following activities take time and resources, of course, but your investment can be rewarded many times over when you incorporate what you discover about customers into your planning, be it for B2C or B2B segments. There's an old saying among business planners, and it's still true today: *Customer-driven firms win, product-driven firms don't.*

Asking some important questions

Consider the following questions (and there are many more that might apply to your industry):

- What's the state of your customer's business?
  - Is your customer's business booming, maturing, or dying?
  - Is it facing increased competition or enjoying record sales and profits?
  - Is it shedding assets, outsourcing operations, and restructuring?
  - Is it threatening to become a competitor to you?
- How does your customer's company manage its supply chain management operations?
  - Does your customer purchase from you centrally, or does it have buyers scattered around the company?
  - Does the purchase require several levels of approval before your customer makes a decision?
  - Do senior executives (who may or may not know much about product details) make the ultimate purchase decisions?
  - Does your customer use an online bidding system for RFPs (request for proposals)?
- Who's important to whom?
  - Do your customer's key decision-makers tend to be engineers, finance, or marketing staff?
  - Does your customer use both small and large suppliers? Does it seek diversity in its suppliers?
  - Does your customer have a policy of requiring more than one supplier in critical areas?
  - Does your customer appear to have a long-term relationship with existing suppliers? Does it use suppliers also used by industry leaders, or does it use mavericks?

Investigating unique forces

TIP

As you develop strategies for managing your business customers, take the time to investigate the unique forces of business-to-business markets:

- Get out into the field and talk to potential business buyers. Phone calls, letters, and online or other communication modes are efficient, but nothing beats the effectiveness of a face-to-face meeting that allows for relationship personalization.
- Attend conferences and conventions that your business customers attend, and find out about critical events and forces that shape their thinking. Maybe even sponsor a meet-and-greet there.

You also might investigate a supplier of tools to enhance your digital marketing efforts. Many fine vendors are in this space today, and they're not just for the big guys. For example, Adobe Systems, the Silicon Valley firm you probably know best from its pioneering PDF (Portable Document Format) product, set up Adobe Marketing Cloud in 2012. Adobe provides a comprehensive and integrated set of digital marketing solutions to its customers and partners. Even though it counts a good number of Fortune 500 firms as customers, it also has something for small and medium-sized enterprises. These solutions focus on analytics, web and app experience management, testing and targeting, advertising, audience management, video, social engagement, and campaign orchestration — all on a single platform. This allows you to get a deep insight into your customers and then build personalized campaigns to manage the relationships. Adobe is not the only one out there offering these services, but it's a good example of how you can get some help until you're able to build your own in-house digital capabilities.

IN THIS CHAPTER

- Seeing the value in competition
- Unveiling your real competitors
- Making use of strategic groups
- Keeping tabs on your competitors' actions
- Predicting what your competitors are going to do next
- Putting together competitive data

Chapter 8

Covering Your Competition

Spending time with the competition isn't anyone's idea of fun. Who could possibly forget the Lindsay Lohan character having to deal with the "Plastics" in *Mean Girls*? Think they're out to get you? You bet they are. But the more you know about the competition, the better off you are when it comes to figuring out their next move — and setting a strategy to stay one step ahead.

If you haven't gotten around to thinking about the competition yet, you're in bad company; many businesses fail to take this part of planning seriously. Typical excuses include the following:

> *We have no way of knowing who all our competitors really are or what they're up to anyway.*
>
> Or, *We already know everything about them. We compete with them every day.*
>
> And worse: *The competition? Hah! No one could possibly beat us; we're invincible.*

Business owners or managers in the first group wring their hands because trying to find out about the competition is tough. Those in the second group cover their eyes, assuming that if they don't look too hard, nothing bad can happen. The third? They're living in Fantasyland today. Talk about three blind mice; all these groups are making a big mistake. The competitor you're familiar with is much less dangerous than an unknown enemy.

In this chapter, we show you why you need to have competitors in the first place. We help you identify your current competitors and your potential competitors. We look at competition from the viewpoint of customers and the choices they make in the marketplace. And we examine your competitors in relation to their strategies and company structure, introducing the idea of strategic groups. After identifying your competitors, we help you understand them better by looking at what they do; by forecasting their future plans; and by checking out their capabilities, strategies, goals, and assumptions.

Understanding the Value of Competitors

Competition can be like Mom telling you to eat your spinach. It's not exactly the highlight of your day. But you know what? Spinach is really good for you! Always trust Mom. Competing with the other guys out there can be like that. Wouldn't it be so much easier if you could just open the store, display your wares, take the customers' cash, and go home? Wasn't that like the Soviet Union back when — and we know how that movie ended.

Competition is at the heart of capitalism, and it's good for you, us, and everyone else in the system. Competition is why we have those cool new products and services that define our lives today. It sparks the invention of new technologies, expands market opportunities, drives the start-up of new firms, and creates entire new industries. It also brings out the best in you. Competitors force you to sharpen your strategies, hone your business plans, and go that extra mile when it comes to satisfying customers.

But there's another dirty little secret down in the bowels of capitalism: Those who benefit from its rewards often want to pull the chairs out from any new players at the table. Old Adam Smith, the father of the market system, warned us long ago that whenever two or more businesspeople were conversing quietly in a corner, they were likely trying to figure out a way to rig the system to their own benefit. And boy, was he right.

WARNING

New entrants into an established market represent a threat to firms already there. It is not unheard of for these incumbents to try to block the newcomer from getting in. If your business plan has some innovative new features in it, don't be surprised to find the opposition loading up their legal artillery to try to stop you. For example, Tesla, the upstart electric vehicle (EV) manufacturer, uses a direct-to-consumer distribution model that eliminates independent dealerships (other than those owned by Tesla); its buyers typically use online channels to place orders. The powerful auto dealers' association flexed its political muscle by persuading state legislatures to ban this practice in numerous states, such as Michigan, home to traditional auto firms General Motors and Ford. Tesla continues to fight these anti-competitive laws in court, but it is a costly battle.

But thankfully, not that long ago public policymakers began to re-acquaint themselves with this sad truth of the U.S. economic system. They began to deregulate industries that had slowed to a halt in terms of openness to change. As consumer benefits began to proliferate in untold ways, other nations also hopped on the deregulation bandwagon. Incumbents in industries as varied as airlines, financial services, telecommunications and postal services, public utilities, taxis, and more were now faced with serious competition for the first time in decades as entry barriers fell.

In each of these industries, a newly competitive marketplace has resulted in more products, services, and customers — along with more choices and lower prices for customers. Well-run companies that played by the rules have grown stronger, and market expansion has made room for many new players. Among the biggest beneficiaries of all are people who travel, use ATMs, send express mail, call home from the road, and turn on the lights at night.

REMEMBER

Competition is a force to be reckoned with because it empowers customers, not the candlestick makers only. (If you need a refresher on customer needs, benefits, and buying behaviors, turn to Chapters 6 and 7.) Customers are always out there making market choices, deciding what to buy and where to spend money based on their needs and willingness to pay. How do they do it? The process is based on the value equation, which looks like this:

$$\text{Customer value} = \text{Benefits} \div \text{Price}$$

The equation may look a bit odd at first, but it points to a simple truth: Consumers are always making choices, some consciously, others less so, many purely through habit. Think about the last time you went out to run errands and stopped by the grocery store. Maybe you chose a store brand over a higher-priced national one for a canned good, but you bought your favorite brand of ice cream that you always buy. Driving home, you put gas in the car, opting for the most conveniently located neighborhood station even though its prices were a little higher than an

independent supplier across town. Consciously or not, you were weighing benefits against price.


REMEMBER

In the capitalist marketplace, the customer has choice, sometimes in bewildering amounts. And the forces of competition encourage each player in your industry to figure out how to provide customers the best value possible based on their own individual preferences. Did you notice that the shopper in the preceding example didn't always opt for lower price? But why not — isn't that what the economists tell us is the basic driver of economic decision-making? Yes, price is always a factor in the marketplace, but even the academics have had to adjust to the reality of personal behavior that includes value calculations beyond price and cost alone. What's in this for you? The opportunity for business success consists of more than just underpricing the others in your space. Competitive markets mean knowing your customers (as we see in Chapters 6 and 7) but also knowing who else is out there serving them, and how they are doing so.

Identifying Your Real Competitors

You've probably already heard that old saw about the two kids who go hiking in the woods. They suddenly come across a bear. One kid immediately bends down and tightens their shoelaces. The other says, "There's no way we can outrun that bear." The first one quickly replies, "I'm not interested in outrunning the bear, doofus. I just want to outrun you!" The point, of course, is that like the feisty young sprinter in the story, you need to know who you're really competing against.

You can come up with a list of possible competitors based on any number of factors. The problem is finding a method that identifies the competitors who truly impact your company. That's not always an obvious choice. You've got to get into the head of your customers first to ensure you grasp what they're really looking for. Is that buyer of a hot and speedy new convertible sports car in the hunt just for wheels? Perhaps not. Actually, he may have paid a visit to the boat dealer out by the harbor to take a spin in that spiff 45-footer with berths for four below. Now that you think of it, you notice the guy has recently hit the Big 5-0 and is beginning to question his mortality. The kids are out of the house, finally. But the hair's thinning a bit, a few grays. Not fun. How to hang on to fleeting youth? "I want a new sports car! Or maybe that cool bay cruiser I've always coveted." In reality both these suppliers of nonessential luxury products are fighting for the same demographically defined customer. What the poor guy really wants is to deny Father Time by getting something fancy that relates to his bygone youth. Be sure you grasp the lessons of Chapters 6 and 7 about customers and their underlying motivations before moving on.

To really understand your competition, you need to know the following:

- How customers make choices
- How customers use products
- The capabilities of your competitors
- Your competitors' strategies
- Where future competition may come from

Considering competition based on customer choice

REMEMBER

Customers choose to buy certain products based on a value equation, weighing the benefits of several products against their relative prices (see the earlier section "Understanding the Value of Competitors"). But which products do customers actually compare? If you want to know who your real competitors are, you need to know how many products — and which products — your customers typically look at before they decide to buy. If you know who your customers are and what their selection criteria are — that is, what they look for in a product or service — you can divide a list of competitors into groups based on how intensely they compete with you.

Travel and tourism is a multi-trillion dollar industry today (that's a trillion with a T). Millions of people work in this sector, and hundreds of thousands are employed in jobs that help travelers do their trip planning. Taking a vacation, booking lodging and transportation, adding on some special visits to mollify the kids — that used to be the job of the thousands of travel agencies that dotted the landscape in offices spread throughout every city and town in the United States, and other nations of the world, too. Many were independent operators, some part of a larger chain like American Express or Thomas Cook, yet others affiliated with organizations like AAA (the American Automobile Association, where you got those free maps and travel books).

The live, in-person travel advisor is still there, but time and technology have restructured this industry. There are now two primary segments, based on how customers contact and interact with the provider: traditional brick-and-mortar agencies, and online travel agencies (OTAs) that began to flourish with the rise of the Internet at the end of the 1990s (and some firms, of course, offer services through both channels).

But if you're in this industry, or planning to enter, is that all you need to know about your competition — just choose one segment and jump in? Hardly. To

achieve your business goals and learn who you're up against, you're going to need to further subdivide the two basic segments along a multitude of narrower variables. For starters, the industry caters to different kinds of customers. Some are families on a budget, others are searching for a once-in-a-lifetime experience with an almost unlimited budget. Some focus on solo business travelers; others contract with large corporations to handle all their employees' travel needs. And then there are agents who handle only a certain type of travel experience (like cruises or adventure tours), or a certain geographic region (southern Europe, Tuscany, Rome), or certain customer demographics (singles, senior citizens, LGBTQ, multi-generational family reunions). The only limitation appears to be imagination.

REMEMBER

When you've decided on which particular sub-segment you want to compete in, you need to identify who else is already there. You might start by typing keywords into your preferred search engine (for example, "wine country tours") and see what pops up. Here's how you should organize your search:

- **Head-to-head competitors:** Together, these companies represent your most intense competition. Your customers probably look at them, too, before deciding. They might ask you to compare your features, benefits, and pricing with these competitors' products. You want to know as much as you can about these competitors. If you're an independent brick-and-mortar agent, try drawing a circle of five to ten miles around your location. What other agents are in this same space? Which ones are optimized to offer specific services similar to yours? If you specialize in a certain type of traveler experience, search the Internet for competitors targeting the same market.

  If you are an OTA like Travelocity/Orbitz/Expedia (all part of the same firm these days), Booking.com, or Trip.com, you need to know how big their supplier network is (airlines, hotels, restaurants, and so on). What unique features do they have, such as points programs or refund policies? How user-friendly is their online platform? Do they have any arrangements with airlines, hotels, or some corporate clients that give them a special advantage?

- **First-tier competitors:** These companies are direct competitors, but perhaps not quite as fierce as the head-to-head kind. In the OTA segment, this could be smaller incumbents like Tripadvisor.com or Trivago. For brick-and-mortar, maybe a lone agent working from a home office. You may run up against one of these only in certain areas and among particular kinds of customers. You don't want to ignore this group too long, however, because any of these companies may have the desire and capability to become a head-to-head competitor. Or they get acquired, and now they have more resources to come after you.

- **Indirect competitors:** These competitors are the ones you don't often think about. Some of the major transportation providers such as airlines offer their own travel agency services, giving airfare discounts if you book related travel services like car rentals or hotels through them. And AAA, as noted earlier, provides a wide range of travel arrangements for its members. Some credit card suppliers do the same. Their products surface as alternatives to yours only occasionally, and you usually have more important competition to worry about. Again, this group deserves a periodic review because indirect competitors always have the potential to surprise you with competing products that come out of the blue.

TIP

You should be able to count your head-to-head competitors on one hand. You may have twice as many first-tier competitors to track and an equal number of indirect competitors. Be careful to keep the number of competitors that you track manageable. Your head-to-head competition deserves much more attention than your indirect competitors, obviously, but you should set up a schedule for reviewing companies in each of the three competitor groups. Start with a weekly analysis of your head-to-head competition, a monthly review of first-tier competitors, and a quarterly review of your indirect competitors, adjusting the schedule to fit the pace of change in your industry.

TIP

One way to come up with levels of competition in your business is to ask potential customers to consider playing their product-selection process backward for you, as we describe in the following list. (For more detailed information on how customers make choices, check out Chapters 6 and 7.) Sometimes, you can also get this kind of information through your salespeople or customer-service representatives (if you have them):

1. **Ask customers for the short list of products that they seriously evaluated for purchase.**

   Your head-to-head competitors probably offer these products.

2. **Ask customers for the larger list that they came up with when they started investigating what was available in the market.**

   Your first-tier competitors are likely to offer these products.

3. **Ask customers for the names of products that popped into their heads when they first decided to go shopping.**

   These products may include those your indirect competitors offer.

Paying attention to product usage and unexpected new competition

Looking at products and services in the context of how customers use them gives you another viewpoint from which to eye the competition.

Consider this example: For centuries sufferers of hair loss (alopecia for the in-crowd) looked for a cure, especially males who saw this Samson-like curse as a threat to their masculinity. Lots of scammers touted snake-oil remedies, from ointments to more complex products. But nothing worked. In the 1950s researchers at the pharmaceutical firm Upjohn developed Minoxidil as a compound to treat ulcers; it proved a bust for that application, though further research showed it was effective in treating high blood pressure. It was relabeled as Loniten and approved for this indication in the 1970s. As physicians began to prescribe Loniten, however, some patients began to experience an unexpected side effect: hair growth. Not everyone was thrilled with this, but as word spread, some thought it was a miracle cure for baldness. In 1988 the regulatory agencies gave approval to the compound as a hair restorative under yet another new name, Rogaine.

Prescriptions grew rapidly, a women's version was introduced shortly after, and by the mid-1990s, it was authorized for over-the-counter sales. The charlatan peddlers out there took a haircut. In 2006 Johnson & Johnson, the pharma giant, acquired the Rogaine brand, which now accounts for more than 50 percent of this nearly $8 billion global market. That's a real growth story.

TIP

When you survey the competition in your defined market, you've got to be conscious that there might be something that comes out of left field and surprises everyone. These are obviously hard to track in any systematic way, but you can take some steps to stay on the cutting edge of your industry:

1. **Ask customers to think about situations, applications, or occasions in which they may use your product.**
2. **Ask customers to come up with other kinds of products or services that would also be appropriate and may be just as satisfying in the same situations.**

By viewing your competitors from a marketplace perspective — how customers choose and then use alternative products — you're rewarded with a more complete picture of the competitive landscape that you face.

Spotting strategic groups

If you step back and look at the competitors around you, their differing appearances may amaze you. In certain industries, for example, companies that have a full product line compete with companies that offer a single product. In other industries, companies that gain recognition for their innovative research and development compete with companies that don't develop anything on their own.

How can competitors in the same industry be so different? Over time, doesn't every company figure out the best strategy for their industry, as well as the most efficient and effective ways to do business? And then they all converge on that one best way? These good questions have two possible answers:

- Companies don't always discover a best way to do things. Markets and industries are complex, and different ways of doing business can exist side by side and be equally successful.
- Companies that do business one way can't always easily change and start doing business another way.

Identifying competitors based on their unique capabilities and strategies has a great deal in common with some of the industry analysis topics we discuss in Chapter 5. Sometimes you can take that analysis one step further and divide companies in your industry into groups based on what they do and how they operate — sort of like the market segments that we talk about in Chapter 6, but this time applied to companies rather than individual customers.

REMEMBER

A *strategic group* is a set of companies in a particular industry that look alike and tend to behave in similar ways. In particular, firms in the same strategic group have the following traits:

- They display similar characteristics (products on offer, size, geography).
- They operate in similar ways (degree of risk-taking, level of aggressiveness).
- They demonstrate similar capabilities (employee skills, special tools, brand image).
- They pursue related strategies (customer segments, distribution, marketing, and product-line decisions).

You can apply all sorts of business criteria to identify the most useful strategic groups. Although every industry is different, you need to consider these general variables:

- Companies that manufacture most of their product components versus those that outsource components or only resell products made by others
- Companies that produce name-brand products versus those that produce generic or private-label brands
- Companies that rely on their own R&D (research and development) versus those that license or buy technology
- Companies that have a full product line versus those that have limited or specialized products
- Companies that emphasize marketing versus those that focus on production
- Companies that compete in multiple industries versus those in only one

Strategic groups fall somewhere between an individual company and the entire industry. Lumping your competition into groups is helpful, because all the companies in a strategic group tend to be affected by, and react to, changes in the marketplace in the same ways. But grouping works only if those companies stay put in their assigned group long enough to be analyzed. Fortunately, they usually do.

As part of your industry analysis, you already may have discovered a few entry barriers — factors that make it tough to get into your business, such as high capital costs, expensive distribution systems, new technology, and the like. You also may have come up with some exit barriers — factors that keep competitors from getting out of the business, such as expensive factories with lots of debt and long-term labor agreements. Strategic groups can have the same kind of mobility barriers, which tend to keep competitors where they are, in one group or another.

REMEMBER

Strategic groups can be a great time-saver in business planning, because when you put all your competitors in strategic groups, you know where to focus your energies. You can spend most of your time analyzing the companies in your own strategic group and deal with the rest of the companies in clusters instead of tracking each company separately.

TIP

To divide your list of competitors into strategic groups, follow these steps:

1. **Put your competitors in a small number of groups, based on their similarities.**
2. **Add your company to one of the groups.**

3. **Looking at each group carefully, try to come up with the basic criteria that you used to make your selections.**

4. **Take a hard look at the group in which you put your company.**

   Are these competitors really closest to you in terms of their characteristics and the criteria that you identify?

5. **Ask a few trusted customers to look over your groups and see whether they agree.**

   Viewing the world through your customers' eyes is always worthwhile and can sometimes be a real eye-opener.

6. **Adjust the groups, if necessary, and work on additional criteria that may point to other strategic groupings.**

WARNING

Strategic groups are relevant and useful in many industries; they often provide a means of organizing competitors in ways that can simplify the competitive landscape. But keep in mind that all industries don't play by the same rules. If the mobility barriers aren't very high, for example, or technology is changing how customers perceive a particular product or service line, then companies are free to adjust their capabilities and change strategies quickly. If you are an automobile manufacturer today, would you include Apple or Amazon as players in your group? What if local government authorities mandate new health and safety requirements for restaurants — will all the current incumbents be able to comply? Or what if these same public agencies decide that a company's workforce must be considered as internal employees rather than external contractors favored by gig economy firms? Make sure that the groups you identify in your industry are still relevant before you have a chance to analyze them.

Focusing on future competition

A defining element of business in the 21st century is globalization. The lowering of international trade barriers and the revolution in communications technology as well as transportation paved the way (or perhaps smoothed the waters) for an explosion of cross-border trade. But for too many firms in too many industries, globalization was an update of the three monkeys who saw no evil, heard no evil, and spoke no evil. That is, they ignored the threat until it was too late.

We all know about management failures in the auto, consumer electronics, steel, and so many other industries in which domestic American firms once ruled the roost with their smug attitudes about foreign competition. When the new guys came knockin' at the door, they were ignored at best or probably ridiculed for their exotic company names or new product features that no American customer would possibly want. And those low prices? Obviously low because the hardware was junk. But then again. . .

Talk about learning a lesson the hard way. Today we don't need to warn you about keeping a constant lookout for competitors no matter what their country of origin. Globalization has opened our eyes as well as our markets. The following are the likeliest sources of new competition to scan for threats:

- **Market expansion:** A company that operated successfully for years outside your geographic region decides to expand into your territory, making it an overnight competitor. Those low-priced Mahindra compact tractors that now compete with John Deere came from India, home base for its world-leading market share (and in fact, it now operates multiple factories in the United States, too). Alternatively, a company that dominates another market segment sees an opportunity to target your customers as well — is there any place that Amazon won't go?
- **Product expansion:** A company decides to take advantage of its brand name, its technology, or its distribution system and creates (or acquires) a new product line in direct competition with yours. Coca-Cola may have started with a single drink but now offers more than 500. Pepsi-Cola owns Quaker Oats cereals, Stacy's Pita Chips, and Pearl Milling (what used to be called Aunt Jemima) pancake mix.
- **Backward integration:** One of your major customers decides that it can do what you do — and do it faster, better, and/or cheaper. So the former customer sets up shop and hands the business that it used to give you to its in-house group. Suddenly, your old customer is a new competitor. Ever notice all those Kirkland brands at Costco?
- **Forward integration:** Your company buys many products from many suppliers. One day, one of those suppliers decides that it can bring all the pieces together as well as you can. So it creates a new business and a product line that competes with yours. Huawei, the controversial Chinese maker of networking components for the telecommunications industry, now offers its own branded cellphones, laptops, speakers, and other such consumer electronic goods — in direct competition with some of its component customers.
- **Change in fortune:** Out of the blue, a major company purchases a minor competitor. With access to new resources (financing, marketing, and distribution), the minor competitor becomes a major player. Dollar Shave Club was a scrappy new online shaving start-up in 2012, with a disruptive business model. Then in 2016 it was acquired by the $60 billion UK-based Unilever, a global giant in FMCG (fast-moving consumer goods) markets. Now Dollar Shave Club competes in hair care, skin care, oral care, and even fragrance markets, among others. We bet Procter & Gamble is a lot more interested in this little guy now.

REMEMBER

Keeping track of future antagonists is as important as tracking your current ones. You can avoid a close shave yourself by systematically watching out for these competitors. When they appear, they may catch you off guard and be all the more dangerous because of their unknown pedigree. So keep your eyes and ears open, and don't be shy about asking your customers and suppliers about competitors on a regular basis.

Tracking Your Competitors' Actions

Suppose you're armed with a fresh list of competitors. You rank which of those competitors you have to watch most carefully and tag them as head-to-head competitors, first-tier competitors, or indirect competitors. (See the earlier section "Identifying Your Real Competitors.") Maybe you even put them into strategic groups, singling out the competitors in your playpen most in need of special attention. So what's next? You should decide which of the competitors on your list you want to spend more time with. Keeping track of competitors' actions involves looking at both what the companies are capable of doing today as well as what they plan to do in the future.

Determining competitors' capabilities

You need to ask the same kinds of questions about your competitors that you ask yourself when you complete a company self-checkup in Chapters 9 and 10. We introduce the basics here, but turn to those chapters for all the details.

What should be of the most concern to you is how well these others stack up against your own primary strengths and weaknesses. No need to get agitated about, say, a competitor's ability to cut a few shekels of cost here and there when you're in a luxury goods market that turns on brand perception more than price. But if the other guy hires that hot new celebrity with her new hit show to pitch its goods? Now that's something entirely different.

REMEMbER

To determine your competitors' capabilities, start with this list of important business functions and areas. The following questions should get you going, but if you need more help, check out Chapters 9 and 10, especially the information on value chains in the latter. You can also take a peek at the later section "Organizing facts and figures."

- **Management:** What do you know about the background and experience of the company's chief honchos? What functional areas (marketing, finance, engineering) do they come out of? What about the board of directors? How

many talented, qualified, and accomplished people are at or near the top? Do any managers hail from another industry? If so, what are their past track records?

- **Organization:** How structured and centralized is the company's organization? Does it have tight controls in place, or does it delegate authority down through lower organizational levels? Does it promote from within or hire from the outside? How would you describe the corporate culture?
- **Customer base:** What is the company's share of the market? Is it growing? How loyal are its customers? Are customers concentrated in one segment, or do the company's products appeal to several segments?
- **Research and development:** Is the company known for innovation and technology? Is it even involved in R&D? How often does it come out with new products? Does it have patents and copyrights to rely on? How stable and committed are the members of its technical staff? Does the company have sources of outside expertise to draw upon?
- **Operations:** How modern are the company's facilities? Has it gone digital yet, and if so in what areas of operations? If the company is a manufacturer, does it have flexible production facilities? What about capacity? Can the company count on its suppliers? What's the general attitude of the workforce? Does the company have a history of labor disputes?
- **Marketing and sales:** How strong are the company's brands? How broad is the product line? Does the company have a reputation for quality? Does the company put a large amount of its resources into advertising and promotion? Is it known for its customer service? Are the salespeople aggressive and well-trained? How are they compensated?
- **Distribution and delivery:** How many distribution channels does the company sell through? Does it have a good relationship with its distributors? Is it quick to take advantage of new distribution opportunities?
- **Financial condition:** Is the company's revenue stable, growing, or shrinking? How about profits? Does the company manage costs well? Are profit metrics steady? What is the cash-flow situation? Is long-term debt manageable? Does the company have ready access to fresh funds?

TIP

As you start digging, it's a good idea to compose a half-page or so corporate bio on each competitor. Each one should capture the company's defining traits, and not just the usual data on sales volume, product line-up, and so on. Be sure to include the following:

- Capability to respond quickly
- Willingness to change

- Determination to compete
- Capacity to grow

This may sound like a poor imitation of some psychiatrist, but you won't regret the effort. It's not always what a competitor has that drives its behavior, but rather how it manages those resources it has. This was the sad lesson learned by too many U.S.-based firms that initially dismissed foreign competition when globalization began to churn the waters.

Assessing competitors' strategies

Your competitors' capabilities tell you something important about their capacity to get things done right now in your business. But what are they planning to do for the future?

REMEMBER

To answer that question, you need to assess their capabilities strategically. (We talk a lot more about how to think strategically in Chapter 14, so turn there for the details.) The following strategies are sometimes called generic strategies, because they've been tried many times before and because they work well in almost any market or industry:

- **Low cost:** The first generic strategy comes from a basic economic principle: If you can offer a product or service at the lowest price in the market, all else being equal, customers are likely going to buy from you. In the retail food industry, Walmart, Costco, Aldi, and other discount chains compete almost exclusively on low cost. This strategy assumes that you can also produce your product at a low-enough cost so that the company makes a profit over time, which is why a lot of firms choosing this path tend to be big — production volume equals low cost (scale economies as described in Chapter 5). The strategy also assumes that to reach low-cost status, your product or service doesn't compromise other things customers want, such as a given level of quality (that "all else being equal" caveat we just mention). How about this for a promotional come-on: "Hey traveler, fly us! Our prices are 35 percent lower and more than 90 percent of our flights get there safely!" Whoopee.
- **Something different:** This strategy is based on the simple notion that if you can come up with something unique in the products you offer or the services you provide, some customers — maybe a lot — will be willing to pay for the difference. Bottom-feeders, who buy only on price (see the preceding point), are always out there, but very significant numbers don't want to be just like the Joneses next door. They prefer the alternate path. The potential for a strategy of differentiation usually occurs in markets where customers have higher incomes and where available marketing media provides mechanisms

to communicate differences effectively. The private jet industry, for example, is thriving today; in the United States there are more than 20,000 of them up there, and the firms operating in this space generate close to $25 billion a year in revenue.

- **Focus:** The last generic strategy is about the specific kinds of customers you decide to serve. Instead of positioning yourself everywhere in the market and trying to sell products and services to everyone, focus strategies are about firms that carefully choose customers along some given attribute and cater only to them. This attribute might be geographic, demographic, or really just about anything that allows for you to narrow down your market beyond some basic differentiator. Taco Bueno, a fast-food chain started in 1967 in Texas featuring Tex-Mex dishes, has today about 150 stores limited to seven central southern states. Compare that to Taco Bell, started in 1962 in California and today operating more than 7,000 stores in more than 25 countries.

A competitor doesn't have to go with just one of these three generic strategies. The Swiss-based Swatch Group makes that eponymous timepiece, hardly considered a luxury brand. But it also makes high-end Omega, Longines, and Breguet watches, more fine jewelry than mere watches. Chapter 14 shows that generic strategies are often combined.

TIP

Put together a short summary of what strategies you think your competitors may be coming up with (add it to the file you started with the short bios of your primary market opponents we suggest in the previous section). Review their capabilities and past actions, considering the following questions:

- What generic strategies has each competitor adopted in the past?
- Have the strategies generally been successful?
- Are changes in the industry forcing competitors to change their strategies?
- What kinds of change is each competitor capable of making — what limits their flexibility and what enables it?

Usually, you find that a long-term strategy requires time to implement and the total commitment of the company. It turns out that knowing a little about your competitors' history is very useful in understanding their strategies. It also helps you keep in mind what you think your competitors are capable of in the future. Remember, you can use the concept of strategic groups to simplify this process. (See the earlier section "Spotting strategic groups.")

Predicting Your Competitors' Moves

Trying to predict where your competitors are headed isn't easy, of course, kind of like predicting the weather. But modern meteorological science has dramatically improved what was once left to those who spoke to the weather gods. Knowing where your competitors plan to be in the months and years to come certainly depends on where they are today, as well as on their capabilities and the strategies that they've set in motion. If you know where to look and what to do, like the modern meteorologist, there's a lot you can find that will give you some good clues.

TIP

One approach is to employ "game theory." This is a highly logical procedure (think math) that presumes rationality on the part of industry competitors who are pursuing profit as their motive. It doesn't work in all cases, because not all business planners are "rational" in the traditional sense (how could someone like Elon Musk possibly believe that he could successfully take on Detroit and the entrenched auto giants?). But it may be worth a look for some of you out there as you try to assess the competition's next move. Find a quick overview at `www.investopedia.com/terms/g/gametheory.asp`.

Many companies intentionally (or accidentally) send market signals about how they may behave. Some companies, for example, always lower their prices only when a competitor moves first. Looking at the past actions of competitors can provide you with an indication of what they may do next. Predicting your competitors' actions also requires a little insight into what they think and how they think — the goals that they aim for, as well as the assumptions that they make about the industry.

Figuring out competitors' goals

Your competitors' mission, vision, and values statements tell you a great deal about what they expect of themselves in the future (see Chapters 3 and 4). These documents aren't top-secret; they communicate a company's intentions to all its stakeholders, and you should take advantage of them. You don't have to read your competitors' minds. All you have to do is read what they say about themselves and what they plan to do. (See the later section "Organizing facts and figures" for places to find such info.)

When the late Jack Welch was CEO of General Electric, he instituted one of the most famous — and emulated — business goals in recent history. Shortly after taking over in 1981, he spelled out the giant company's new goals to his senior managers: market share, market share, and market share. There was growing evidence at the time that profits were disproportionately located in the top two

market leaders in an industry, and then fell off precipitously further down the line. He wanted GE to become either first or second in market share in each of its many businesses — or else. No one misunderstood what the "or else" meant.

GE's competitors could have listened to Welch, because the company sent a clear signal about how it intended to compete in the future. And he followed through, firing managers and ultimately selling off divisions that failed the number-one-or-two-in-the-market test. Any company that went head-to-head with GE for market share had a battle on its hands. The companies that understood this fact had both a warning and the opportunity to adjust their own strategies to meet a changed competitive landscape.

REMEMBER

To discover the details about your competitors' plans, take the following steps:

1. **Get out your list of primary competitors.**
2. **Dig up as much information as you can find on each competitor's values, vision, and mission statements, as well as any stated business goals and objectives.**
3. **Ask customers, suppliers, your sales staff, and maybe even former employees of your competitors for information about each of your competitor's long-term plans.**
4. **Enter your educated estimation of your competitors' financial and strategic goals in the dossiers you've been compiling.**

Uncovering competitors' assumptions

What your competitors plan to do is usually related to their assumptions about themselves, about you and other companies like you, and about your industry — how they think and the way in which they see the world. Sometimes you can get important clues about your competitors' assumptions by going back over their goals and objectives. Companies can't easily make a statement about where they want to go without giving something away about where they think they are today. You can often come up with valuable insights by comparing your competitors' assumptions about the industry with what you know (and think) to be true.

Just as marketers tell us that consumers operationalize their perceptions of reality rather than reality itself, we humans also translate much of what we observe through a screen of assumptions — about the world, people, and also goods we buy in the marketplace. Many of these assumptions are formed early in life through a variety of sources, and over time they get deeply ingrained in how we see and interpret things. One result is that people from different generations can look at a similar product but see a different reality.

Take the Silent Generation we discuss in Chapter 7. These folks were there when Japan was defeated in World War II and also when that country began to get back on its feet as a dramatically changed market-based democracy in the 1950s. Japanese firms took advantage of lowered international trade practices and began to export goods to the United States. But how were they received? "Japanese junk! Those producers can't make anything; remember how we won the war?" A fair number of the key decision-makers for American firms whose products were the target of the new Japanese competition fell within this group of naysayers. Based on assumptions formed in their formative years of development, these executives dismissed the threat. But the rising Baby Boomers loved the new stuff from Japan. Toyota, Sony, and Nokia became beloved brands. These new customers from a different generational era didn't harbor the bias of the past.

As Korean manufacturers followed the Japanese into global markets, there were criticisms of the first wave of goods pushing into the United States from this emerging economy. But when Hyundai began to challenge Japanese automakers and Samsung took on consumer electronics brand leaders, opinions began to change again. These new products were pretty darn good by comparison, and the price was right. A Korean firm like TSMC, founded in 1987, is now rightly regarded as the world's top supplier of semiconductors.

And today? There's a whole generation of business planners who write off Chinese companies as purveyors of low-cost and low-quality goods based on what was on offer in the 1990s. What are your assumptions about the country of origin of the goods and services with which you compete? Are they valid assumptions — or shaded by your past beliefs? Might be worth a reality check; one place to start would be investigating how and where that top-end high-quality $1,000 iPhone you use got made.

TIP

Assumptions aren't always true. As noted in our examples, false assumptions can be very dangerous for companies, especially when they lead to so-called conventional wisdom or result in competitive blind spots. Social psychologists have been pointing this out for some time now; one trap is called "confirmation bias," which translates in normal English to only seeing what you're looking for — and ignoring any evidence that might suggest otherwise. Avoid it! Here's a tip or two:

- **Conventional wisdom:** Prevailing assumptions in an industry often become so ingrained that companies mistake them for the gospel truth. Conventional wisdom is almost always proved wrong when an unconventional competitor comes along. Watch your competitors for signs that they take their assumptions too seriously and have forgotten the importance of asking "Why?"
- **Blind spots:** Missing the significance of events or trends in an industry is all too easy, especially if they run counter to prevailing notions and conventional wisdom. A competitor's worldview often dictates what that company sees and doesn't see. As you track your competitors, look closely for actions and reactions that may point to blind spots and a misreading of what's happening in the marketplace.

Business headlines of the past few decades have been dominated by stories about feisty little disrupters who challenged the industry giants and their conventional approaches, and won. In most cases, defeat was a function of poor judgment rather than a lack of resources.

Competing to Win

The more you get to know your competitors, the better off you are when it comes to understanding their actions and anticipating their moves.

REMEMBER

But the more you discover about your competitors, the more they probably discover about yourself. You probably put out as much information about your company and its intentions as your competitors do, so listening to yourself is just as important as listening to them. Put yourself on your list of competitors. Interpret your actions from a competitor's point of view. Here's one question we always like to raise for our own consulting clients: "If you had to attack yourself, how would you do it?" That way, you understand the implications of your competitive behavior in the industry as well as you understand your competitors' behaviors.

If you're serious about the competition, you can't do all this analysis as a one-off exercise, file it away, and be finished with it. The market never sleeps, and if you start ignoring the constant chatter out there, you're setting yourself up for a bad surprise. You have to monitor your competitors in a systematic and ongoing manner. If you're good at observing your competitors, you can choose the competitive battles that you have the resources to win. That way you won't get ambushed and trapped in competitive situations where you're bound to lose, or end up in zero-sum games (whoops — game theory speak; sorry).

Organizing facts and figures

To find out what really makes your competitors tick, take advantage of data from all sorts of places. (Refer to Chapter 5 for a list of resources.) Start your search using the power of the Internet. You can usually find facts and figures on the competition included in the following resources:

- Business, trade, and technical sites
- Trade shows
- Company documents
- Government filings
- Stock-market analysis

- Management speeches
- Suppliers and distributors
- Customer feedback
- Academic studies and papers
- Your employees

And let's not forget the fee-based sources of data that are available. Throughout this book we implore you to do your own spade work when doing business planning. But we also admit that there are suppliers of comprehensive and up-to-the-minute information about your industry and the competition that inhabits that space. Sometimes these guns for hire can also serve up data that no other source could ever bring to the table. Be careful if the information you get from a paid source seems too proprietary — it could end up costing you far more than you paid. But most of these organizations can cut the time considerably in getting the dope on the competition out there. Here's just one for your consideration: Fuld+Company (`www.fuld.com`), a highly professional consulting firm that employs state-of-the-art investigatory methodologies and serves clients throughout the world.

TIP

Whew! That's a pretty hairy list we've compiled. It might take a lot of sleuthing to track down all the information you need to do a serious competitor analysis. But nothing's worse than being blindsided. Where to start? Each of the target areas we specify has its own pot of potential gold. To gather information on management, for example, gossipy stuff is easier to find than you may think. People love to talk about themselves — and today everything is out there on the web. Have any of your employees worked for a competitor before? That person's recollections could be a veritable gold mine.

How are other firms structured? Scan through the usual sources to find what you can — industry news media, company newsletters, the library. You might even try looking for so-called "case studies" of firms. These are short accounts of specific companies and how they handled some problem, typically used at collegiate business schools for training the future business leaders of the world. Most all cases are available in public files somewhere; there are thousands of them.

The last item in our list of competition data sources deserves a special note. Your employees are an invaluable source of data when it comes to the competition. As you look inside your company, start with your salespeople, who are smack-dab in the middle of the information stream. They talk with customers, deal with distributors, and occasionally run into competitors. They hear all the gossip, rumors, and news flashes that flow through your industry. Take advantage of their position at the crossroads of data flow and figure out how to capture what they know — and how to use it to your advantage.

WARNING

But caution: Don't push beyond the line of a legitimate request. Your salespeople should be seen as upright and conscientious, so don't ask for something with which they would feel uncomfortable (and if they eventually move on to a competitor, would you want them spilling the beans on your operation to the new boss?). As for others in your organization, you can't use certain pieces of information that a former employee may have about a competitor — anything that may be construed as proprietary information or trade secrets. High-tech companies are forever exchanging threats and lawsuits over alleged violations of trade secrets laws. If you feel you're standing on shaky ground, check out Chapter 3 and your company's values statement — and keep your company's lawyer in the loop.

You need a way to organize the facts and figures that you collect from your many sources so you can turn the pieces into useful competitive information. Filing cabinets and file folders used to do the trick nicely. Now, however, it probably makes more sense to set up a computer-based system to keep track of the data. As you set up the system, keep in mind that information about your competitors won't fall in your lap in the next two days — instead, it trickles in over weeks, months, and years.

TIP

More than likely, you already have bits and pieces of data on your key competitors stashed away. You just need to develop a procedure that keeps them coming in and brings them together to create a useful, up-to-date profile of the competition. The following steps should help:

1. **Start with a pilot procedure for tracking competitors.**
2. **Set up a company-wide system for tracking competitors.**
3. **Make someone responsible for competitor analysis.**
4. **Make it your priority to see that the system is carried out.**

Choosing your battles

REMEMBER

The more thoroughly you understand your competitors — what they did in the past, what they do now, and what they may do in the future — the better you can plan for and choose the competitive battles that you want to take part in. Naturally, you want to go after markets where you have a strategy and the capability to succeed. But you have to keep your eyes wide open, because you're never alone in any marketplace for long. By embracing the competition rather than ignoring it, you have the added advantage of knowing where the competition is weakest. Choose each battleground by pitting your strengths against areas where the competition has weaknesses.

It was the famed Chinese military strategist and philosopher Sun Tzu who said, "Every battle is won before it is fought." If you do your competitor analysis right as we outline it in this chapter, chances are you'll be on the right side of the fray when the medals and ribbons are handed out.

3 Weighing Your Company's Prospects

IN THIS PART . . .

We help you look in the mirror and make an honest assessment about what you see. We set out to discover all the capabilities and resources that you have. We try to determine which of them are strengths and which are weaknesses by looking at what you need to succeed in your industry — and what opportunities and threats you face.

We help you focus on what your company does best by looking at the areas where you provide the most value to customers. And we help you figure out how to develop a workable business model so that you can maintain and extend the competitive advantages you already have in the market.

Finally, we turn to your finances and help you create an objective portrait of your company based on your income, profits, assets, and cash position, and then we help you use the portrait to create a financial forecast and a budget.

IN THIS CHAPTER

- Discovering your capabilities and resources
- Spotting company strengths and weaknesses
- Using SWOT to analyze your business landscape

Chapter 9

Assessing Where You Stand Today

Have you ever noticed how, when your BF texts you a picture of the two of you at that super little eatery you were at together last night, you silently say to yourself, "OMG, that couldn't be me — that person seems so . . . so old, or looks like [fill in your favorite negative expression here]." Or worse, that new acquaintance is shown a picture of you taken, we mean really, not that long ago, and exclaims, "Wow, you must have been a real catch back then!" "Back then? Back then? But I still look the same!" Sorry, but no you don't.

In fact, we don't know exactly what we look like to other people, do we? Which explains the difficulty most people have creating an honest self-portrait — whether they try to recognize their appearance or make objective statements about their strengths and weaknesses.

Assessing yourself isn't an easy task. You have to measure strengths and weaknesses relative to the situations at hand; a strength in one circumstance may prove to be a weakness in another. Leadership and snap decision-making, for example, may serve you extremely well in an emergency. But the same temperament may be a liability when you're a part of a team that must navigate delicate give-and-take negotiations.

If your business is already up and running, you face similar problems of seeing clearly and objectively when you take on the task of measuring your company's internal strengths and weaknesses. If you're just starting up a business, this chapter shows you what you need to think about to get into gear. Because successful business planning absolutely requires that you always know where you currently stand.

In this chapter, we help you get a handle on your company's strengths and weaknesses in relation to the opportunities and threats that you face. We look at ways that you can spot potential strengths and weaknesses by making a meaningful list of your capabilities and resources. We show you how the critical success factors in your industry come into play to determine which of those capabilities and resources are strengths and which aren't. We help you pull all the pieces of the puzzle together — your company's strengths, weaknesses, opportunities, and threats (SWOT) — to create a complete picture. And we also create a strategic balance sheet that helps you keep track of where you stand, what you should do, and when you should do it.

Doing Situation Analysis

It shouldn't surprise you that many businesses fail miserably at the job of objective self-analysis. They cling to a distorted image of the resources that they command and the capabilities that they bring to the marketplace. To avoid this trap, examine your company's situation by using a tried-and-true approach known as SWOT. Don't worry about first responders in body armor here; *SWOT* is simply an acronym for *strengths, weaknesses, opportunities,* and *threats.*

You can't measure your company's strengths and weaknesses in a vacuum, of course. Your situation depends not only on your capabilities and resources, but also on the opportunities and threats that arise from situations beyond your control. (Check out Chapter 5 to review opportunities and threats.) Depending on the situations that you face, opportunities and threats appear, disappear, and change all the time, and your company's strengths and weaknesses change with them.

TIP

Because knowing where your company stands today is such an important part of a business plan, a thorough SWOT analysis is something that you should complete more than once. In fact, you should carry out a SWOT review on a regular basis, depending on how fast your business environment, the industry, and your company change. (To complete the full SWOT analysis, turn to the final section of this chapter.)

Identifying Strengths and Weaknesses

Your company's *strengths* are the capabilities, resources, and skills that you can draw upon to carry out strategies, implement plans, and achieve the goals that you set for the company. Your company's *weaknesses* are any lack of skills or a deficiency in your capabilities and resources relative to the competition that may stop you from acting on strategies and plans or from accomplishing your goals. The following sections help you identify both strengths and weaknesses.

Keeping frames of reference

To capture your first impressions of your company, complete the Company Strengths and Weaknesses Questionnaire (see Figure 9-1). On the right side of the questionnaire, assess your capabilities and resources in each area. On the left side, rate the importance of these elements to your industry.

Company Strengths and Weaknesses Questionnaire

Importance to Industry			*Business Area*	*Your Capabilities and Resources*			
Low	*Moderate*	*High*		*Poor*	*Fair*	*Good*	*Excellent*
☐	☐	☐	Management	☐	☐	☐	☐
☐	☐	☐	Organization	☐	☐	☐	☐
☐	☐	☐	Customer base	☐	☐	☐	☐
☐	☐	☐	Research & development	☐	☐	☐	☐
☐	☐	☐	Digital presence	☐	☐	☐	☐
☐	☐	☐	Operations	☐	☐	☐	☐
☐	☐	☐	Marketing & sales	☐	☐	☐	☐
☐	☐	☐	Distribution & delivery	☐	☐	☐	☐
☐	☐	☐	Financial condition	☐	☐	☐	☐

FIGURE 9-1: Fill out the questionnaire to get a quick take on your company's strengths and weaknesses in major business areas.

After you complete the questionnaire shown in Figure 9-1, you should have a beginning list of your company's strengths and weaknesses. To be objective, however, you need to go beyond first impressions and look at your business assets from more than one point of view. Different frames of reference offer the advantage of smoothing out biases that creep into a single viewpoint. They also offer the best chance of making your list as complete as it can be. Consider these three independent viewpoints:

- **Internal view:** Draw on the managerial experience inside your company (use your own experience or that of your friends and former co-workers if you're self-employed) to come up with a consensus on your business strengths and

weaknesses. You may want to use the same people to get a sense of what happened in the recent past as well. A little corporate history can show you how your company's strengths and weaknesses have changed over time — and how easily or not the organization can shift gears.

- **Outside view:** Perhaps you identify company strengths as assets only because your competitors haven't reacted yet, or maybe you ignore real weaknesses because everybody else has them, too. You need an objective outside assessment of what's happening in your business, and consultants can actually be of some use. If you can't afford that kind of advice, make sure that you at least monitor the business media to get an outside view of what the experts say about your industry's key players.
- **Competitive view:** Beware of becoming too self-absorbed in this analysis. Step back and look around, using your competitors as yardsticks, if you can. Your competitors do business in the same industry and marketplace, and they show strength or weakness in all the key areas that interest you. If your list is going to mean anything when the time comes to apply it to your business situation, you have to measure your strengths and weaknesses against your competitors'. (Flip to Chapter 8 for more information on the competition.)

TIP

If you don't have a management team that can conduct a situation analysis, bring together one of the informal groups that you rely on for some of your other planning tasks. You might even recruit a team of bright and eager young college students studying business management in a nearby school; they love these kind of real-life assignments, and they also get course credit. Ask the group members to spend some time analyzing strengths and weaknesses. Make sure that the group looks at your company's situation from various perspectives, using the different frames of reference in the preceding list.

Defining capabilities and resources

In putting together a list of your company's capabilities and resources, cast your net as widely as possible. Start by reviewing all the business areas we introduce in the Company Strengths and Weaknesses Questionnaire (refer to Figure 9-1). In each area, try to identify as many capabilities and resources as possible by using different frames of reference (refer to the bulleted list in the previous section). At the same time, assess how relevant each capability or resource is in helping you carry out your plans and achieve your business goals. You use this master list as raw material when the time comes to identify your company's strengths and weaknesses.

Management: Setting direction from the top

Your company's management team brings together experience, talent, and commitment. You want team members to find their direction from your company's mission, values, and vision statements, as well as from the business goals and objectives that you plan to achieve. Highly skilled managers and owners are particularly important in industries that face increasing competition or fast-changing technologies (but try to think of an industry that doesn't fit into one of these two categories today — hah).

WARNING

Management determines what your company does in the future. Senior managers are officially charged with setting the direction and strategy for your company and laying the foundation for a new company, but all managers indirectly set a tone that encourages certain activities and discourages others. Your firm's culture often is the key factor in the ability of lower-level management to have an effect on outcomes. Numerous studies have shown convincingly that culture starts at the top. Most business firms are definitely not participative democracies, and as a result, essentially no history of bottoms-up insurrections exists. Some firms are known for their autocratic culture: Question senior management, and you're shown the door, pronto. Others are perhaps too loose, and the company resembles a child-care center more than a professional business organization. The trick is to establish and maintain a culture that's right for the industry and its demands. (See Chapter 17 for more on this important topic.)

REMEMBER

The following are some key questions to ask about the management and/or ownership of your company:

- How long have managers been around at various levels in your company? (Alternatively, what variety of experiences do you have as an owner?)
- Does your company plan to hire from the outside or promote from within?
- What's the general tone set by you and your company's management — frat house, convent, or somewhere in between?
- Do you have a management-development program in place? (Alternatively, how do you plan to develop your own skills, if you're a sole proprietor?)
- What backgrounds do you or your managers have? Are you all cut from the same cloth, or are there some oddballs who can provide a touch of diversity in thinking and doing?
- How do you measure management performance in your company? Are you a strict results-only firm, or do you value process as equally important?
- How would you rate the general quality of your skills or those of your management team?

Organization: Bringing people together

The people who make up your company and its workforce represent one of your primary resources, both in terms of who they are and how you organize them. Although human resources (HR) are important to all companies, they play an especially key role for companies in service industries, in which people are closely tied to what you offer since the "product" itself is intangible. (We take a closer look at your organization in Chapter 16.)

REMEMBER

Your organization starts with who your employees are, and that characteristic depends first on how well you select and train them. Beyond that, the work environment and your company's incentive systems determine who goes on to become a dedicated, hard-working employee and who gets frustrated and finally gives up. The setup of your organization (its structure and how it adapts) can be just as important as who your employees are when it comes to creating a company team — even a small one — that performs at the highest levels, year in and year out. (See the nearby sidebar on Amazon for an example of the importance of an organization's setup.)

REMEMBER

The following are some key questions about your organization to consider:

- What words best describe the overall structure of your organization?
- How many reporting levels do you have between a front-line employee and your CEO?
- How often does your company reorganize?
- What are your employees' general attitudes about their jobs and responsibilities?
- How long do employees stay with your company?
- Does your company have ways to measure and track employees' attitudes and morale?
- What does your company do to maintain morale and positive job performance?
- Pretend you're at the zoo. Which animal there best describes your firm?

Customer base: Pleasing the crowds

Your business success depends, to a great extent, on the satisfaction and loyalty of your customers. In Chapters 6 and 7, you discover who those customers are and what makes them tick, because understanding your customers and satisfying their wants and needs are critical to the future of your company.

AMAZON: CUSTOMER HEAVEN, BUT WAREHOUSE WORKHOUSE?

Amazon is the second-largest private sector employer in America and is challenging Walmart for the number-one spot. It continues to build new warehouses as the popularity of online shopping zooms upward. Even though the company has installed state-of-the-art handling systems to move goods off the shelves and route them to the right table for boxing, it still needs human hands for much of the work — hundreds of thousands of them. To manage all these workers, Amazon sets demanding productivity targets that measure nearly every aspect of a person's movements, and a sophisticated computerized control system tracks employees to the second, including bathroom break times.

Amazon claims it invests hundreds of millions of dollars in worker safety initiatives, and there is no reason to doubt these efforts. But it should also be noted that the firm's management has consistently opposed any unionization of its workforce, fearful that higher labor costs could make it more difficult to maintain its low-cost strategy. (We don't want to isolate Amazon regarding labor practices; Walmart takes the same position, as do many other employers.) But one outcome at Amazon has been an unusually high rate of warehouse employee turnover, as the demanding productivity targets lead to health issues, mental anxiety and stress, and general burnout. High rates of turnover drive up overall HR costs as well as cause reputational damage to the brand. Moreover, there also have been repeated attempts by organizers to unionize the workforce.

Labor unions are controversial organizations, no doubt. The globalization of markets has resulted in cost competition, forcing many domestic firms in the United States and other advanced economies to seek means to lower them in order to remain viable. One way was to offshore jobs to foreign factories, which unions opposed. But a more persistent strategy has been automation, as robots and AI (artificial intelligence) technology increasingly replace humans in the workplace. But until human workers are totally eliminated, firms like Amazon will need to consider carefully how it manages the workforce and the consequences of its actions — not only on workers themselves but on its customers and public officials who have leverage over the firm in one form or another. You, too, need to determine your own red lines in this regard. See Chapter 17 for more on this vital issue.

Zappos was a pioneer in the online shoe retailing business. Early on its creative co-founder, the late Tony Hsieh, realized that his disruptive new business model needed something extra, since shoes and how well they fit (to say nothing of appearance) can be very different for every different buyer. He chose outstanding customer service as his differentiator. Customers could order multiple sizes of the same shoe, because sizing is not exactly a science. Also, there was a free return

policy, no questions asked. Loyal customers loved the firm; in a relatively short period of time, sales grew to more than $1 billion. Tony constantly preached service; one line on the values statement read: "Build Open and Honest Relationships with Communication." If a customer wanted to contact the firm via email, they could go for it — Zappos would respond to every single one that came in, even to the CEO. This and other then unique customer service practices were described by Mr. Hsieh in a famed *Harvard Business Review* article he authored; it's worth a read if you're interested in seeing how world-class customer service works (`https://hbr.org/2010/07/how-i-did-it-zapposs-ceo-on-going-to-extremes-for-customers`).

REMEMBER

The following are some key questions to consider when you study your customer base:

- What does your company do to create loyal customers?
- How much effort do you put into tracking customers' attitudes, satisfaction, and loyalty?
- What do you offer customers that keeps them coming back?
- How easy and economical is it for your company to acquire new customers?
- How many years does a typical customer stay with you?
- What are your competitors doing to build loyalty that you aren't?

Research and development: Inventing the future

Research and development (R&D) often plays an important role in the long-term success of a company. R&D is particularly critical in industries where new and better products come along all the time. But your research and product-development efforts must align with your business strategy and planning to make the investments pay off.

Firms that discover, develop, and then market prescription drugs are faced with a constant problem: After a certain period of time, their Rx compounds "go generic" — that is, they lose their patent status and others can copy them. As a result, a key indicator of pharmaceutical companies' future prospects is how well their "pipeline" of new products is filled. In 2020 Merck devoted more than $13 billion to R&D, more than 28 percent of its total revenue; Regeneron, a biotech firm, spent more than 30 percent. These are not atypical numbers either, because keeping the pipeline humming is what keeps the share price up.

The telecommunications industry is another big spender. Rarely would a firm in this sector allocate less than 10 percent of total revenue to the engineers in the new product development department as they hunt for the next big thing. Tech

firms are also known for their propensity for M&A (mergers and acquisitions) action. It's really hard to develop new things, especially for larger firms that are more bureaucratic in their attitude toward risk. One remedy is to outsource the R&D function by constantly scanning the horizon for something new that fits well with current directions, and then buy it.

REMEMBER

If innovation is a critical success factor in your industry, keeping up with the Joneses isn't a luxury: You either spend or bend — and possibly break. The following key questions help you examine the role of R&D in your company:

- To what extent does technology drive your industry?
- Does your company have a consistent, long-term commitment to R&D?
- How many dollars do you spend on basic research as opposed to applied research?
- How long have the key people on your research team been with you? Are you able to attract the new tech talent coming into the market?
- Does your company protect what it owns with ironclad copyrights and patents?
- Have you set up collaborative partnerships with universities, government agencies, or outside research labs?
- Do you have technology-sharing agreements (licensing) with other companies in your industry?

Digital presence: Competing in the 21st century

No matter who you are and what you're planning for your business, you want to do it in the 21st century — right? If our assumption is correct, then we've got some advice for you: *Think digital!* Even Grandma is using the Internet to buy things and likely texting with her smartphone to the grandkids on their birthdays.

Digital commerce represents one of the great revolutions of modern times, up there with the Industrial Revolution of the late 19th century. It's changing everything it touches, and as consumers become increasingly comfortable with its benefits and powers, they are demanding that suppliers — that means you and your business — get with it and join the parade. As you consider each and every aspect of your business plan — operations, marketing, finance, customer service, hiring, whatever — you absolutely need to understand how the digital revolution has invaded and altered the landscape.

Keep this uppermost in mind as you review your current situation analysis and map out better ways to compete (look at Chapter 8 for details on how to this). If you don't, you will be as long gone as the 20th century.

Operations: Making things work

The operations side of your business has always been critical if you're a company manufacturing physical products. However, the rise of "new economy" service sector firms (that is, suppliers of intangible products like finance, healthcare, education, online retailing, and so on) has cast a new light on operational excellence. This is due to the digital revolution. Today, it's digitize or die for many business firms.

The products that you offer, be they tangible or intangible, depend entirely on the capabilities and resources of your operational facilities and workforce. It's pretty obvious that if a fire destroys your factory, it's going to cause headaches. But what if your website is thrown offline due to an unrecognized bug coming from an upgrade, or a hack by someone in [fill in your least favorite country]? Customers demand value in all markets today, and they simply won't tolerate inefficiencies in any business.

REMEMBER

Whether you make doughnuts or provide clients with data warehouses, produce cereal boxes or serial ports, run a bank or manage a hotel, operations are at the heart of your enterprise. We are truly in a New Industrial Revolution, and it is sweeping along everything in its path. It's not just the making of physical goods that is being transformed by technology, but services provided by trained and credentialed professionals are also in the line of fire today. Many tasks traditionally done by accountants, attorneys, professors, and physicians, to name a few, can now be done more efficiently and at significantly lower cost by robotic systems. As well, the machine-like consistency of the work is also improving quality in such cases. In your own industry, what are the tasks for which the robots are coming? And are you prepared?

Operations in your company are driven, to some extent, by costs on one side and product or service quality on the other. The tension between controlling costs and improving quality has led many businesses to explore new ways to reduce costs and increase quality at the same time. New digital technologies are making this seeming contradiction possible.

How you run your operations is often at the heart of major business success stories. Way back when, Ford's innovation of a moving assembly line allowed it to cut manufacturing costs dramatically, leading to lower prices for old Henry's Model T that "put America on wheels." More recently Sam Walton's relentless push for continuous cost reduction in every aspect of the business, especially inventory management, allowed Walmart to become the world's number one retailer via its motto of EDLP — that is, "everyday low prices." And somewhat surprisingly, Walmart is now chasing Amazon and its super-efficient online retailing model that prizes operational excellence via cost-reducing technologies (see the earlier sidebar for Amazon's approach).

REMEMBER

The following are some questions on the operations side of your business to mull over:

- Does your company have programs for controlling cost and improving quality?
- Has your company taken full advantage of new digital technologies?
- Are your operating costs in line with those of the rest of the industry?
- How quickly can you scale production or expand services to meet new demand?
- Does your company use outside suppliers?
- Is your operations workforce flexible, well trained, and prepared for change? Have you explored the use of robots and/or AI to fulfill tasks?
- Can you apply your operations expertise to other parts of the business?

Marketing and sales: Telling a good story

At one time some business folks thought it was simply a "build it and they will come" world. This mentality could be found in many industries, especially high-tech. Engineers and scientists, with their natural skepticism of marketing puffery and promotional gimmicks, often thought this function was a waste of time and money. Better to put the resources into the lab. But the best product or service out there won't take your company far if you don't successfully market and sell it to your target audience. How you communicate to your markets, both current and potential, determines success.

This is true if the marketing and sales team consists of real people or if it's an entirely digital force, using online methods like email or video conferencing, or even such state-of-the-art tools as virtual reality (VR) to connect. The overall marketing function — advertising, promotion, public relations (PR) — serves as your eyes and ears, giving you feedback on what customers think about and look for. It's also your voice, telling your company's story and putting your products and services in context, offering solutions, satisfying needs, and fulfilling wants in the marketplace.

The global market for snacks is approaching $500 billion. These are convenience foods that are eaten outside traditional meal times, portable and easy to consume on the go. They're popular with consumer segments near the lower end of the income scale, business folks who travel and live on the road, and teenagers — especially teenagers. And it's a very competitive market. The global beverage and snack firm PepsiCo owns the Doritos brand of flavored tortilla chips that are sold in disposable packages of varying size.

The marketers at Doritos in the United Kingdom decided they needed a better way to get to those finicky teens who loved an experience, it seems, as much as a product. They came up with an innovative new marketing campaign targeted to this demographic, termed "Make Your Play." It offers fans a chance to win tickets to live music events, at no cost, and uses augmented reality technology to liven up things. The kids would have to locate one of the numerous posters the firm displayed throughout cities in the United Kingdom, and then scan a QR code found there onto their smartphone. Once done, this opened an audio reactive portal showing 3D objects that resembled Doritos chips and playing music by a current singer or group. How cool! After the 60-second-plus experience, viewers could use their smartphones to enter for a chance to win a ticket to a live performance by one of the entertainers featured in the video. Double cool if you win. And a win-win for Doritos and its partners in the music world as well.

REMEMBER

The following are some questions to consider about how you currently market your product or service:

- Put together a small group of your customers and ask them for their honest opinion on your brand image. Thumbs up or down?
- When was the last time you updated your marketing image?
- Think about your current target audience (say, Baby Boomers or Generation Z) and then examine how you access the group. Are you using print newspaper ads for Gen Z with no online contact? Perhaps it's time to change.
- Does your brand image use language or logos that inadvertently appeal to consumers who are not your prime target?
- What "origin story" do you have to tell customers about your firm and its offerings — or do you even have one?
- Take a look at your primary competitors and compare their marketing approach to yours. Which is more appealing? Why?

Distribution and delivery: Completing the cycle

To be successful, you have to make sure that your products and services actually get to their final destinations and into your customers' hands. Distribution and delivery systems must come into play. No matter how good your products are, your customers have to be able to get them when and where they want them.

Your company most likely distributes its products and services through *traditional channels* — time-tested ways in which you and your competitors have always reached customers. On top of that, your distribution and delivery costs may represent a significant part of your total expenses. The standard costs often include

warehouse operations, transportation, logistics, and product returns. If you operate in retail, you can end up paying for expensive shelf space as well. Supermarkets routinely ask for money up front before they stock a new item, and you pay more for the best shelf locations. After all, supermarkets control what customers see — and buy — as harried shoppers troop down the aisles with kids and carts in tow.

How — and where — customers shop is often just as important as what they buy, so when a different way to deliver products and services comes along, the new system revolutionizes a marketplace or even an entire economy. For some time now, the Internet has offered companies a new and powerful way to reach out to their customers more directly, increasing company clout and, at the same time, lowering distribution costs. The lockdowns created by the worldwide COVID-19 pandemic has turbocharged the move to online purchasing and delivery, changing forever how some industries reach and serve their customers. In the market for a used car? Carvana.com might be your choice; this online retailer not only displays its broad national inventory on its website, but it also takes trade-ins, arranges financing, and delivers right to your garage door — which would be the first time the buyer actually gets to see and touch the snazzy new toy.

It's not just the distributors of more durable goods sold on e-commerce platforms like Amazon and eBay that connect to customers via the web today. Food purveyors, from restaurants to supermarkets, are just one example of new businesses now traveling this so-called D2C (direct to customer) route. And guess what? Customers love it! D2C has transformed distribution, and it's here to stay. In fact, countless firms have adopted so-called "omni-channel" distribution systems, in which you, the customer, can select from multiple ways to get what you've just ordered. Delivered to your home? Got it (and want it express shipped; just click here!). Or do you want to pick it up yourself at the physical store? No problem. Worried about those nasties following delivery trucks and then pilfering the package off the front porch? You can have it delivered to a store with secure lockers nearby your home. Have you considered yet how these nontraditional channels might be right for your business?

TIP

It's not just the distribution of products that has undergone change. The way a product is packaged also can have an impact on how what's inside is perceived by customers. In Chapter 4 we note how the British-made Mini car (now owned by BMW) promoted its unusual shape and styling as central to its quirky image. In a prior edition of this book, we featured L'eggs, the pantyhose made by Hanes, which revolutionized that market through an innovative new package design (if you don't know, the name says it all). Today take a look at the beverage bins of your favorite food market and inspect the many new packaging choices there, from dairy products to soda, beer, and much more.

If your business consists of physical products, give some thought to how a new packaging design might attract buyers. It's not just the shape but also the materials used — the texture and feel can also make a difference. But don't forget that brick-and-mortar retailers are selling space, so they won't be too happy if your dandy new design takes up too much room on the shelf without generating greater sales volume.

What if your business is a service rather than a producer of something physical — say, an online provider of some good? The preceding advice can be applied to your business as well. Do you remember AOL, Yahoo, Lycos, or Excite? They were the leading Internet portals back around the year 2000. But then came Google. That firm's home page has long been the envy of many. It is pristine, uncluttered, minimal. When it was first floated in 1999, it contrasted sharply with other portals that seemed more like Times Square at midnight than a web page; for those others, every pixel seemed to bulge with a blaring message. Today the Google design remains — pure and beckoning. What subliminal message does your home page send — a Middle Eastern bazaar? Not that there's anything wrong with that if it fits with how you want to be perceived. But if not? Maybe the time is ripe to give your intangible business some new "packaging."

REMEMBER

The following are some questions about the distribution and delivery of your product or service:

- What are the costs associated with your inventory system?
- Can you reduce inventories by changing the way that you process orders?
- How much time does it take you to fill a customer order, and can you reduce the time?
- What are relative costs in these channels? Which are most effective?
- How much control do your distributors have over your company?
- Can you use any new channels to reach your customers more directly?

Financial condition: Keeping track of money

The long-term financial health of your company determines the overall health of your company, period. You simply can't survive in business for long without having your financial house in order. Come to think of it, the expenses that you have to track when looking at company finances aren't all that different from the issues that you face in running your own household.

If you're just starting in business, for example, how much money your company can get its hands on up front (your *initial capital*) is a key to survival. When your company is up and running, you need to make sure that more money comes in than goes out (a *positive cash flow*) so that you can pay all your bills. (Remember those times when the mortgage and utility bills were due, but payday hadn't come yet?)

REMEMBER

Figuring out how to keep your company financially fit is critical to planning your business (look at the example of Nucor Steel we highlight in a nearby sidebar). When you take the time to look over your important financial statements, you give your company the benefit of a regular financial checkup. The checkup is usually routine, but every once in a while you uncover an early-warning symptom — lower-than-expected profits, for example, or an out-of-line promotional expense. Now all your financial vigilance is worth it.

REMEMBER

The following is a list of questions to ask about your company's financial health. (If you don't know how to answer these questions, delegate some time to spend with Chapters 11 and 12.)

- How fast are your revenue and profits growing?
- How often are you carefully monitoring your company's cash flow?
- Does your company have ready access to cash reserves such as a line of credit? How much?
- Does your company — and every business unit or area — have a line-by-line budget for the coming year?
- Do you consistently track key financial ratios for the company? What external sources monitor these?
- How does your company's financial picture compare with that of the competition?

Monitoring critical success factors

REMEMBER

Not all your capabilities are equally important. Some may be critical to success. Others may be nice to have but are not especially relevant to your business. You must decide whether your capabilities and resources represent company strengths that you can leverage or weaknesses you have to correct as you plan for the future. To do that, you have to be clear about what's important to your industry and the marketplace. The *critical success factors* (CSFs) are the general capabilities and resources that absolutely have to be in place for any company in your industry to succeed over the long haul.

HIDING YOUR STRENGTH IN PLAIN SIGHT

Nucor Steel is one of the best firms in its industry bar none, and that includes global competitors. But a key to understanding its strength can be found in the balance sheet (see Chapter 11 for more on understanding your firm's balance sheet and managing your finances). Steel is a classical cyclical industry, as its derived demand nature leads to sales ups and downs that company executives can't stabilize no matter how smart they are (see Chapter 7 for an explanation of derived demand). How well a steelmaker manages its financial risks is as important to how efficient its technology is — and Nucor is a master in financial management.

Following the Great Recession of 2008–2009, many industries suffered massive shocks as demand tanked, and steel was one of them. But while many ran for cover, and some even bit the dust, Nucor saw opportunities open up. With valuations and prices down, the firm bought industry competitors, built new facilities, entered joint ventures, and upgraded its existing steel mills. It was able to do so because it had consistently managed its long-term debt better than others, keeping it low, and it also had enough cash on hand to allow for quick buys when something good popped up. More detailed financial metrics like current ratios, acid tests, and the times-interest-earned ratio also demonstrates Nucor's superiority compared to the competition. This firm's financial condition is as strong as, well, steel.

Suppose you're the head of a cosmetics firm, and you come across a supremely talented chemist who would make a great leader for your R&D and new product development department. You decide to make the offer, even though it requires a sizable outlay in compensation to bring the chemist on to the team. Have you created a powerful strength for your company with this hire? This should be a slam dunk — or so you think.

Well, maybe not. When you look at the realities of the cosmetics industry, you quickly realize that the primary CSF is your ability to craft a powerful brand that is attractive to your customers. They buy the image you convey as much as, if not more than, the ingredients in the product (you're selling "hope," remember?). Perhaps the funds needed to hire and keep that whiz-bang chemist would be better spent on a new promotional campaign. Don't forget that you don't get to grade your own strengths and weaknesses report card; only your customers do.

You may have already prepared a list of CSFs (if you haven't, take a look at Chapter 5). Along with a CSF list, you need a set of your company's capabilities and resources. You can use the two lists to construct a grid, which in turn allows you to compare your capabilities and resources with those that your industry thinks are important. In a perfect world, the lists match up exactly, but that

seldom occurs. The completed grid helps you identify your company's current strengths and weaknesses (see Figure 9-2).

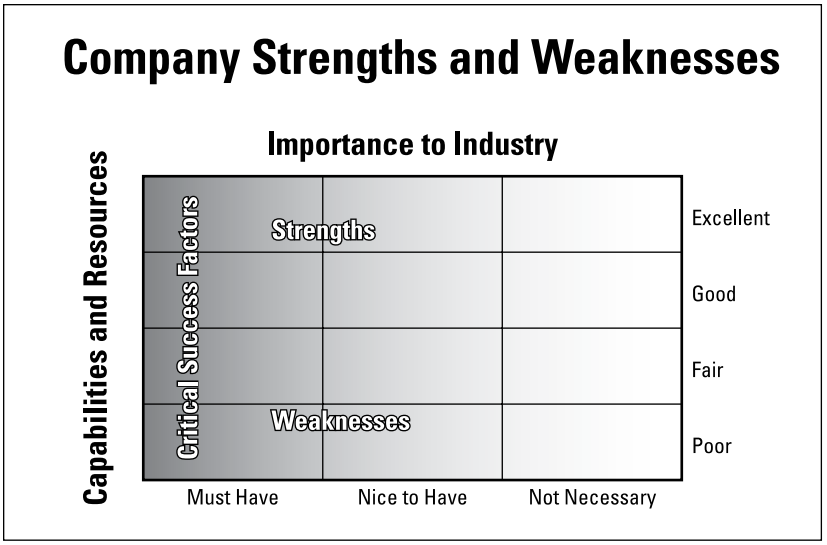

FIGURE 9-2: Compare your capabilities and resources with the critical success factors (CSFs) in your industry.

REMEMBER

To complete a grid similar to the one in Figure 9-2, remember the following:

- The capabilities and resources that you place up and down the left side of the grid are in your industry's "must-have" category. They represent critical success factors.
- The capabilities and resources that you place in the top-left corner of the grid are critical success factors in which your company is good or excellent. They represent your company's strengths.
- The capabilities and resources that you place in the bottom-left corner of the grid are critical success factors in which your company is only fair or even poor. They represent your company's weaknesses.

WARNING

It's easy to highlight the value of those capabilities that your company already excels in: "Look at us — the data shows we're *Numero Uno* in the industry when it comes to treating retired employees with dignity. Let's celebrate!" But flip the coin, as you can just as easily underestimate the importance of things that your company doesn't do as well, but perhaps count for a lot more. "Come on, sure, our prices might be higher than the competition, but our customers love us and won't ever jump ship" (a sentiment that usually surfaces just before the latest market share report comes in). Admitting that you devote valuable resources to areas that

don't necessarily affect customer decision-making is a hard pill to swallow, just as is admitting that you may be neglecting key business areas. Cognitive psychologists call this "optimism bias." Do that reality check and try to be as objective as you can when making judgments about your business and yourself; bringing in an outsider for a second opinion might help.

Analyzing Your Situation in 3-D

You must be prepared to take advantage of your company's strengths and minimize its weaknesses, which means that you have to know how to recognize opportunities when they arise and prepare for threats before they overtake you. Timing is everything here, and it represents another major dimension that you have to think about. We discuss this more in Chapter 14, where we acquaint you with the "dynamic capabilities" model of strategic management.

Getting a glance at competitors

Create strengths-and-weaknesses grids for two or three of your most intense competitors. (Turn to Figures 9-1 and 9-2 for grid info and Chapter 8 for a refresher on exactly who your competitors are and what information you have about them.) You don't know as much about your competitors as you know about yourself, of course, so the grids can't be as complete as they may be for your company. But what you *do* know tells you a great deal.

REMEMBER

Comparing the strengths and weaknesses of competitors with your own can help you see where competitive opportunities and threats to your business may come from. Opportunities often arise when your company has a strength that you can exploit in a critical area in which your competition is weak. And you can sometimes anticipate a threat when you see the reverse situation — when a competitor takes advantage of a key strength by making a move in an area where you're weak. Because the competitive landscape always changes, plan to monitor these grids on a regular basis.

Completing your SWOT analysis

REMEMBER

A *SWOT* analysis (an analysis of your strengths, weaknesses, opportunities, and threats) allows you to construct a strategic balance sheet for your company. In the analysis, you bring together all the internal factors, including your company's strengths and weaknesses. You weigh these factors against the external forces that you identify, such as the opportunities and threats your company faces due to

competitive forces or trends in your business environment. How these factors balance out determines what your company should do and when you should do it. Strategy, after all, is essentially a resource allocation decision — the management guidance system for putting your resources where they will do the most good. SWOT is the tool you use to accomplish this.

Follow these steps to complete the SWOT analysis grid (and check out Figures 9-1 and 9-2 for info on coming up with a strengths/weaknesses grid):

1. **Divide all the strengths that you identify into two groups, based on whether you associate them with potential opportunities in your industry or with latent threats.**
2. **Divide all the weaknesses the same way — one group associated with opportunities and the other with threats.**
3. **Construct a grid with four quadrants.**
4. **Place your company's strengths and weaknesses, paired with industry opportunities or threats, in one of the four boxes (see Figure 9-3).**

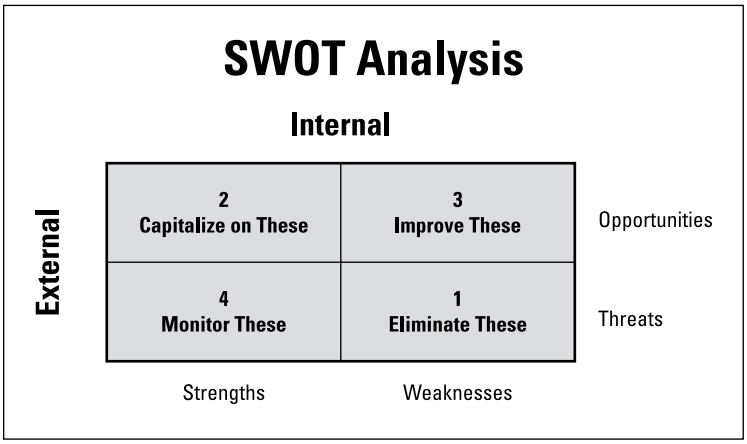

FIGURE 9-3: The SWOT grid balances your company's internal strengths and weaknesses against external opportunities and threats.

REMEMBER

Change is the only constant in your business, your industry, and your marketplace. Constant change means that you can't complete your SWOT analysis only as a one-off exercise; you have to revise the grid regularly as your company grows and as the environment around you changes. Think of your SWOT analysis as a continuous process — something that you do repeatedly as an important part of your business-planning cycle.

IN THIS CHAPTER

- Discovering your abilities
- Creating your company's value chain
- Looking for a competitive advantage
- Identifying your company's core competence
- Maintaining a competitive advantage
- Using the value chain to allocate resources

Chapter 10

Profiting from Your Business Plan

Let's admit it: We live in a world of almost infinite choice today. If you're a customer out shopping for something at the mall or browsing the web in the comfort of your home, it can be downright confusing sometimes to try to sort through the multitude of goods and services on offer. In reality this is one benefit of the capitalist marketplace: In most cases what's available is not limited to a single supplier. As we note in Chapter 8, the barriers of the past that kept new entrants out of many industries started to fall like ten-pins under the forces of de-regulation.

And of course, there's another reason why choices are so abundant. If you're successful in business, no matter what it is you do, you can count on someone else trying to crash your party no matter how big the bouncer. It always happens.

As customers go about making decisions on what to buy and where to shop in that massive bazaar of a market out there, they continually weigh various combinations of product or service benefits against price. This calculation is referred to as the *value equation.* (Read Chapter 8 if you want to know more about the equation.)

But what does it actually mean to have the best value? If you want to be successful in your marketplace, you need to know exactly where and how your products add value in the eyes of your customers.

In this chapter, we take a look at creating customer value around products and services. The approach is called the *value chain,* and we use it to identify which parts of your business are responsible for adding the greatest value for customers. We look at how to put together a value proposition for your customers and how you can use it as the basis for your *business model* — that is, turning your plan into a money-making machine. We also show you how to use your value chain to help explain why you may have a competitive advantage in the marketplace, and we talk about how you can maintain that competitive advantage over the long term. Finally, we show you how to make the most of your company's human and financial resources as you put your business plan and business model to work.

Describing What You Do Best

Describing what your company does best — summarizing your key business activities in a few well-chosen sentences or in a clear diagram — should be easy, shouldn't it? It's not. (Refer to Chapter 4 for help in capturing your business in 50 words or less.) From the inside of your company looking out, you may have difficulty pushing away the everyday details and getting at the core of what actually keeps you in business from one day to the next.

Due to this difficulty, business consultants in the "how to write a vision/mission statement" patch remain in business. They may have fancy names for the services they offer, but the essence of what they do is simple: They help you describe what you do. The truth, of course, is that they don't really possess any more valuable knowledge than you. Consultants seem to have a clearer view of your business simply because they can sweep away some of your mental blinders and view it from the outside looking in, unhindered by unrecognized bias.

If you have done your planning conscientiously, you have a built-in understanding of your business and what really makes your company successful — you just need to unlock what you already know.

Looking at the links in a value chain

REMEMBER

A business constructs its *value chain* from the sequence of activities that it engages in to increase the value of its products and services in the eyes of its customers (see Figure 10-1). The chain shows where a business may have an advantage over its competitors, and it connects a company to the marketplace, making sure that

it doesn't stray too far from the customers it plans to serve. The links in a value chain help you better understand your business activities.

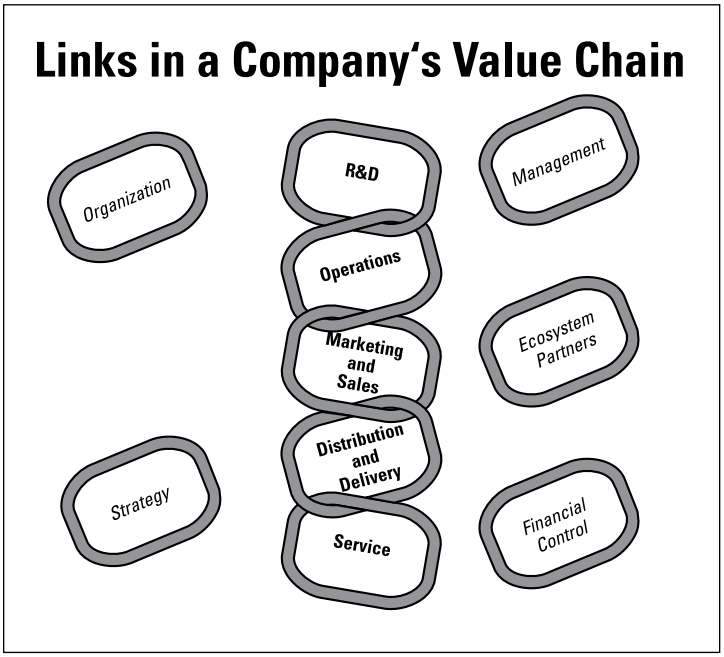

FIGURE 10-1: A company's value chain has two types of links: primary activities and supporting activities.

Primary links in the value chain are the business functions representing the heart of what your company does (see Chapter 9). Primary links are usually sequential. They're the essential stages that your company goes through in developing, producing, and getting products to market, and they often involve the following:

- Research and development
- Operations
- Marketing and sales
- Distribution and delivery
- Post-sale service

Supporting links in the value chain contribute to the overall success of the business by strengthening your company's primary links. Supporting links are often spread throughout an organization. They assist and tie together all the primary business

functions, as well as support one another. The activities often involve the following:

- Management, involving support functions such as human resources (HR), legal, and information technology (IT)
- Ecosystem partners who share resources or expertise with you
- Organizational structure
- Strategic planning skills
- Financial and accounting control

THE GREAT U.S. STEEL CONUNDRUM

Created in 1901 out of the combined steel holdings of the banker J.P. Morgan and entrepreneur Andrew Carnegie, U.S. Steel was a giant corporation on the day it was born. The firm started with 70 percent of the U.S. basic steel-making capacity and became the world's first billion-dollar company. For the next half-century, however, U.S. Steel saw its share of the market erode until it fell down to 20 percent by the mid-1960s. Curiously, however, profits remained relatively healthy. Thus, the riddle of U.S. Steel: How did the company manage to keep its profits consistently high throughout this 60-year period while losing almost three-quarters of its market share?

The answer: U.S. Steel's share of the market didn't really matter.

You may be shaking your head and asking how that could possibly be the case. Well, the first head of U.S. Steel was one Judge Elbert Gary. Ever hear of Gary, Indiana, the site of America's largest steel mill? The judge started out worrying about his company's market share, too — but he worried that it was too big. He feared that U.S. President Teddy Roosevelt and his trust-busters would think that U.S. Steel looked a lot like a monopoly and would break the company up into much smaller pieces.

Judge Gary turned out to be one smart capitalist. Although he didn't have a name for it at the time, he created a value chain for U.S. Steel. He knew that one of the most important links in the steel-making value chain was the mining of its basic ingredients: iron ore, coal, and limestone. Coincidentally, U.S. Steel owned vast land holdings and pretty much controlled the source of a good portion of these raw materials. So the good judge decided to invite other firms to join him in making steel — the more, the merrier. In fact, he demanded competition, and the industry recognized him as an industrial statesman for his efforts at the time. He never stopped making tons of money for U.S. Steel, of course. He more or less ignored investments in mill efficiency or new technologies; he knew that the real source of profit in his business was in the sale of raw materials to any and all competitors.

We note previously that strategic management is about resource allocation: No organization has unlimited resources, so it's absolutely fundamental that you provide those activities that are most responsible for your success with what they need. At the same time, you want to ensure that you're not overfunding activities that are perhaps necessary but not as critical. A value chain analysis allows you to figure out which of these links is most critical to success. The concept is actually quite old, although it wasn't recognized as such for some time. See the example of U.S. Steel in the nearby sidebar.

Forging your value chain

To develop your company's value chain — the sequence of activities that you go through in the process of adding value to your products and services — you need a list of your company's capabilities and resources. Take a look at Chapter 9 if you need help.

You can construct a framework for your value chain by creating a grid that divides your business into value-creating areas (see Figure 10-2). You place activities in the grid based on whether they act as part of your primary business functions, or whether you associate them with supporting areas.

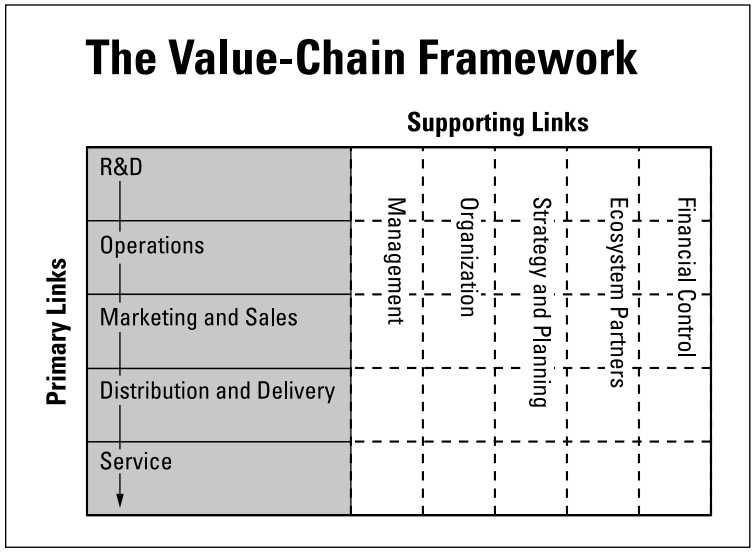

FIGURE 10-2: The value-chain framework.

REMEMBER

Follow these steps to create the grid that shapes your value chain:

1. **List all the key business areas that work to put together your company's products and services and get them out to customers.**

   Include such departments as R&D, operations, marketing, sales, distribution, delivery, and service. (See Chapter 9 for more details on these areas.)

2. **Arrange a list of key business areas in order, from the first good idea R&D produces to the finished product or service.**

3. **List the general business areas in your company that support the primary business functions.**

   Include such supporting areas as management, IT, organization and human resources, strategy and planning, ecosystem partners, and financial and accounting control.

4. **Construct a grid similar to the one you see in Figure 10-2, using your lists of primary and supporting business areas.**

TIP

Your value chain may not look exactly like all those organization charts you see floating around your company. Figures 10-1 and 10-2 are generic in nature; not every link necessarily applies to your own organization. The primary and supporting business functions that add customer value may be framed differently, depending on whom you ask, so you should talk to customers and to co-workers. Ask your customers to describe your business as they see it — like consultants, they may have a better vantage point. You may end up with a value chain that is either longer or shorter, depending on your business's own unique characteristics.

To fill in the value-chain grid, you have to fill in all the specific value-adding activities — the capabilities and resources that your company uses to increase the value of your products and services. Follow these steps:

1. **Go through the lists of capabilities and resources that you identify in Chapter 9 and make a first pass at placing them in the value-chain grid.**

2. **In the boxes on the left side of the value-chain grid, place value-adding activities that directly contribute to your primary business functions.**

   These activities make up the primary links in your value chain.

3. **Place value-adding activities that you associate with supporting functions in grid boxes across from the primary functions that they support.**

   These activities make up the supporting links in the value chain.

4. **On the grid, include a description of the customer value that the various links add, as well as how they add that value.**

REMEMBER

The value chain offers you a unique look at your company through your customers' eyes. Every link in the value chain is something that you do as a company. Every link is an activity that you spend money on. It helps if you have a good cost-accounting system in place. Cost accounting is the method by which you track costs to specific activities. In general, you should be spending the most on those activities that create the greatest value for your customers; activities that are not as valuable should accordingly be less costly. If you discover through research that some activity you're undertaking is not as valuable as you thought in the eyes of the customer, then it's a pretty strong signal to re-allocate those resources to where they are more important — or even to outsource or totally eliminate that activity if possible. The value chain allows you to see exactly what value customers get out of each link. It gives you a relatively clear picture of why you stay in business, as well as where you could do a better job.

Understanding your value proposition

One of the leading American gaming institutions (OK, casinos) had a problem. It had located about ten of its restaurants in a semicircle between two huge gambling halls where the slot machines and other games of chance were located. But a number of those restaurants were doing very poorly, with few diners. No matter how many changes were made — food choice, format, design — nothing was working. And then something else was realized: The poorly patronized ones were on the left side of the restaurant pavilion.

Guess what? Approximately 90 percent of people are right-handed (this is called lateral dominance). Due to some neurological tic, we tend to favor the dominant side of our body. Only a few hungry patrons started off on the left side of the pavilion and couldn't wait to get back to the slots. The advantage of the well-patronized restaurants there? Location, location, location!

REMEMBER

You can find your own competitive advantage by listening to (and sometimes looking at) your customers and how they behave. Then use the value chain (see the previous section) to boil it all down into a clear statement of what benefits you provide your customers and what real value they place on them. Businesspeople refer to the previous statement as the *value proposition* — fancy jargon for a simple idea. A value proposition may be similar to your company's mission statement (see Chapter 4 for the details), but the proposition is more narrowly focused on customers — what you provide them and what they take away. Consider this: When a potential customer is searching the web for a particular good or service and they come across your site, it has been estimated that they will spend no more than 15 seconds before moving on if they aren't engaged. This means you have to have a clear concept of what you offer and why it's valuable and be able to communicate it efficiently and effectively.

PROFESSIONAL NETWORKING SITE — OR JOBS BOARD?

LinkedIn.com was started in 2002 by a group of young entrepreneurs in Silicon Valley. Some had prior experience in social networking, creating sites for online dating or bringing together people in a neighborhood, like golfers looking for playing partners. Their new venture would be an online network for professionals to meet and share mutual interests. The idea proved popular, and less than two years later, the site had 1 million followers; by 2007, 10 million followers. Venture capital funding flowed in as the firm expanded throughout the world.

As hits to the site expanded, the management at LinkedIn began to realize something: It was a jobs board. Users posted relevant information about themselves, usually resumes, but didn't want to simply meet others with similar backgrounds and share ideas and insights. It seemed that job recruiters were viewing posts and salespeople were scrutinizing users' interests. LinkedIn became a jobs agency without realizing it. Now, LinkedIn has nearly 750 million users, and 95 percent of job recruiters use the site to find talent. Almost all of LinkedIn's revenue comes from recruitment-related posting fees.

In 2016 Microsoft bought the firm for more than $25 billion, its biggest acquisition ever. Some of the founders now live comfortable lives as billionaires. What a job that must be.

Consider these examples:

- Shopify lets you know it can handle all your e-commerce needs, from selling to shipping to processing payments, no matter where you sell from.
- Rolex offers unparalleled luxury and the ultimate in snob appeal in the world of timepieces.
- Slack makes users' working lives simpler, more pleasant, and more productive.

But companies often provide their customers with more value than first meets the eye — even more value than the businesses themselves may realize.

Putting Together a Business Model

Suppose you have a great idea for a new design for a car. You analyzed all the ones that already exist in the segment you're thinking of, and you spoke to carefully selected potential buyers and added in all the bells and whistles that your research

uncovered. You then approached a venture capital (VC) fund to see about start-up financing. "Looks cool," the good folks there said, "but tell me, just what makes the car go?"

Good question. What's the money engine for your business? VCs are interested in making a good return on their investment, and you should be, too. What you need to know is just how your business plan will make money — what will make it go, what's your profit engine? This is called a *business model*, and it should be at the very heart of your business plan and reflected in each of its sections.

How will you make money?

REMEMBER

Whether you like it or not, at some point you have to get down to the nuts-and-bolts details of your company's finances — income statements, balance sheets, cash flow, budgeting, and all that numbers stuff. We try to make it as painless as possible in Chapters 11 and 12. For now, you need to ponder something much more basic: generating profit. A business *plan* describes how you're going to compete — what you will do, your customers and value proposition, how you position yourself against the competition, and the like. But a business *model* should describe how to make money out of your plan. Do you know how you're going to accomplish this?

Simple, you say. Your customers give you money in exchange for the products and services you provide, right? A simple exchange. Well, much like the value chains that support them (refer to the earlier section "Describing What You Do Best"), business models aren't always that obvious or straightforward. Do you really think that Google is just a search engine and Facebook a social media platform? In fact they are both advertising agencies — to the extent that well over 90 percent of their considerable profit comes from selling ads. Businesses often make a profit on areas outside of the main product or service that customers don't focus on. These areas can bring great success. Some surprising examples of this follow:

- Given the price of a good meal out, you may think that successful restaurants rake in the dough. And many of them do. But fine dining restaurants make the bulk of their profits not on those delicious appetizers and entrees, but on the drinks that they serve before, during, and after the meal. For many of these restaurants, wine is the single biggest source of profit.
- Do you recall Blockbuster Video, the DVD rental chain that flourished in the pre-streaming days? At one time it had more than 9,000 stores. One reason it ultimately failed was because the video rental business had a little secret: Blockbuster made nearly $1 billion in late fees, some 70 percent of its profit. When Netflix got started as a mail-order DVD rental outfit, it eliminated those irksome charges, and customers loved the resulting savings. Blockbuster went bust soon after.

So, have you figured out yet how you can profit from your own business?

MAKING MONEY IN THE MEDIA SECTOR

You can generate revenue (and profit) from a business in multiple ways. Take the media sector, which includes print and digital today. In the past, print newspapers had two principal sources of revenue: subscriptions and advertising. The former were typically "loss leaders" — that is, the revenue didn't cover costs, but a low price was necessary to draw in large numbers of readers. Advertisers, of course, wanted to expose their offerings to as many pairs of eyeballs as possible, so upping readership was the way to go for a newspaper. The more readers, then the more the paper could charge for advertising rates for space on its pages. "Want ads" revenue was particularly popular; those little alphabetized notices for job hunters and other seeking a specific good or service kept many a paper afloat.

But then specialized new publications such as *Auto Trader* or *Boat Trader* siphoned off interested customers. Worse, in 1995 along came Craigslist, and the local ad market began to dry up fast. eBay also debuted in 1995, taking another big slice of the market.

The digital revolution created revenue dilemmas for media providers. Media firms had to adopt a digital presence. But how to make money, especially with sites like Craigslist or eBay open to all without charge? The problem was that the Internet originally was a free good, and when that became entrenched in the minds of users, it was difficult to now ask for payment. As a result, most digital media providers made their sites free to view for all comers, and generated revenue by selling display or banner advertising in high-visibility areas of the site. For many viewers, however, these were annoying to say the least, especially when they seemingly screamed out at you in vivid color, and you couldn't avoid them in order to read what you wanted. Additionally, platforms like Facebook began to scrape off news stories for viewing on their own sites, with no payment to the original source. Given that 75 percent of millennials source their news from Facebook rather than elsewhere, the lawyers have been called.

So should the media firm install *paywalls* — charging subscribers an admission fee to view? Or would that kill viewership? Some firms have offered premium subscription choices, giving access to something beyond the free stuff for a payment (sites offering basic versus enhanced versions are referred to as *freemiums*). These can include access to columns by top-rated opinion page commentators or an invitation to join an event, either in person or virtually, with high-profile presenters. Another revenue source is through affiliate linking. The *New York Times* has a product review website called The Wirecutter, which gives expert analyses of given products or services and then provides a link to a vendor that sells the goods — and the *Times* gets a fee for any such sales that follow. Finally, there's sponsored or *native* content, in which an advertiser provides paid copy alongside a traditional story, highlighting, of course, its own product or point of view that relates to some aspect of the news story.

Business models for media firms are still a work in progress as they try to remain profitable in this highly competitive sector that affords low entry barriers to new players. Stay tuned; the revolution is still in progress.

How's your timing?

How you expect to make your money is only one part of your business model. An equally important piece relates to *when* you get the cash. It may seem nice to think that the green is going to start pouring in tomorrow; however, reality suggests that your company may begin incurring costs and spending money months (or maybe even years) before a revenue stream begins to flow. In the case of pharmaceuticals, for instance, a company can spend years and tens if not hundreds of millions of dollars developing and testing a drug before the first physician prescribes it and a health-care plan pays out a reimbursement.

REMEMBER

If your business must spend money before it starts sending out those invoices, your business model must include a timeline that takes the following factors into account:

- The up-front costs you expect when you set up your business (refer to Chapter 12 for more information on how to make a budget)
- The source of funds to pay for your up-front costs (see Chapter 2 for good ideas on how to fund a new business venture)
- A schedule showing when you expect cash to roll in (check out the section on projected cash flow in Chapter 12)

WARNING

The question of timing is as important for small companies as it is for big ones. The number one reason for small business failure is lack of sufficient cash flow, or access to capital. Many retail businesses that operate year-round actually take in most of their revenue during only one season — summer for family holiday venues or the Christmas holiday rush. In some cases, retailers rake in half of their annual revenues during late November and December. Timing for these establishments is quite literally a make-or-break affair.

Making Your Business Model Work

Companies don't stay in business year after year by accident. Sure, maybe a manager somewhere or another gets lucky occasionally, making a brilliant move without knowing its significance. People win the lottery every week. But that kind of luck never lasts long, especially when the competition is intense (and studies have shown that about 70 percent of lottery winners and those who receive an unexpected large windfall go bankrupt in a few years).

DAVID MEETS GOLIATH

Can anyone compete against a giant opponent whose business philosophy is take no prisoners? The history of survivors in this category is a thin book indeed. Powell's Books is a David-versus-Goliath success story. The firm originally opened its doors near the University of Chicago in 1970 but soon found itself in Portland, Oregon, where it remains today in the same location, which houses more than a million books. It built its business through a passionate commitment to books and reading by the father and son founders. The company listened carefully to its community and brought in staff who were just as committed — sales personnel who knew their products cover to cover and could give expert guidance to customers' queries, whatever they might be. Those customers kept coming back, and the store was open to them 365 days a year, from early in the morning to late at night (bibliophiles are a strange breed). Success followed, and two branch stores were added in the Portland region. Life was good in this family business.

All seemed well, that is, until July 1995, when an earthquake called Amazon occurred. The innovative new business model of selling books online transformed not only the bookstore industry but soon all of retailing. The traditional economics of the industry were turned upside down, and brick-and-mortar stores began to go under like rowboats in a storm. Little more than a decade after Amazon's entry, more than half of the independent booksellers in the United States were out of business.

But Powell's persevered. It is the largest independent bookstore in the world today. How has this business weathered the storm? Emily Powell, the current third-generation proprietor, said, "My grandfather taught me that our job is to connect the writer's voice with the reader's ear and not let our egos get in between. My father taught me not only the love of the book itself but also how to love the business of bookselling." By remaining true to its core values and never forgetting its strengths and purpose — that Powell's is a *customer service* business — it remains standing. The COVID-19 pandemic has brought on new challenges, to be sure, but so far it looks like this story is one that will have a happy ending.

Companies succeed over the long haul because they understand what their customers value the most, and they figure out how to make money providing products and services that consistently meet or exceed customer expectations — doing so better than competitors. By capturing this information in your business plan, you improve the odds of your business model continuing to work in the future.

Searching for a competitive advantage

What makes particular establishments, like Powell's Books in Portland, Oregon, so unique? Or for that matter, Amazon? (See the nearby sidebar "David meets

Goliath" for more about these two businesses.) Every business that's been successful over time has an advantage, or it wouldn't have lasted. Old AT&T, the American Telephone & Telegraph Company founded by the inventor Alexander Graham Bell in 1887, remained unchallenged until 1984, even though it had numerous problems and lots of unhappy campers as customers. How did it survive so long? Its advantage was that it was a government-sanctioned monopoly. That helped.

REMEMBER

Competitive advantage means exactly what it says; a company has some sort of advantage over the competition. Where does it come from? Usually out of the distinct and special value that the company can offer its customers — and from the premium that customers place on that value. Ask yourself this basic question:

> *Why do customers choose my company and its products when other competitors in the industry have more-or-less similar offerings?*

You can find the answer in the strongest links of your value chain — the links that produce the bulk of your customer value. Location, service, brand image, collaboration with ecosystem partners, and unique product features are some of the links that create a competitive advantage in the marketplace.

Focusing on core competence

You create your competitive advantage in the marketplace. Your advantages have everything to do with your customers — with the relative value that they place on your products and services and with the purchase decisions that they finally make. What internal capabilities and resources do you have, and what business activities do you engage in that lead directly to your competitive advantage? You must make sure to capture these in your business plan.

REMEMBER

Go back to your company's value chain (which we discuss in the earlier section "Describing What You Do Best") and focus on the links that provide your competitive advantage. When you do, you come face to face with something that the gurus call your core competence. Simply defined, *core competence* is your company's special capability to create a competitive advantage in the marketplace. In almost all cases, this gift is specific to your company. Think of core competence as being your business's DNA. Unlike your personal genetic code, however, your company's core competence is something you can build on — or lose, depending on how attentive you are to your marketplace and your business.

Amazon was started in a garage in Seattle, Washington, in 1994. But the unexpected rapid growth of the firm led to a confusing internal structure of tasks and responsibilities. Sometimes the left hand didn't know what the right hand was

doing, and there were issues with trying to scale rapidly to meet demand. Amazon realized that it had to start fixing its digital operating system (OS), or growth would stall. Then, beginning around 2000, Amazon decided to partner with third-party merchants so they could build online shopping sites on top of its own OS, creating shared revenue opportunities for both. This initiative seemed to go well.

Coincidentally, in 2003 senior executives convened for a short retreat at founder Jeff Bezos's home to discuss Amazon's "core competence." This powwow, however, soon turned into a longer meeting and led to the realization that in fact, Amazon had become highly skilled at running reliable, scalable, cost-effective data centers. Given that its business was low-margin, the operating systems had to be as lean and efficient as possible. At that point the light bulb went on, and the firm began to lay the foundation for the establishment of Amazon Web Services (AWS), the cloud computing service it launched in 2006. AWS now offers its IT capabilities to firms and governments worldwide. In recent years the unit accounted for under 15 percent of Amazon's total revenue — but was the source of almost 65 percent of Amazon's total operating profit. So who's your daddy, Amazon?

TIP

A company's core competence can point the way toward new market opportunities. In the Amazon example, the firm's relatively small IT service provider AWS became the profit driver for the entire company. Honda, the Japanese maker of all things that are powered by gasoline, realized that its core competence was in designing and manufacturing engines. The company created product lines in lawn mowers, snow throwers, snowmobiles, and all-terrain vehicles, to name just a few of its motor-based businesses besides its traditional motorcycles and cars. Honda benefits from a common competitive advantage (state-of-the-art engines) in each of these different markets. Take another look at your company's core competence to see whether you can come up with any new business directions based on your existing skills and capabilities.

Sustaining an advantage over time

Every company that manages to stay in business has some sort of competitive advantage and core competence to draw upon; otherwise, it simply can't exist. But here comes the million-dollar question: How can you renew and sustain that competitive advantage over time? Customers and their needs shift constantly as competition gets more intense, new technologies are innovated, and industries evolve. One respected business academic estimated that in the rapid-fire world of 21st-century commerce, a firm's advantage lasted no more than three or four years. When you think about it, your competitive advantage and the core competence that supports it aren't guaranteed to stay around. You rent them; you don't own them. You want to make sure that you keep a long-term lease on both.

Sustained competitive advantage — the business world's Holy Grail — is a company's capability to renew competitive advantages over and over again in the face of a constantly changing business environment and marketplace. But if you want to sustain competitive advantages over time, you need to have a long-term strategy in place. Unfortunately, few do. Chapter 8 introduces three common alternatives called generic strategies and gives you a handle on what your competitors may be up to. Chapter 14 takes a much closer look at your strategic options. And Chapter 15 gives you some examples of what we term FD&H companies: fat, dumb, and happy. These firms achieved success but began to think they lived in a static world — and paid the price for their arrogance.

REMEMBER

Spend some time thinking about strategies that your company can use on an ongoing basis to see that you preserve your core competence. How can you sustain the competitive advantage that your company already has? Upload a blank Word doc and provide answers to these key questions:

- Where will changes in your business most likely come from?
- How are those changes likely to affect your company's competitive advantage?
- What can your company do to maintain core competence in the face of change?

Focus on each of the major forces that fuel change in your industry:

- Your customers and their changing needs and requirements
- Your competitors and their changing capabilities, strategies, and goals
- Your company, its value chain, and its shifting strengths and weaknesses

REMEMBER

As you create your business plan, make sure that you continue to track these forces so that they don't threaten the core competence you work so hard to achieve.

Earmarking Resources

The value chain lays out a schematic of your company as your customers see it. Links in the chain reflect the value that customers place on different aspects of your capabilities. The strongest links capture your competitive advantage in the market and define your core competence as a business. Because the value chain is so good at helping you measure the importance of your business decisions, it

comes in handy when you put together your business plan. In particular, the value chain is invaluable when it comes time to earmark scarce resources toward specific business activities.

When it comes time for your firm's annual budgeting session, you can bet that every department and cost or profit center will be hounding the chief cashiers (usually the CEO and CFO) for more funding for the coming year. It's like the kids before Christmas scribbling down their wish lists for Santa. It's the rare manager who says, "Nah, we're fine; we don't need anymore." Just the opposite, in fact. Most will have fancy PowerPoints with charts and exhibits purporting to show how the sales curve will rocket upward with a higher budget allocation this time around. It might seem easy to placate all the pleas by evenly spreading, say, total funds in the new capital expenditure account to all the firm's units. Be like Santa Claus, where everyone gets something; that should shut 'em up for a while.

But while this seems like fair and balanced decision-making in action, is it really sensible to spread your company's limited resources equally among all the areas that make up your business? Probably not. Each time you set aside time and money for a particular business activity, you place a bet on your business plan. You bet that the resources you commit are going to contribute to your business, add value to what you do, and eventually come back around to generate revenue and profits. You should leverage that bet, however, by putting the available resources into those activities that objective analysis has demonstrated to be the real drivers of your success. Being a budget dictator — a benign one, of course — is usually the best course of action to ensure that you'll still have a chimney for Santa to come back to next year.

REMEMBER

So how do you know where to place your bets? You guessed it: You go back to your company's value chain. Consider this simple way to check your resource allocation based on your value chain:

1. **Look at where your company currently spends money.**

   Make a quick-and-dirty estimate of how you divvy up yearly expenses among business activities, and jot the numbers down on your value-chain grid (refer to Figure 10-2). To keep things simple, use percentages.

2. **Look at where your customers think that you provide them value.**

   Take the total value that customers think you provide and divvy it up among your business activities. If customers pay $100 to buy your widget, for example, what percentage do they pay for features, how much for service, and how much for convenience?

3. **As a reminder, highlight the boxes on the value-chain grid that represent your core competence.**

4. **Analyze the completed grid.**

   If the percentages line up and are concentrated in the highlighted boxes, you're in good shape. But if you find a glaring mismatch in terms of where you spend money, what your core competence is, and where your customers think that your products give them value, you need to reassess where you direct your company's resources.

And one more thing. Don't forget to leave out those cookies and milk for Santa by the budget tree.

IN THIS CHAPTER

- Understanding how you calculate profits
- Balancing assets against your liabilities
- Keeping track of your cash
- Looking at your company's financial ratios

Chapter 11

Figuring Out the Financial Details

Numbers. Some people love them; others are bored by them; some begin to stammer, shake, and exhibit other physical signs of distress around them. But almost everyone agrees that — love 'em or hate 'em — numbers are the way that you keep track of things. Think baseball, cholesterol, your performance in school, the stock market, and, of course, your very own business venture. Numbers tell you more than simply the score at the end of the game or the final Dow Jones closing, however. When you put them together in the right ways, numbers paint a detailed picture of everything from the career of a ball player to the state of the global economy.

You're probably familiar with the financial forms that a lender requires when you want to borrow money for a new car, a bigger house, or your dream cabin in the mountains. Those tedious documents include an income statement, as well as some sort of balance sheet. The income statement tells the funding fairies where you get your money and where you spend it, and how much is left over when the countin' is done. The balance sheet lists the value of all the assets you own and balances the value against the money that you owe, including your car loans, mortgages, credit cards, and even personal I-owe-yous.

Financial statements tell the lender a great deal about you, and the decision-makers there discover even more by taking numbers from the statements and calculating a bunch of ratios (likely both calculated and evaluated by an algorithm today). It totals your monthly loan payments and divides that number by your monthly income, for example, and then compares this ratio with the average for other borrowers. The result gives the lending source a good measure of your ability to repay the loan. (And to be thorough, we also should inform you that any potential lender will access your FICO score; this metric, invented by a firm called Fair, Isaac and Company, uses an algorithm to estimate your creditworthiness.) Taken together, the statements and ratios create a financial portrait that the lender uses to get to know you better. And the better your lender knows you, the more comfortable it is with the decision to loan you money. The same goes for when you try to obtain money to start a business.

In this chapter, we introduce the basic financial statements and ratios that professionals widely use in business planning. In fact, they look almost identical to those that paint a picture of your personal finances, only a little more complicated. We show you how an income statement and a balance sheet are put together. We explain cash-flow statements, which do pretty much what the name implies (they detail where the money comes from, where it goes, and how much is left over). Finally, we explore simple financial ratios that you can use to evaluate your business.

Finance and economics might be on the dull side for many entrepreneurs, as well as seasoned managers, but if you don't have at least a basic grasp of how your firm survives day to day in terms of its financial situation, you could well find yourself in the unemployment line.

REMEMBER

Heads up: This chapter and Chapter 12 are just chock-full of financial reporting minutiae, some — we know, we know — boring at best. But our intention is to let you make the choice: Analyze the data in detail to get a clear sense of what the numbers mean and how they relate to your business, or just do a quick speed-read and perhaps let someone else in the firm do the down-and-dirty work.

TIP

And don't forget that several excellent software programs out there can do all of the heavy lifting for you after you plug in your basic numbers. For one, try `www.capterra.com` and click on "Software Categories" on the menu bar; then click "Browse All Categories" and scroll down to those covering "Financial." It will give you links to top-rated financial software vendors along with a snapshot evaluation of each. This will save you a ton of time, especially if you're not a numbers junky.

Reading Income Statements

REMEMBER

An *income statement* presents the proverbial bottom line. By adding all the revenue that you receive from selling goods or services and then subtracting the total cost of operating your company, the income statement shows *net profit* — how much money your company makes or loses over a given period. Here's how to think of net profit:

Net profit = Revenue – Costs

The most important thing to remember here is the fact that the income statement captures a very simple idea. No matter what your accountants call it — an income statement, an earnings report, or a P&L statement of profit and loss — or how complicated they make it look, the income statement still uses the same basic principle of subtracting cost from revenue to show profit.

Your income statement should cover a period that makes the most sense for your business planning: monthly, quarterly, or yearly. You get a better financial picture of your company and its direction if you look at income statements over several periods and even over several years and compare the numbers. In Chapter 12, you develop a *pro-forma* income statement — a forecast of your future profits based on projected revenue and costs.

In this chapter, we use a fictional firm we call "Yenta's Yogurt" (YY). It's a yogurt-based drink maker and marketer, selling a branded product through grocery stores, convenience stores, and an online channel. Yenta's has been up and running for several years now, and gross revenue is approaching $1 million.

Look at the various parts of an income statement for Yenta's Yogurt in Figure 11-1. Notice that it includes a two-year comparison to show how revenue, costs, and profits have changed. YY is a small company; if you want to make it a big company, just add three zeros after all the numbers (don't you wish you could do this for your own business — poof, you're a millionaire!). In either case, the income statement works exactly the same way.

Rendering revenue

Revenue refers to all the money that a company takes in. The most important source of revenue (usually the sale of goods or services) always appears as the first item on the income statement — in the case of Yenta's Yogurt (refer to Figure 11-1), you see gross revenue on sales. In this context, *gross* doesn't mean anything unpleasant; it

indicates the total revenue without costs subtracted. Revenue from sources other than sales, such as interest earned or other payments not related to product revenue, usually shows up a bit later on the income statement.

Income Statement at a Glance

Yenta's Yogurt

	INCOME STATEMENT AS OF DECEMBER 31		
		This Year	Last Year
1	Gross Revenue on Sales	$ 810,000	$ 750,000
2	Cost of goods sold	-560,000	-520,000
	Gross Profit	250,000	230,000
3	Sales, general, and administration	-140,000	-140,000
	Depreciation expense	-30,000	- 25,000
	Operating Profit	80,000	65,000
4	Dividend and interest income	+ 3,000	+ 2,000
	Interest expense	- 13,000	- 14,000
	Profit Before Taxes	70,000	53,000
5	Taxes	- 20,000	- 18,000
	NET PROFIT FOR YEAR	**$ 50,000**	**$ 35,000**

FIGURE 11-1: An income statement subtracts the costs of your various business activities from your gross revenue to arrive at the company profit.

Gross revenue on sales is based on the number of units sold during a particular period multiplied by the prices paid. YY sold 32,400 12-pack cases of the drink at a price of $25 each case, for a gross revenue of $810,000 (this was the wholesale price received by YY; retailers marked up the retail price by varying percentages when selling to their own customers). You may have several products or kinds of services, or your prices may change over time. Maybe you have to make an allowance for items that customers return. All these considerations contribute to your calculation of gross revenue on sales.

Calculating costs

Typically, most businesses have to spend money to make money. You can divide the cost of doing business into general categories that reflect the separate activities that your company is involved in and the different kinds of expenses that you incur. Major cost categories include cost of goods sold, sales and administration expenses, depreciation, interest expense — and don't forget taxes (though we'd love to). Each item deserves its own entry on the income statement.

Cost of goods sold

The *cost of goods sold* (COGS) combines all the direct costs of putting together your product or service, such as raw materials, supplies, and labor. If you offer a daycare service for young children, for example, the costs associated with delivering the service — meals, pillows and blankets, books and toys, and salaries for your assistants — go into the COGS.

Sales, general, and administration expenses

Sales, general, and administration expenses (SG&A) combine all the costs associated with supporting your product or service; these are often referred to as "overhead," since they are not costs directly related to making the product (your COGS noted in the previous section). If the company consists of you, your laptop, and some spare space in the guest bedroom, the costs don't amount to much. But for larger companies, these costs seem to go on and on. SG&A includes salaries and overhead for the sales staff, as well as the receptionist, clerical employees, and the boss. SG&A also can include advertising and promotion, travel, telephone calls, accounting fees, office supplies, dues and subscriptions, and everyone's favorite: miscellaneous expenses.

Depreciation and interest expenses

Depreciation expense is a standard way to spread both the cost and the usefulness of big-ticket items out over time. Whether you buy a building, a truck, or a computer, almost any durable item slowly declines in value due to simple wear and tear or because new technology makes the item obsolete. Bean counters have come up with various ways to calculate that depreciation. All the methods allow you to allocate a portion of the purchase price as a business expense. *Interest expense* includes all the money that you pay out to the parties that loan you funds to operate your business.

Taxes


REMEMBER

Even Albert Einstein stopped short of trying to figure his own taxes (and then again, so did a number of folks now serving 5 to 10). But taxes are a fact of life and represent another cost of doing business. You can minimize your company's taxes by keeping careful track of all your other expenses — expenses that lower your profit and, therefore, lower your taxes. But be careful here; when in doubt, consult a tax authority. Better safe than sorry.

Pondering profits

Profit is the pot of gold at the end of the business rainbow. When you run your business well, the total costs flowing out are less than all the revenue coming in. Your profit, of course, represents the difference. But you should consider different kinds of profit at various stages along the way:

- **Gross profit:** *Gross profit* (terrible term, we agree) measures how much money your company still has after you subtract all the direct costs of putting together your product or service (cost of goods sold) from the total revenue generated by sales.
- **Operating profit:** *Operating profit* accounts for all the additional sales, general, and administration (SG&A) costs that you incur as part of operating your business.
- **Profit before taxes:** *Profit before taxes* takes everything else into account, including any financial transactions that you make. Your income from other sources (such as investment dividends and interest) is included here.
- **Net profit:** *Net profit,* of course, represents the bottom line after the government subtracts the company's tax bite. In our example, Yenta's Yogurt (refer to Figure 11-1) made money in its most recent annual reporting period (yeah!).

Interpreting Balance Sheets

An income statement reports on the financial results of your business over a given period; a *balance sheet* is more like a snapshot of your financial condition at a particular time. The income statement lists your revenue, your costs, and the profit that you make. The balance sheet, on the other hand, captures what your company

owns, what it owes, and, therefore, what it's worth at a given moment. Ideally, the balance sheet tells you how much money you would have left over if you sell absolutely everything and then pay every last one of your debts. Your investors and particularly your lenders are interested in your balance sheet, because it gives them some idea of what their investment in your company is worth.

The things that your company owns are called *assets.* The amounts that you owe make up your *liabilities.* The difference between the two represents the *equity* in your business. Think of equity in terms of the following equation:

Equity = Assets – Liabilities

REMEMBER

The equation couldn't be simpler. So, naturally, accountants dreamed up another, less-straightforward way of looking at this equation — and, of course, you find this one on most balance sheets. It looks like this:

Assets = Liabilities + Equity

You always find a balance sheet divided into two parts. The top half deals with all the company's assets; the bottom half lists liabilities and equity. Because of the second equation, the top and bottom half are always in balance, adding up to exactly the same amount.

With the preparation of tax returns in mind, you often compile the balance sheet for the last day of the year. Figure 11-2 shows YY's balance sheet. In this case, we provide figures for two years so that you can make a comparison; this is always a good idea as you — and your investors — want to have an indication of current trends.

Ascertaining assets

Your company's *assets* include anything and everything you own that has any monetary value. When you think about your assets in terms of the balance sheet, all that should concern you is how much each asset is worth and how quickly you can sell it. So you separate assets into categories, depending on how *liquid* they are — how fast and easy you can liquidate (or sell) them into cold, hard cash. You can dispose of *current assets* within a year if you have to, whereas *fixed assets* often take much longer to get rid of.

Balance Sheet at a Glance

Yenta's Yogurt

	BALANCE SHEET ON DECEMBER 31		
	ASSETS	**This Year**	**Last Year**
	Current Assets		
1	Cash	30,000	15,000
	Investment portfolio	35,000	20,000
	Accounts receivable	135,000	150,000
	Inventories	115,000	120,000
	Prepaid expenses	5,000	5,000
	Total Current Assets	$ 320,000	$ 310,000
	Fixed Assets		
2	Land	60,000	60,000
	Buildings, equipment, machinery	355,000	315,000
	Minus accumulated depreciation	-125,000	-95,000
	Total Net Fixed Assets	$ 290,000	$ 280,000
3	**Intangibles (goodwill, patents)**	$ 5,000	$ 5,000
	TOTAL ASSETS	**$ 615,000**	**$ 595,000**
	LIABILITIES & OWNERS' EQUITY	**This Year**	**Last Year**
	Current Liabilities		
4	Accounts payable	60,000	70,000
	Accrued expenses payable	80,000	90,000
	Total Current Liabilities	$ 140,000	$ 160,000
5	**Long-term Liabilities**	$ 90,000	$ 100,000
	Owners' Equity		
6	Invested capital	155,000	150,000
	Accumulated retained earnings	230,000	185,000
	Total Owners' Equity	$ 385,000	$ 335,000
	TOTAL LIABILITIES & OWNERS' EQUITY	**$ 615,000**	**$ 595,000**

FIGURE 11-2: The balance sheet captures what the company owns, what it owes, and what it's worth.

Current assets

Current assets represent your company's readily available reserves. As such, you draw on these assets to fund your day-to-day business operations; you may have to turn to them in a financial emergency as well. Current assets include the following:

- **Cash:** You can't get any more liquid than cash, which is just what you expect it to be: bills and coins in the till, the petty-cash fund, money deposited in the bank, and cryptocurrency with your online DeFi source if that's your thing.
- **Investment portfolio:** Investments are usually liquid assets. Your investment portfolio includes savings accounts, short-term government bonds, and other safe securities that you invest in to watch your cash earn a bit of money while you wait to use it.
- **Accounts receivable:** *Accounts receivable* represents the money that customers owe you for goods and services that you previously delivered. Maybe you give customers 30, 60, or 90 days to pay.
- **Inventories:** The cash value of your inventories should reflect the costs of the raw materials and supplies that you have on hand, as well as the value of partially finished products and products that your shipping department is ready to transport.

Fixed assets

Fixed assets are fixed in the sense that you can't readily convert them into cash. These assets are the big-ticket items that usually cost a great deal of money up front and are meant to last for several years.

On the balance sheet, the value of a fixed asset is based on its original cost minus its accumulated depreciation over time, so the figure doesn't necessarily reflect the true market value of the asset or how much it may actually cost to replace it. Fixed assets can include the following:

- **Land:** You list the land that your company owns separately on the balance sheet, because it doesn't depreciate over time; its value on the books remains the same from year to year. (This, unfortunately, is one of the quirks of modern accounting. Suppose that you purchased the land in your business ten years ago. By now, it's worth double because of appreciation in the local real estate market. But yet on the books, it still shows as the original purchase value. Result? Your firm might be worth far more in value than what shows on the balance sheet.)

- **Buildings, equipment, and machinery:** This asset class represents the original cost of all the big-ticket items that you invest in to operate your company.
- **Minus accumulated depreciation:** Depreciation measures the decline in the useful value of a big-ticket item over time, so the original cost of all your fixed assets (excluding any land) is reduced by an amount equal to the total depreciation accumulated over the years. Notice that YY shows accumulated depreciation increasing by $30,000 in its most recent year (see Figure 11-2). Because its fixed assets are now worth $30,000 less on paper, YY also takes a $30,000 depreciation expense on its income statement (refer to number three in Figure 11-1).

Intangibles

You can't hold them in your hand or store them in a warehouse, but intangibles can be extremely important to your company. *Intangibles* include such things as your rights to a manufacturing patent, a long-term contract, an exclusive service franchise, or a brand name or logo. How important is the "swoosh" to Nike, for example?

Categorizing liabilities and owners' equity

Your company's *liabilities* cover all the debts and obligations that you enter into as you run your business. In the same way that you divide up your assets, your liabilities come in categories based on how soon you must pay. *Current liabilities* are those that you have to pay off within a year; *long-term liabilities* may stay on the books much longer. When you subtract these liabilities from total assets, you come up with *owners' equity*, which is a measure of how much the company is worth.

Current liabilities

Current liabilities are the debts that your company agrees to pay in the short term (say, within a year), so you have to be able to cover them from your current assets. What you have left over (the difference between your current assets and current liabilities) is so important that it has a name: *working capital*, or the chunk of money that you actually have to work with in the short term.

Accounts payable represents the amounts that you owe your regular business creditors as part of your ongoing operations. Your company also owes salaries and wages to its employees, interest on bank loans, and the taxes that you haven't sent in. These liabilities are *accrued expenses payable.*

Long-term liabilities

Long-term liabilities usually represent large chunks of money that you pay back over several years. You may have gone to the bank and secured a loan against your company's assets. In any case, you probably use the money to invest in the long-term growth of your business.

Owners' equity

There are two major sources of equity: money and resources that flow in from outside the company, and profits that the owners keep and pump back into the company. Owners' equity can be any of the following:

- **Invested capital:** The money that people invest in your company can take various forms, from the direct infusion of cash by inside owners to the buying and selling of stocks that represent small chunks of the company owned by outside investors. *Invested capital* represents the total of all this money.
- **Accumulated retained earnings:** After your company starts making a profit each year (and we hope it does), you can distribute it to the owners (that arrangement is where dividends come from) or keep part of it to reinvest in the business. *Accumulated retained earnings* represent the profits that you put back into the company year after year.

Examining Cash-Flow Statements

If you know what your company is worth and how much it makes every year, can't you just relax and assume that your financial plan is in reasonably good order? After all, what else do you need to know?

As it turns out, you have to keep close track of one other absolutely indispensable resource: cash. No matter how good your situation looks on paper — no matter how bright the balance sheet and how rosy the income statement — you still need cash on hand to pay the bills. The fact that you retain assets and make a profit doesn't automatically mean that you have money in the bank.

REMEMBER

The *cash-flow statement* monitors changes in your cash position over a set period. The top half of the statement tracks the flow of cash in and out of your company; the bottom half reports where the funds end up. Just like a balance sheet (see the earlier section "Interpreting Balance Sheets"), the money represented on the top and bottom halves of a cash-flow statement match. For newer

firms, this is the statement that usually gets the most attention from your investors: When you're out of cash, you're usually out of business.

Figure 11-3 shows a cash-flow statement for Yenta's Yogurt. The cash-flow statement contains many of the same elements as an income statement with a few critical adjustments.

Cash Flow at a Glance

Yenta's Yogurt

CASH FLOW AS OF DECEMBER 31		
INFLOW AND OUTFLOW	**This Year**	**Last Year**
Funds Provided By:		
Gross receipts on sales	825,000	760,000
Dividend and interest income	3,000	2,000
Invested capital	5,000	10,000
Total Funds In	$ 833,000	$ 772,000
Funds Used For:		
Cost of goods produced	555,000	515,000
Sales, general, and administration	160,000	150,000
Interest expense	13,000	14,000
Taxes	20,000	18,000
Buildings, equipment, machinery	40,000	50,000
Long-term debt reduction	10,000	5,000
Dividend distribution to owners	5,000	5,000
Total Funds Out	$ 803,000	$ 757,000
NET CHANGE IN CASH POSITION	**$ 30,000**	**$ 15,000**
CHANGES BY ACCOUNT	**This Year**	**Last Year**
Changes In Liquid Assets		
Cash	15,000	5,000
Investment portfolio	15,000	10,000
Total Changes	$ 30,000	$ 15,000
NET CHANGE IN CASH POSITION	**$ 30,000**	**$ 15,000**

FIGURE 11-3: A cash-flow statement monitors changes in a company's cash position over time.

Moving money: Cash in and cash out

The top half of the cash-flow statement deals with the inflow and outflow of cash, tracking where your company gets funds and how you use them. The cash-flow statement is a little more telling than an income statement, because the cash-flow statement shows money coming in only when you actually deposit it and money going out only when you actually write a check.

Knowing where your funds come from

Where does all your money originate? Your funds are usually made up of the following:

- **Gross receipts on sales:** This entry represents the total money that you take in on sales during the period. Gross receipts are based on your gross revenue. YY, as Figure 11-3 shows, received all $810,000 in gross revenue this year plus $15,000 in accounts receivable that customers owed the company from last year, for a total of $825,000.
- **Dividend and interest income:** Your income from savings accounts and other securities is also reported in your income statement.
- **Invested capital:** The money invested in your company shows up as part of the owners' equity on your balance sheet. As Figure 11-3 shows, YY received an additional $5,000 in invested capital this year.

Gauging how you use your funds

Where does all your money go? The cash-flow statement keeps track of the costs and expenses that you incur for anything and everything. These funds usually consist of the following:

- **Cost of goods produced:** This entry represents the total cost of producing your product or service during the period. YY, as shown in Figure 11-3, reduced its overall inventory by $5,000 this period, so the company's cost of goods produced was $5,000 less than its cost of goods sold from the income statement.
- **Sales, general, and administration (SG&A):** These expenses are the same SG&A expenses that appear on an income statement (see the earlier section "Sales, general, and administration expenses"). YY, as shown in Figure 11-3, paid down $10,000 in both its accounts payable and expenses payable this year, increasing its SG&A cash outflow by $20,000 for a total of $160,000.

- **Interest expense and taxes:** Interest expense and taxes show up on the income statement as well. The number reflects the amount that you actually pay out during the period.
- **Buildings, equipment, machinery:** When your company buys a big-ticket item, it doesn't appear on your income statement as an expense, because you're really just trading cash for another asset. When you buy the building, truck, or computer, however, you have to pay for it. The cash-flow statement reflects the costs. YY, as shown in Figure 11-3, shelled out $40,000 this year for new equipment.
- **Long-term debt reduction:** It costs you money to pay down any long-term debt that your company may have, and that expense doesn't appear on the income statement. YY reduced its long-term debt by $5,000 last year and $10,000 this year.
- **Dividend distribution to owners:** The portion of your company's profits that you decide to give back to the owners comes directly out of your cash box. YY distributed $5,000 to its owners this year.

Watching cash levels rise and fall

The flow of cash in and out of your business is like water flowing in and out of a reservoir. If more water comes in than goes out, the water level goes up. When your company's cash reserves rise, the money flows into one or more of your liquid-asset accounts. The bottom half of your cash-flow statement keeps track of what happens to those accounts. This year, for example, YY improved its cash reserves, liquid assets, and investment portfolio by $30,000 (see Figure 11-3). Not coincidentally, this $30,000 is the difference between the $833,000 that YY took in during the year (total funds in) and the $803,000 that it spent (total funds out).

Evaluating Financial Ratios

Armed with an income statement, a balance sheet, and a cash-flow statement, you have a relatively complete financial picture of your company in front of you (if not, check out the three preceding sections on those topics). But when you look over everything, what does that financial picture actually tell you? Is it good news or bad news? What should you plan to do differently as you go forward?

Your financial picture may tell you that you pay your bills on time, keep a cash cushion, and make some money. But could your company do better down the road? Ideally, you could look at the picture year after year and compare it against

a competitor, several competitors, or even your entire industry. But companies come in all shapes and sizes, and comparing numbers from any two companies and making sense of them is a hard task.

As a result, companies use *financial ratios.* When you divide one number by another, you create a ratio and eliminate many of the problems you encounter when comparing numbers on different scales.

TIP

If you want to compare your company's financial ratios with those of major competitors or with an industry average, you need to get your hands on some outside data. You can always start by asking your banker, accountant, or investment advisor, because financial institutions keep close track of standard ratios across industries. But you should also check out financial-data services. The U.S. Library of Congress provides access to Standard and Poor's *Industry Surveys* (`www.loc.gov/rr/business//company/industry_surveys.html`). Value-Line and Moody's are also sources of detailed industry data, while Dun & Bradstreet offers a publication called *Industry Norms and Key Business Ratios*, also available on the Library of Congress website (`https://guides.loc.gov/dun-and-bradstreet/key-business-ratios`). There really is a massive amount of data out there today, most of which is available at your fingertips. Try some artful Googling and see what you come up with that is specific to your own needs.

Financial ratios fall into three categories. The first two categories take your company's vital signs to gauge your chances of pulling through (remaining solvent, that is). One set of ratios measures your company's capability to meet its obligations in the short term; the other looks at the long term. The final set of ratios indicates just how strong and vigorous your company really is, measuring its relative profitability from several points of view.

Meeting short-term obligations

The overriding importance of promptly paying your bills every month is the major reason why current assets and current liabilities receive special attention on a company's balance sheet (see Figure 11-2). The difference between the two — your working capital — represents a safety net that protects you from financial catastrophe.

Having liquid assets available when you absolutely need them to meet short-term obligations is called *liquidity.* You can use several financial ratios to test your company's liquidity.

Current ratio

You determine your company's current ratio by looking at your balance sheet and dividing your total current assets by your total current liabilities:

Current ratio = Current assets ÷ Current liabilities

Yenta's Yogurt, for example, has a current ratio of $320,000 ÷ $140,000, or 2.3 (refer to Figure 11-2). You can also express this ratio as 2.3 to 1 or 2.3:1.

TIP

What magic number should you aim for? If your company falls below a current ratio of 1.0, you face serious financial danger. In most cases, you want the number to stay above 2.0, which means that you have more than twice the current assets that you need to cover current liabilities.

Quick ratio

You sometimes hear the quick ratio called the *acid test,* due to it being more stringent than the current ratio. The quick ratio doesn't allow you to count inventories and prepaid expenses as part of your current assets because of the difficulty in turning them back into cash quickly. This situation holds particularly true in industries in which products go out of fashion rapidly or become quickly outdated by new technology.

The quick ratio is as follows:

Quick ratio = (Cash + Investments + Receivables) ÷ Current liabilities

YY has a quick ratio for this year of $200,000 ÷ $140,000, or 1.4 (refer to Figure 11-2). You want to keep your company's quick ratio above 1.0 by a comfortable margin or measure it by standards in your industry.

Inventory turnover

Inventory turnover tells you something about the liquidity of your inventories. This ratio divides the cost of goods sold, as shown on your yearly income statement, by the average value of your inventories. If you don't know the average, you can estimate it by using the inventories listed on the balance sheet at the end of the year. Here's the formula:

Inventory turnover = Cost of goods sold ÷ Inventories

YY has an inventory turnover of $560,000 ÷ $115,000, or 4.9. (Refer to Figures 11-1 and 11-2 for the company's income statement and balance sheet, respectively.)

This ratio means that YY turns over its inventory almost five times each year. Expressed in days, YY carries a 75-day (365 ÷ 4.9) supply of inventory.

Is a 75-day supply of inventory good or bad? It depends on the industry and on the time of year. For Yenta's Yogurt, 75 days is likely too much; after all, these are perishable products. As automation, computers, and information systems make business operations more efficient across all industries, inventory turnover is on the rise, and the average number of days that inventory of any kind hangs around continues to shrink.

Receivables turnover

Receivables turnover gives you information about how fast customers pay you by dividing the sales that you make on credit by the average accounts receivable. If an average isn't available, you can use the accounts receivable from the balance sheet. Here's the formula:

Receivables turnover = Sales on credit ÷ Accounts receivable

If YY makes 80 percent of its sales on credit, its receivables turnover is ($810,000 × 0.8) ÷ $135,000, or 4.8. (Refer to Figures 11-1 and 11-2 for YY's income statement and balance sheet, respectively.) In other words, the company turns over its receivables 4.8 times per year, or once every 76 days on average — not a good turnover if YY's payment terms are 30 or 60 days. Unlike fine wine, receivables don't improve with age.

Remembering long-term responsibilities

Your company's liquidity keeps you solvent from day to day and month to month, but what about your ability to pay back long-term debt year after year? Two financial ratios indicate what kind of shape you're in over the long haul. The first ratio gauges how easily your company can continue to make interest payments on the debt; the second determines whether the principal amount of your debt is in any danger.

If you've read this chapter from the beginning, you may be getting really bored with financial ratios by now (actually, you may be snoring). But your lenders — bankers and bondholders, if you have them — find these long-term ratios incredibly fascinating, due to your possession of their money.

Times interest earned

Earnings before you pay any interest expense and taxes (EBIT) represents the profit that you have available to make your interest payments. Here's the formula:

Times interest earned = Earnings before interest and taxes ÷ Interest expense

Yenta's Yogurt, for example, has an EBIT of $83,000 divided by an interest expense of $13,000 this year for a times-interest-earned ratio of 6.4. (Refer to Figure 11-1 for the company's income statement.) In other words, YY has 6.4 times as much profit as it needs to pay off its interest expense obligation.

TIP

You may also hear the same number called an *interest coverage.* Lenders get mighty nervous if this ratio ever gets anywhere close to 1.0, because at that point, you must use every last cent of profit to pay interest on the long-term debt.

Debt-to-equity

The debt-to-equity ratio says a great deal about the general financial structure of your company. After all, you can raise money to support your company in only two ways: Borrow it and promise to pay it back with interest, or sell pieces of the company and promise to share all the rewards of ownership. The first method is debt; the second, equity. Here's the formula:

Debt-to-equity = Long-term liabilities ÷ Owners' equity

YY has a debt-to-equity ratio of $90,000 ÷ $385,000, or 0.23. (Refer to Figure 11-2 for YY's balance sheet.) This ratio means that the company has more than four times as much equity financing as it does long-term debt.

Lenders love to see plenty of equity supporting a company's debt, because they know that the money they loan out is safer. Equity investors, on the other hand, actually want to take on some risk. They like to see relatively high debt-to-equity ratios, because that situation increases their leverage (see the later section "Return on equity") and can substantially boost their profits (as the following section points out).

Reading relative profitability

Profitability shows you how well you measure up when it comes to creating financial value out of your company. Profitability ratios allow you to keep track of your performance year by year. They also allow you to compare your profitability against the performance of other competitors, other industries, and even other ways of investing resources. By comparing profitability ratios, you begin to see

whether your company measures up, generating the kinds of financial rewards that justify the risks involved.

Profitability ratios come in three flavors. The first type of ratio examines profit relative to your company sales. The second type examines profit relative to total assets. The final type examines profit relative to owners' equity. Each of the ratios reflects how attractive your company is to an investor.

Net profit margin

The net profit margin ratio says more about your costs in relation to the prices that you charge than about net profit divided by gross revenue. If your net profit margin is low compared with the margins of other companies in your industry, your prices are generally lower or your costs are too high. Lower margins are acceptable if they lead to greater sales, larger market share, and bigger profits down the road, but you want to monitor the ratio carefully. On the other hand, no one quibbles with high net profit margins, although the high number is an awfully good way to attract new competitors.

Here's the ratio:

Net profit margin = Net profit ÷ Gross revenue on sales

YY has a net profit margin this year of $50,000 ÷ $810,000, or 6.2 percent. (To examine YY's income statement, refer to Figure 11-1.) That result shows a substantial increase from the 4.6 percent the year before. This is good.

TIP

When you calculate your net profit margin, you should also think about calculating margins based on your operating profit and gross profit. Together, these ratios give you a better idea of where your company's profitability comes from.

Return on investment

Net profit divided by total assets gives you the overall return that you can make on your company's assets — sometimes referred to as *return on assets* (ROA). Here's the formula:

Return on investment = Net profit ÷ Total assets

Because these assets are equal to all your debt and equity combined (refer to the earlier section "Interpreting Balance Sheets"), the ratio measures an average return on the total investment in your company. What does the ratio mean? *Return on investment* (ROI) is widely used as a test of company profitability, because you can compare it to other types of investments that an investor can put money into.

WARNING

The value of the total assets you use in the calculation of ROI usually is taken from your company's balance sheet and may be way off base. If the assets have been around for a while, the numbers on the page may not reflect real replacement costs, and if the assets are undervalued (like real estate purchased long ago), the ROI is bound to be a bit exaggerated.

YY has an ROI this year of $50,000 ÷ $615,000, or 8.1 percent. (Refer to Figures 11-1 and 11-2 for the company's income statement and balance sheet.) That figure is up from 5.9 percent the year before, and the increase certainly represents good news.

Return on equity

Net profit divided by the owners' equity in your company gives you the return on the equity portion of the investment (ROE). Keep in mind that you already took care of all your bankers and bondholders first by paying their return — the interest expense on your debt — out of your profits. Whatever remains goes to the owners and represents their return on equity. Here's the ratio:

Return on equity = Net profit ÷ Owners' equity

You always pay your creditors first, and you pay them a fixed amount; everything else goes to the owners. Now you find out where *leverage* comes in. The more you finance your company by building debt, the more leveraged you are; the more leveraged you are, the more you use other people's money to make money. Leverage works beautifully as long as you successfully put that money to work — creating returns that measure higher than your interest costs. Otherwise, your lenders may end up owning your company. Ouch!

YY, for example, has an ROE of $50,000 ÷ $385,000, or 13.0 percent. (The income statement and balance sheet shown in Figures 11-1 and 11-2 shed some light on where these figures come from.) Without any leverage, that ROE is the same as the company's return on investment (ROI), only 8.1 percent (see the previous section). More leverage may raise the ROE even higher, upping your risk of losing your company if your revenues fall too far too fast. In short, leverage makes the good years better for the owners and the bad years much worse.

IN THIS CHAPTER

- Forecasting your financial picture
- Looking at financial alternatives
- Forming your company's budget

Chapter 12

Forecasting and Budgeting

You've most likely sat down at the kitchen table at some point in your life to put together a household budget — when money was tight and you had to pinch every penny to cover all your bills. Everybody knows what a budget is, of course: a way to figure out how much you need to spend on essentials (rent, utilities, car payments) and incidentals (all the frills that you don't exactly *need,* like that new set of golf clubs). By its very nature, a budget looks ahead and combines a forecast and a set of guidelines for spending money.

As you may know from experience, putting together a budget is much easier if you have some basic financial information to work with. You can take comfort in knowing how much money is going to come in, for example, and when you expect it to arrive. You also need to keep track of the essentials that you have to take care of immediately, such as the mortgage and the car payment. Only then can you find out what you have left over. In your business, the leftover is your *working capital.*

For your company, your financial picture resides in the financial statements you put together. Take a look at Chapter 11 (no, not Chapter 11 bankruptcy — the one in this book) for more statement information. These financial statements — income statements, balance sheets, and cash-flow statements — are fairly straightforward, because you base them on how your company has performed in the prior years. Unfortunately, financial information isn't quite as easy to put

together and use when you have to plan for next year, three years from now, or even five years down the road.

REMEMBER

Why go to all the trouble of predicting your finances in the first place? The answer is simple: Although the financial estimates and forecasts aren't your business plan by themselves, they support your business plan in critical ways. Without them, you face the real danger of allowing your financial condition — money (or the lack of it) — to take control of, or even replace, your business plan.

In this chapter, we help you construct a financial forecast for your company, including a pro-forma income statement, an estimated balance sheet, and a projected cash-flow statement. Because nothing in the future is certain, we also introduce scenario planning and what-if analysis as ways to consider several financial alternatives. Finally, we show you how you can use your financial forecast to create a budget.

TIP

This chapter has lots — and we mean lots! — of detail. We could have made it far shorter by simply listing terms and one-line descriptions, which for some of you may have been sufficient for your needs. Instead, we chose the long route — that is, providing the detail we think appropriate to someone who knows essentially nothing about financial reports. In this way, we hope we've created the best of both worlds for you: If you want the whole enchilada, here it is; if you want just a tasting menu, skim through the material at a more rapid pace. And in either case, you can always come back for a deeper dive.

Constructing a Financial Forecast

So far, no one has found a way to accurately predict every detail of the future. The only thing we know for certain is that we face an uncertain future.

You make decisions every day based on your personal views of what lies ahead. Although situations may often end up surprising you, your assumptions about the future at least give you the basic framework to plan your life. Your expectations, no matter how outlandish, encourage you to set objectives, move forward, and achieve your goals somewhere down the road.

You can think about the future of your company in much the same way. Assumptions about your industry and marketplace — that you'll have no new competitors, that a new technology will catch on, or that customers will remain loyal, for example — provide a framework to plan around. Your expectations of what lies ahead influence your business objectives and the long-term goals you set for the company.

REMEMBER

You need to know what your business assumptions are and where they come from, because your assumptions are as critical as your numbers when it comes to making financial predictions. If you make the assumption that no new competitors will enter the market, say why. If you see a period of rapid technological change ahead, explain your reasons. Don't try to hide your business assumptions in a footnote somewhere. State them clearly in the Financial Review section of your business plan. (For a recap of the important pieces of a business plan, see Chapter 1, and for an example, see the Appendix.) That way, you make your financial forecast as honest, adaptable, and useful as it can be. If you keep all your assumptions out in the open,

- Everybody who looks at your forecast knows exactly what's behind it.
- You know exactly where to go when you need to change your assumptions.

As you may have experienced elsewhere in life, coming up with predictions that you really believe in isn't always easy. You may trust some numbers (next year's sales figures) more than you do others (the size of an untested brand-new market). Your best estimates form the basis of some of your financial predictions, and you may use sophisticated number-crunching techniques to arrive at others. After you get the hang of it, you begin to see what a powerful and useful planning tool a financial forecast can be. You find yourself turning to it to help answer all sorts of important questions, such as these:

- What cash demands does your business face in the coming year?
- Can your company cover its debt obligations over the next three years?
- Does your business plan lead to profitability this year?

WARNING

With so many important questions at stake, a financial forecast is worth all the time and effort that you can spend on it. If you're not careful, a forecast can turn out to be way off base. Did you ever hear of "GIGO," the old computer hacker's expression: "Garbage in, garbage out"? The same is true of financial forecasts. Your prediction is only as good as the numbers that go into it. If the numbers are off the mark, look for one of the following reasons:

- Unrealistic expectations
- Nonobjective assumptions
- Unchecked predictions

The following sections examine the financial statements that make up a financial forecast. After we explain how you can put these statements together, we point out which of the numbers are most important and which are the most sensitive to changes.

Piecing together your pro-forma income statement

Pro forma refers to something that you describe or estimate in advance. (It can also signify a mere formality that you can ignore — but don't get your hopes up; we're talking about a serious part of a business plan.) When you construct your financial forecast, you should include *pro-forma income statements* — documents that show where you plan to get your money and how you plan to spend it — for at least three years and for as long as five years into the future, depending on the nature of your business. You should subdivide the first two years into quarterly income projections. After two years, when your income projections are much less certain, annual projections are fine. (For info on income statements, go to Chapter 11.)

TIP

Your company's pro-forma income statements predict what sort of profit you expect to make in the future by asking you to project your total business revenue and then to subtract all your anticipated costs. The following should help you get ready:

- If you're already in business and have a financial history to work with, upload all your past financial statements right away. (If these are not already in a spreadsheet format like Excel, then convert them to one.) You can use them to help you figure out what's likely to happen next.
- If you run or are developing a new company and you don't have a history to fall back on, you have to find other ways to get information on expected revenues and costs. Talk to people in similar businesses, and consult industry data through links on the Internet and other informative media.

The pro-forma income statement has two parts: projected revenue and anticipated costs.

Projected revenue

Your company's projected revenue is based primarily on your sales forecast — exactly how much of your product or service you plan to sell. You have to think about two things: how much you expect to sell, naturally, and how much you want to charge. Unfortunately, you can't completely separate the two projections, because any change in price usually affects the level of your sales (price up, volume down, and vice versa).

WARNING

Your sales forecast is likely to be the single most important business prediction that you ever make. If you get it wrong, the error can lead to mountains of unsold inventory at one end, or a sea of unhappy, dissatisfied customers at the other — a financial disaster in the making. (And if you have outside investors, your troubles are just beginning.)

How do you make an accurate sales forecast? Start by looking at this formula:

Sales forecast = Market size × Growth rate × Market-share target

REMEMBER

Look at the equation in this broken-down form:

- Market size estimates the current number of potential customers or units of the good.
- Growth rate estimates the speed of market growth.
- Market-share target estimates the percentage of the market that you plan to capture.

Because your sales forecast has such a tremendous impact on the rest of your financial forecast — not to mention on the company itself — you should try to support your estimates with as much hard data as you can get. Depending on your situation, you can also rely on the following guides:

- **Company experience:** If you have experience and a track record in the market, you can use your sales history to make a sales prediction.
- **Industry data:** Industry data on market size and estimates of future growth come from all quarters, including trade associations, investment companies, and market-research firms (which we cover more extensively in Chapter 5).
- **Outside trends:** In certain markets, sales levels mirror trends in other markets, social trends, or economic trends (a phenomenon we describe in Chapter 13).

  Even if a product is brand-new, you can sometimes find a substitute market to track as a reference. When frozen yogurt first appeared on the scene, for example, its producers turned to the sales history of ice cream to help support their sales forecasts.

REMEMBER

After you come up with your sales forecast, multiply it by the average price that you expect to charge for your product or service. The result is your projected revenue:

Projected revenue = Sales forecast (in units of your good) × Average price

Where does the average price come from? You base your average price on what you think your customers are willing to pay and what your competitors charge (refer to Part 2 for more information on how to analyze your industry and customers).

Now put all the numbers together and see how they work. We use an imaginary company called Yenta's Yogurt (YY) as an example. Sally Smart, the flavored

yogurt product manager, starts putting together a three-year revenue projection. Utilizing industry and market data along with sales history, Sally estimates that the entire market for flavored yogurts will grow about 10 percent a year and that YY's market share will increase by roughly 2 percent a year, with projected price increases of approximately $1 to $2 per case of 12 yogurt containers (a very positive projection — you can't always assume that market share and prices will increase). She puts the numbers together in a table so that she can easily refer to the underlying estimates and the assumptions that support them (see Table 12-1). All of this should be done in an Excel spreadsheet (or comparable tool) so you can quickly tweak numbers and see the overall effect.

TABLE 12-1 **Flavored Yogurt Revenue Projection for Yenta's Yogurt Co. (YY)**

Revenue Projection	Year 1	Year 2	Year 3
Projected total market size (units)	210,000	231,000	254,100
Projected YY market share (%)	20	22	24
Sales forecast (units)	42,000	50,820	60,980
Average price	$26	$27	$29
Projected revenue	**$1,092,000**	**$1,372,140**	**$1,768,420**

Anticipated costs

You still have to look at anticipated costs — the price tag of doing business over the next several years. To make life a little easier, you can break anticipated costs into the major categories that appear in a pro-forma income statement: projected cost of goods sold; projected sales, general, and administration expenses; projected interest expenses; and projected taxes and depreciation (flip to Chapter 11 for more details). The following list defines these categories:

- **Projected cost of goods sold (COGS):** COGS, which combines all the direct costs associated with putting together your product or delivering your service, is likely to be your single largest expense.

  Although the following formula may look ugly, treat it as a simple way to calculate your projected COGS. Based on the assumption that the ratio of your costs to your revenue will stay the same,

  Projected COGS = (Current COGS ÷ Current revenue on sales) × Projected revenue

- **Sales, general, and administration (SG&A):** SG&A represents your company's overhead: sales expenses, advertising, travel, accounting, telephones, and all the other costs associated with supporting your business. If your company is brand-new, try to get a feel for what your support costs may be by asking people in similar businesses, cornering your accountant, or checking with a trade association for average support costs in your industry. There also may be something online that can help you here, so don't be afraid to use that source.

  If you have a mature business, you can estimate a range for your SG&A expenses by using two calculations:

  - The first method projects a constant spending level, even if your company's sales start growing. In effect, you assume that your support activities will all get more efficient and accommodate your additional growth without getting bigger themselves.
  - The other method projects a constant SG&A-to-revenue ratio. In this case, you assume that support costs will grow as fast as your revenue without any increase in efficiency. Because your projected SG&A costs are higher, this is the more conservative estimate.

  TIP

  An accurate SG&A forecast probably lies somewhere in between. Given what you know about your company's operations, come up with your own estimate and include the assumptions that you make.

- **Interest expense:** Your interest expense largely results from decisions that you make about your company's long-term financing. Think about what sort of financing your business may need in the future (to acquire office space, computers, machinery, and so on) and what interest rates you may be able to lock in, and then estimate your interest expense as best you can.

- **Taxes and depreciation:** Taxes certainly affect your bottom line, and you want to include your projections and assumptions in your anticipated costs. You usually can estimate the general impact taxes may have on the future by looking at their impact on your company now.

  Depreciation, on the other hand, is an accountant's way of tracking the value that your purchases (equipment, tools, whatever) lose over time. As such, depreciation expense doesn't really come out of your pocket every year. You can estimate the numbers, but don't get too carried away.

WARNING

When you plug the numbers into your pro-forma income statement and calculate your net profit, be prepared for a shock. You may discover that the profit you expected to make in the first year or two turns into a projected loss. But don't panic: New business ventures often lose money until their products catch on and they begin to pay off some of the start-up costs. Whatever you do, don't try to turn a projected loss into a profit by diddling with the numbers. The point isn't to make money on paper; the point is to use the pro-forma income statement as a tool that

can tell you what sort of resources and reserves you need to survive until losses turn into predicted profits.


TIP

Many online software programs can do all of your financial statement estimations for you (for example, `www.quicken.com`). All you need to provide are the numbers, and then the software does all the calculations and in many cases plugs in variables such as tax rates for you.

Estimating your balance sheet

The second part of your financial forecast is the *estimated balance sheet*, which, like a regular balance sheet (see Chapter 11), serves as a snapshot of what your company looks like at a particular moment — what it owns, what it owes, and what it's worth. Your estimated balance sheets describe what you want your company to become in the future and how you plan to achieve your goal. The estimated balance sheets that you put together as parts of your financial forecast should start with the present and extend out three to five years in a series of year-end projections.

The pro-forma income statements in your financial forecast project future revenue, costs, and profits; your estimated balance sheets lay out exactly how your company needs to grow so that it can meet those projections. First, you want to look at what sorts of *assets* you need to support the planned size and scale of your business. After you assess your necessary assets, you have to consider how to finance your company — how much debt you plan to take on *(liabilities)* and how much of your investors' money *(equity)* you plan to use.

Assets

Your company's projected assets at the end of each year include everything from the money that you expect to have in the petty-cash drawer to the buildings and machines that you plan to own. Some are current assets, meaning that you can easily turn them into cash; others are fixed assets, which take much longer to get rid of (refer to Chapter 11 for detailed asset info).

» **Current assets:** The cash you have on hand, as well as accounts receivable and inventories, add up to your current assets. How much should you plan for? That depends on the list of current liabilities (debts) you expect to have, because you have to pay short-term debts out of your current assets. What you have left over is your working capital.

Projected inventories (the amount of product in your warehouse) depend on how fast your company can put together products or services and get them to customers.

- **Fixed assets:** Land, buildings, equipment, machinery, and other assets you can't easily dispose of make up your company's fixed assets. Your estimated balance sheets should account for the big-ticket items that you expect to purchase or get rid of.

  TIP

  Keep an eye on how each machine or piece of equipment helps your bottom line. If you plan to buy something big, make a quick calculation of its *payback period* (how long it takes to pay back the initial cost of the equipment out of the extra profit that you make). Here's a simple example: There's a new machine out there that you can purchase for $10,000. If you buy it, it will reduce your current costs with your existing machine by $3,333 a year. So, in three years the savings equals the cost of the machine: $10,000 ÷ $3,333 = 3). Your payback period is then three years. Is the payback period going to be months, years, or decades? If the payback period you foresee is longer than you'd like, consider an equipment lease as an alternative to an outright purchase.

Liabilities and owners' equity

Estimated balance sheets have to balance, of course, and your projected assets at the end of each future year have to be offset by all the liabilities (current and long-term) that you intend to take on, plus your projected equity in the company. Think about how leveraged you intend to be (how much of your total assets you expect to pay for out of money that you borrow). Your use of leverage in the future says a great deal about your company.

- **Current liabilities:** You estimate in this category all the money that you expect to owe on a short-term basis in the future. Current liabilities include the amounts that you expect to owe other companies as part of your planned business operations, as well as payments you expect to send to the tax people.
- **Long-term liabilities:** The long-term debt that you plan to take on represents the piece of your company that you intend to finance. Don't be surprised, however, if potential creditors put a strict limit on how much they want to loan you, especially if you're new to the business. In general, bankers and bondholders alike want to see enough equity put into your business to make them think that everyone is in the same boat, risk-wise.

  Before you take on a new loan, find out what kind of debt-to-equity ratios similar companies have (for help, turn to Chapter 11). Make sure that yours falls somewhere in the same range.

» **Owners' equity:** The pieces of your company that you, your friends, relatives, acquaintances, and often total strangers lay claim to get lumped together as *owners' equity.*

In general, you can estimate your company's future benefit for the owners by projecting the return that you expect to make on the owners' investment (refer to Chapter 11 for the details). You can compare that return with the earnings of investors in other companies or even other industries.

During the initial stages of your company, equity capital likely comes from the owners themselves — as cash straight out of the wallet or from the sale of stock to other investors. The equity at this stage is crucial, because if you want to borrow money later, you have to show your bankers that you have enough invested in your business to make your company a sound financial risk.

WARNING

Unfortunately, profits have another side — a down side residing in the red. Although you probably don't want to think about it, your company may lose money some years (especially during the early years). Losses don't generate equity; on the contrary, they eat up equity. So you have to plan to have enough equity available to cover any anticipated losses that you project in your pro-forma income statements (refer to the earlier section "Piecing together your pro-forma income statement").

Projecting your cash flow

The flow of cash through a business is much like the flow of oil through an engine: It supports and sustains everything you do and keeps the various parts of your company functioning smoothly. We all know what happens when a car's oil runs dry: The car belches blue smoke and dies. Running out of cash can be just as catastrophic for your company. If you survive the experience, it may take months or even years for your business to recover.

Cash-flow statements keep track of the cash that comes in and out of your company, as well as where the money ends up. Projected cash-flow statements ensure that you never find the cash drawer empty at the end of the month when you have bills to pay.

REMEMBER

Projected cash-flow statements should look three to five years into the future, and for the first two years, they should include quarterly or, better yet, monthly cash-flow estimates. Monthly estimates are particularly important if your company is subject to seasonal cycles. (If you're not sure what a cash-flow statement looks like and how it differs from an income statement, flip to Chapter 11.)

Exploring Alternative Financial Forecasts

Wouldn't it be nice if you could lay out a financial forecast — create your pro-forma income statements, estimated balance sheets, and projected cash-flow statements — and be done with it? Unfortunately, the uncertain future that makes your financial forecast necessary in the first place is unpredictable enough to require constant attention. To keep up, you have to do the following things:

- Monitor your financial situation and revise the parts of your forecast that change when circumstances — and your financial objectives — shift.
- Update the entire financial forecast regularly, keeping track of the accuracy of your past predictions and extending your projections another month, quarter, or year.
- Consider financial assumptions that appear more optimistic and more pessimistic when compared to your best predictions, paying special attention to the estimates that you feel the least certain about.

REMEMBER

Why take the time to look at different financial assumptions? For one thing, different assumptions show you just how far off your forecast can be if the future turns out differently than you expected. Also, the differences that you come up with are an important reminder that your forecasts are only that: forecasts. You have to prepare for alternatives.

Utilizing the DuPont formula

If you want to get a feel for what happens when you change any of the estimates that make up your company's financial forecast, you have to understand how the numbers relate to one another. The DuPont company came up with a useful formula that other companies have used since its inception over 100 years ago (some old things are worth keeping around).

The idea behind the *DuPont formula* is simple: to describe all the ingredients that play a role in determining your return on equity (ROE) — a number that captures the overall profitability of your company. ROE is your company's overall net profit divided by the owners' equity. But knowing that your ROE is 13 percent, for example, is like getting a B+ on a test. You think that you did relatively well, but why did you get that particular grade? Why didn't you get an A? You want to know what contributed to the grade so that you can do better next time.

REMEMBER

By discovering what's behind your company's ROE, you have a way to measure the impact of your financial predictions on your profitability. The DuPont chart shown in Figure 12-1 turns the formula into a pyramid, with the ROE at the top. Each level of the pyramid breaks the ratio into more basic financial ingredients:

First level

ROE = Return on assets (ROA) × Leverage

You can increase your company's return on equity by increasing the overall return on your company assets or by increasing your leverage (the ratio of your total company assets to equity).

Second level

Leverage = Assets ÷ Equity

As your debt increases relative to equity, so does your company's leverage.

ROA = Asset turnover × Net profit margin

You can increase your return on company assets by turning those assets into more sales or by increasing the amount of money that you make on each sale.

Third level

Asset turnover = Sales ÷ Assets

Asset turnover is the amount of money that you take in on sales relative to your company's assets. The bigger your asset turnover, the more efficiently you turn assets into sales.

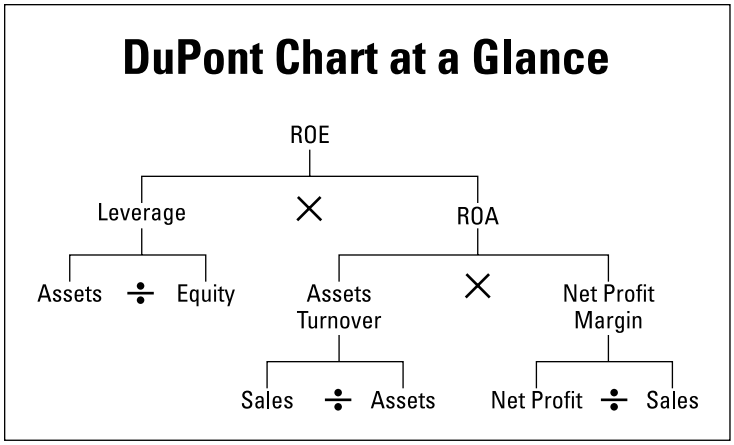

FIGURE 12-1: The DuPont chart turns the DuPont formula into a pyramid, with return on equity (ROE) at the top.

Net profit margin = Net profit ÷ Sales

Net profit margin is the profit that you make after subtracting expenses divided by the amount of money you take in on sales. The larger your profit margin, the lower your overall costs relative to the prices that you charge.

Answering a what-if analysis

After you see the makings of the DuPont formula (outlined in the previous section), you can start exploring different assumptions and what happens when you change the financial forecast. With the DuPont formula, you can look at how those changes can affect your projected profitability, measured by your return on equity. The DuPont formula makes answering questions like the following much easier:

- What if I cut prices by 3 percent?
- What if I increase sales volume by 10 percent?
- What if the cost of goods sold (COGS) goes up by 8 percent?
- What if I reduce company leverage by 25 percent?

TIP

If you get your computer and a spreadsheet program involved in the analysis (just Google "DuPont formula calculator"), you can ask ten what-if questions and get the answers before you have time to think of the next ten.

Making a Budget

The pieces of your financial forecast — the pro-forma income statements, estimated balance sheets, and projected cash-flow statements — are meant to create a moving picture of your financial situation tomorrow, next month, next year, and three or even five years out. You can see a much clearer financial picture in the near term, of course, with your viewpoint clouding up the farther out you try to look. Fortunately, you can use the best of your forecasts to make near-term decisions about where, when, and how much money to spend on your company in the future.

REMEMBER

Making a budget for your company is one of the most important steps that you take as you prepare your business plan and as your company matures. Your budget, in effect, consists of a series of bets that you're willing to place, based on what you expect to happen in your industry and in the marketplace in general. Your budget spells out the origin of your company's resources and where they end up going, and it helps ensure that you make the right financial decisions. And most importantly, your budget is how you bring your strategy to life; see Chapter 14 for details on your organization's strategy and how to create it. As you see in Chapter 14, at the end of the day, strategy is your guide to resource allocation decisions. This means your strategy should determine how you deploy your organization's resources — capital, human resources, everything you use — to achieve your goals and objectives. The budget, by contrast, is your tactical blueprint for making the strategy work: This is where you allocate resources over the coming year — by budgeting them — that will achieve those goals and objectives in the here and now.

Looking inside the budget

The rough outlines of your company's budget look a lot like your projected cash-flow statement. In fact, the cash-flow statement is the perfect place to start. Projected cash flow is a forecast of your company's projected money sources and where your funds may go in the future (check out the earlier section "Projecting your cash flow" for a deeper look). Your budget fills in all the details, turning your financial forecast into a specific plan for taking money in and doling it out. The *master budget* that you create should account for everything that your company plans to do over the next year or two.

Yenta's Yogurt put together a budget for the next two years based on a financial forecast and its projected cash flow (see Figure 12-2). The company's master budget looks a great deal like one of its cash-flow statements (flip to Chapter 11 for a comparison). But the budget goes into more detail in dividing the broad financial objectives into actual revenue and expense targets for specific company activities. The company breaks down the cost of goods produced, for example, into the cost of raw materials and supplies, labor, utilities, and facilities.

Creating your budget

So when should you begin? If you're just starting your business — or find yourself in a company without a budget in place — what better time than the present? If you're up and running, *when* you start the new budget cycle depends on your company's size. For big companies, the yearly budget process should begin six to nine months in advance.

Master Budget

Yenta's Yogurt

REVENUE AND EXPENSES		
	Next Year	Year After
Budgeted Revenue:		
1 Gross receipts on sales	$895,000	$970,000
Dividend and interest income	4,000	5,000
Total Revenue Available	**$ 899,000**	**$ 975,000**
Budgeted Expenses:		
Cost of goods produced	$ 600,000	$ 650,000
Raw materials and supplies	250,000	275,000
Labor costs	300,000	325,000
Utilities and facilities	50,000	50,000
Sales, general, and administration	$ 165,000	$ 170,000
Sales and distribution	90,000	95,000
Advertising and promotion	30,000	30,000
Product service	15,000	20,000
Accounting and office support	30,000	30,000
2 Interest expense	12,500	12,000
Taxes	22,000	24,000
Buildings, equipment, machinery	40,000	$100,000
Equipment and computers	35,000	25,000
Expanded warehouse	5,000	75,000
Development projects	10,000	15,000
New product development	8,000	5,000
New market development	2,000	10,000
Long-term debt reduction	2,500	2,000
Dividend distribution to owners	6,000	7,000
Total Expenses Out	**$ 858,000**	**$ 980,000**
NET CHANGE IN CASH POSITION	**$ 41,000**	**$ -5,000**

FIGURE 12-2: The master budget resembles a projected cash-flow statement.

WARNING

Established companies can use their track record and financial history as starting points for next year's budget. But be careful: When you're a veteran, bad cases of budgetary laziness come easy when you can use last year's numbers as a shortcut to next year's numbers. Far too often we've seen firms use the annual budgeting exercise simply as a means to just keep doing what they've always done, but adding in just a little bit more. The starting point is what you did the last fiscal year (that is, the 12-month period that you use to cover all your financial reports). In these cases, the firm trots out the past year's numbers and adds on an appropriate multiplier that will account for expected growth in the coming year. So what's the problem here? The firm never truly questions whether the budgeting — short-term resource allocation decision-making — is in sync with the overall enterprise strategy; it simply assumes it is.

There's a better way, by using an approach called *zero-based budgeting.* When you insist on zero-based budgeting, you ask everybody — including yourself — to go back and start from ground zero to prepare the budget. Instead of depending on last year's budget numbers, you make full use of your financial forecast and build up a new set of numbers from scratch. You also are able to fundamentally question each and every item in the projected budget for the coming year, which in these current times of constant and radical change is especially critical.

Top-down budgeting approach

REMEMBER

The top-down approach to forming your budget is the simplest way to work through your company's financial plans. The process basically begins and ends with the people in charge. If you have a small company, you may want to invite some outside people to join you and offer their viewpoints, opinions, and expertise — people you trust, such as your banker, accountant, or maybe a close business associate. The process goes like this:

1. **Put the finishing touches on your company's financial forecast, including the pro-forma income statements, expected balance sheets, and projected cash-flow statements.**

   If certain pieces are missing or incomplete, try to get the information that you need or make a note that a necessary document is unavailable. (Check out the earlier section "Constructing a Financial Forecast" to form the pieces of the forecast.)

2. **Meet with your company's decision-makers (or your trusted group, if you're self-employed) to review the financial forecast.**

   Take time to discuss your general expectations about the future. Talk about the business assumptions that go into the forecast and the key predictions and estimates that come out of it.

3. **Meet again to explore possible financial alternatives.**

   After everyone has had a chance to reflect on the financial forecast, look at different sets of business assumptions and weigh their potential effects on the forecast.

4. **Come up with revenue and expense targets for each of your company's major business activities or functional areas (whichever is more appropriate to your company).**

5. **Meet one last time after you draft the budget to review the numbers and to make sure that everyone is on board.**

   Put together a written summary to go along with the numbers so that everyone in the company knows what the budget is, where it comes from, and what it means.

WARNING

Although top-down budgeting works well when you know all the people in your company on a first-name basis, you see the approach's disadvantages as your company gets bigger. By including only the managers at the top, you run the risk of leaving out large chunks of the organization and losing track of your real business situation when it comes time to plug in the numbers. As your company expands, the need for a new technique becomes evident. Enter the bottom-up approach.

Bottom-up budgeting approach

The bottom-up approach to creating your budget is an expanded version of the top-down process, but it takes into account the demands of a bigger company and of more people who have valuable input. You still want to begin creating your budget by getting a group of senior managers together. That group should still spend time coming to a general understanding of, and agreement on, your company's financial forecast. But instead of forcing a budget from the top, the bottom-up approach allows you to build the budget up through the company.

REMEMBER

Don't ask your group of senior managers to go on and dictate the company's budget. At this point in the budget process, the bottom-up approach allows you to get managers and supervisors at all levels of the company involved. The process goes like this:

1. **Meet with senior managers and ask them to review the company's broad financial objectives for each of your major business areas.**

   Try to come up with guidelines that set the tone and direction for budget discussions and negotiations throughout the company. (See the earlier section "Constructing a Financial Forecast" to come up with objectives.)

2. **Ask the top managers to meet with their managers and supervisors at all levels in the organization.**

   Meetings can start with a recap of the budget guidelines, but the discussions should focus on setting revenue and expense targets. After all, these division managers actually have to achieve the numbers and stay within the spending limits.

3. **Summarize the results of the budget negotiations.**

   If necessary, get the senior group members together again to discuss revisions in the financial objectives, based on the insights, perceptions, and wisdom of the company's entire management team.

4. **Approve the budget at the top.**

   In this final pass, look at the overall budget not only in terms of current financial objectives, but also with respect to your larger business goals.

One final point about your organization's budget: After you're done with all the negotiating and "put the budget to bed," everyone knows their budget allocation for the coming year. This implies that you've created an incentive tool for your managers and everyone else in the firm. Achieve the budgeted numbers, and you get a bump to your salary and bonus if the firm provides one. Most people live in the here and now, not three or five or further years out. So, to get that bonus, your team will work as hard as possible to make their numbers. But here's the tricky part: How tightly aligned with your long-term strategy is this next-year's budget? Suppose, for example, your long-term strategic goal is to become the perceived quality leader in your industry. Next, suppose that the budget for your operations department calls for a bonus if the managers there can cut expenses by 10 percent over the coming year. Do you want to guess which target those good folks will strive for? Whatever puts money in the pocket today.

REMEMBER

The point: The budget is your short-term tactical tool to achieve your long-term strategic goals and objectives. Be sure you have your priorities right when doing budgeting.

4 Looking to the Future

IN THIS PART . . .

We help your company look to the future. We help you manage the uncertainty that lies ahead by looking closely at where changes are likely to arise. We talk about how you can anticipate changes ahead of time, assessing what effect these changes could have on your business and how likely they are to really happen.

Of course, you don't necessarily have to accept the future that you predict, so we help you shape your own future by thinking strategically. We introduce you to the business strategies that have worked in the past and show you how to create your own company's strategy for the future. We inform you how the Internet has changed global commerce irrevocably and what the implications of an online presence mean to your business strategy.

Finally, we explore different ways your business can grow. We look at ways to extend your product line, expand into new markets, and branch out into new businesses.

IN THIS CHAPTER

- Seeing the dangers of ignoring change
- Tracking economic, governmental, cultural, and technological trends
- Looking ahead with trend forecasting, scenario planning, and hedging
- Assessing the effects of change

Chapter 13
Confronting Uncertainty

Wasn't it some ancient Greek wise man who said, "Change is the only constant in life"? Wise words indeed. Change defines life. All people expect change. At one time or another, no doubt, you've said, "I really need a change." (Or was it the ex who said that? Never mind.) But you don't often hear people say that they *want* a change or *like* change. People generally prefer stability in their lives. Change makes the future uncertain, and uncertainty makes planning difficult. But you can't avoid change, so what are you going to do? For starters, keep reading this chapter (and this book) and learn to manage change.

But we must warn that you have the privilege of living in an era of unprecedented economic transition. If you're one of those who has fresh ideas about market disruptions, that's good — conditions are favorable. Yet the downside is that the old "rules" often no longer apply, so in many cases you will be flying blind — and might need a parachute. Measure your risks appropriately, whatever it is that you do.

We start by defining the elements of change, including economic, governmental, cultural, and technological trends. We look at ways in which you can anticipate change by forecasting trends and creating alternative scenarios. And we show you how to assess the possible effects of change and how to use innovation to take advantage of change.

Understanding the Dangers of Ignoring Change

Since companies are still run by people, they don't want or like change either, and they come up with hundreds of excuses to try to keep business operations just the way they are. Here are some of the top excuses:

- Never been tried before. (Or we've tried it before.)
- Too radical. I don't like radicals. If it ain't broke, don't fix it.
- We don't have the time. (Or it'll take too much time.)
- We're not ready for it. Our company is different.
- It's impossible. Now get back to work!

REMEMBER

Many companies often try to avoid change, especially if they've been around awhile and seem to be successful in what they do. But denial is not a big river that runs through some other continent. Change needs to be both acknowledged and confronted by the business planner. It is what makes a market work. Change allows companies to form and grow, products and services to get better, competitors to emerge from everywhere, and customers to go on shopping. Small or new companies often champion this change, because they have little interest in maintaining the status quo. Disruption is their entry ticket to the game. In a competitive marketplace, if you stop changing, you die. This is a harsh but true reality.

Good companies understand this fact but often have a hard time acting on it when they become successful — maybe because they have more at stake. The original Fortune 500 list, published in 1955, represented the biggest and best American companies of the era. Today, only a few of those original companies still appear on the list. Many operate in completely different businesses.

Across all industries, the list of companies whose stars have dimmed in the recent past continues to grow, if not glow:

- In the 1950s everyone looked up to General Motors, Sears Roebuck, and US Steel as exemplars of business leadership. "What was good for [America] was good for General Motors, and vice versa" was famously claimed.
- The 1960s and 1970s saw the rise of IBM and McKinsey & Co. as best in class.

- General Electric, Microsoft, and Goldman Sachs were deemed the role models of the 1980s. *In Search of Excellence,* published in 1982 and hailed as the best business book of all time, highlighted 43 American firms that succeeded in the face of fierce foreign competition. Later many declined, some fatally.
- Aggressive "new economy" firms like Blockbuster boomed in the 1990s. So did other tech companies like Hewlett-Packard, ITT Industries, Motorola, and Xerox.

Numerous articles and books have been written on these companies, on their industries, and on their times. In fact they are responsible for a thriving mini-industry within the publishing business. In each case, you can summarize the arguments by stating that these formerly successful companies failed because they didn't or couldn't change with the times. At some point, they each became frozen in the past, and that doomed them to extinction. And now the new century has brought us Facebook, Apple, Amazon, Netflix, and Google — the so-called FAANGs — as the role models for business excellence. Are they destined to suffer a similar fate at some point?

Defining the Dimensions of Change

Events and forces beyond your control continuously change the business conditions around you. You can't fiddle with the laws of physics, but if you want your company to survive, you must keep track of changes as they take place. The experts call the practice *environmental scanning* — not the kind that the U.S. Environmental Protection Agency (EPA) does, but the kind that looks at anything that may affect your business situation. This approach is often called PEST analysis (or STEP if you rearrange the letters, because the first acronym reminds you of your little brother). This is a term that captures the four major categories of change that you need to monitor: political, economic, social/cultural, and technological.

REMEMBER

Although multiple factors can influence your business environment, you can simplify matters by looking at the major trends shown in Figure 13-1. (For the details, check out the following sections.) When radical changes threaten to reshape your industry and marketplace, you can bet that the underlying causes involve broad economic, governmental, cultural, or technological trends.

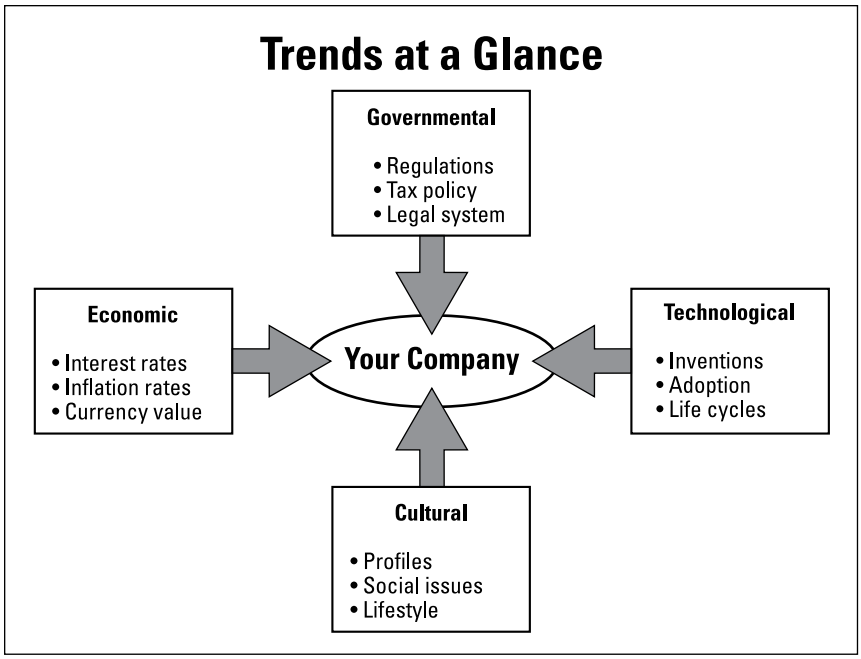

FIGURE 13-1: You can break a business environment scan into four major groups of trends.

Governmental trends

We won't win any prizes by reminding you that the government has a profound effect on your company and your industry. From the rules and regulations that it issues to the tax policies and legal system that it supports, the government is a major player in your marketplace. Because of its sheer size and impact, the government sparks continuing national debate on how large, how wide, and how deeply involved it should be in the day-to-day running of the economy.

Some may desire a return to a mythical past in which small-town America could mind its own business without interference from "outsiders." In that long-gone time, everything was small enough that local social pressure could keep the bad apples from spreading their rot. But that's history. Today our massive national and global economy doesn't allow for such intimacy. We often don't know who supplies our products or where they're located, let alone what individuals might be responsible for decisions. And who wants a world in which companies can sell products that endanger lives or tout benefits that are blatantly false? We also don't want private business firms to be able to ride roughshod over the competition and become bloated monopolists just because they can.

We hope that business leaders realize they have social responsibilities beyond the bottom line. Nobody likes regulation, especially excessive rules and requirements

that raise costs and prices for all without clear societal benefit. But when business folks, for whatever reason, do cross the line of responsibility and harm others, we need an active government that can protect consumers and competitors alike.

REMEMBER

No matter which side of the more-or-less-government debate you stand on, be sure you do the right thing. You also need to keep track of where the discussion in your industry is heading. Governmental actions at any level — local, state, or federal — can rapidly and dramatically alter your business environment, and you should include a summary of the relevant governmental trends in the "Business Environment" section of your business plan (see Chapter 1).

What kinds of issues should you watch for? Topics that arouse public opinion and finally lead to some sort of governmental reaction seem to have a predictable cycle of three stages. The timeline of the cycle, however, has become compressed with the rapid spread of online communications technologies. BSM (before social media) time is history, so you have to respond rapidly today:

- In stage 1 of the cycle, when some new problem or issue arose that was interpreted by some to be harmful, nothing much happened; it might have warranted an article here or an opinion poll there.
- But if the issue touched a nerve and could have serious consequences for many, stage 2 would kick in. It would begin to snowball with national media — ever on the prowl for stories that would attract readers or viewers — jumping on the bandwagon with exposés and accusations that drew attention.
- Finally, in stage 3, if threats to the public good posed by the issue at hand were serious enough, mounting public pressure finally got the political establishment to take action and pass some form of government legislation.

REMEMBER

All three stages are still there today. But stage 1 has gone from taking months or even years to evolve to instant diffusion via social media. One perceived bad experience by an aggrieved customer becomes a viral wave on the web, complete with video or still pictures. If it's your business that is alleged as the bad guy, you could be in deep doo-doo, right now. If it's someone in your industry, you need to get the facts ASAP and ensure the stench doesn't spread to your own organization. Stay alert so you can avoid the dirt.

At the federal level, government has three branches — executive, legislative, and judicial — and each branch can affect your company. You also need to think about local, state, and foreign governments.

TIP

You may need a little help in picking out the governmental activities and trends that can affect your business environment. Almost every industry has a trade association, along with an industry newsletter or two, most of which are conveniently online today. These organizations devote much of their time and resources to keeping tabs on — and influencing — current events at all levels of government. The larger ones also track relevant happenings abroad.

Executive branch

The person who calls the White House home sets the general tone and direction of the U.S. government. When President Joe Biden took office in 2021, he quickly convinced Congress to pass legislation designed to counter the collapse of the economy caused by the COVID-19 pandemic that his administration inherited. Trillions of dollars began to flow into the bank accounts of millions of Americans, and these soon reverberated in ringing cash registers across the country. Certainly not all, but many business firms in numerous industries benefitted. Maybe yours, too.

On the other hand, if you have anything to do with the traditional fossil-fuel energy industry, it could be a different story; that ringing you hear in the distance could be the church bells tolling for thee. As evidence mounts that carbon contributes to global warming and environmental catastrophes, the Biden administration has called for significant curbs on the activities of oil and gas companies.

REMEMBER

Think about this: How might the federal government's agenda influence the future of your industry?

Legislative branch

Congress writes the laws of the land and holds the nation's purse strings. Only the House and Senate, acting together, have the authority to spend your tax dollars. This can range from national security and defense expenditures to social programs such as Social Security and health benefits to enhance the lives of Americans.

More recently, Congress has been wrestling with how to provide oversight to financial market disruptions due to "fintech" innovations. New products and services enabled by technological change, such as cryptocurrencies from Bitcoin to Ethereum to altcoins, are revolutionizing financial markets. Until the dust settles, these markets will remain volatile. If your business is affected, will you discover new opportunities or see only threats?

Judicial branch

The federal courts interpret all the laws that Congress passes each year, so they have a profound effect on every industry in America.

Recent investigations for potential antitrust violations in industries as varied as sports, media, entertainment, airlines, education, and others are shaking up the status quo. Who knows, your little corner of commerce could be next if you don't pay attention (or conversely, an industry breakup could be just the means by which your little firm can now get into the game and survive).

Local and state governments

You are also liable to be touched by the actions of local governmental agencies, from state government to a special purpose "district" in your immediate neighborhood. In many cases, especially if you're a smaller business, these can be more intrusive than something from the feds. These apply to activities as varied as water consumption prohibitions to your proximity to certain types of structures. Some states prohibit the sale of alcoholic beverages within a minimum distance of schools or churches. Others allow or disallow the growing or distribution of cannabis products or paraphernalia. Depending on what you do, you may need a state or local permit or license just to open your doors for business each morning (and some even have restrictions on days and hours of operation).

Foreign governments

Globalization is a recurring theme in this book, and it applies to monitoring foreign government and public policy trends as much as domestic. We note earlier in this chapter that currency fluctuations can impact your ability to plan for your business, even if you don't directly engage in exports or imports from international markets. Look at these recent examples:

- The government of China has taken steps to minimize the influence of foreign cultures on its citizens. This has resulted in problems for U.S. firms engaged in entertainment sectors as varied as movies and TV shows, theme parks, gambling casinos, and publishing that have China-based sales and operations. The same government also wants to clamp down on the online gaming industry in an attempt to get the millions of young Chinese boys and girls who spend hours a day on those obsessive sites to devote more time doing calculus, practicing violin, or something else. U.S.-based firms who compete in China's vast market were caught off guard by these sudden public announcements.
- The upheaval caused by the COVID-19 pandemic wreaked havoc for countless U.S. businesses engaged in the travel and tourism industries. Constantly changing rules and regulations kept these firms in the dark regarding the ability of foreign guests from European nations to travel to the United States and fulfill reservations sometimes made months in advance. U.S.-based firms in manufacturing industries suddenly faced parts shortages as their Asian suppliers shut down as the virus reduced the able-bodied workforce there.

REMEMBER

It can be a *caveat emptor* world when dealing in foreign markets. Exercise caution. (And in fairness to our global readers out there, this advice applies just as much to firms engaged in trade with the United States.)

Economic trends

At an individual level, people use bank accounts, home mortgages, car loans, and credit cards every day to navigate through the financial contingencies of their lives. We save, spend, borrow, dream. At the same time, public agencies responsible for economic oversight and the financial institutions they oversee are making their own calculations, based on mandates to stabilize the national economy and, for private financial actors such as CEOs of corporations, generate profit as they measure the risk and reward trade-offs they face. When combined, these zillions of micro financial decisions create the complex glue that holds our "macro" economy together.

It is a large, complex, and enormously critical task to keep everything rolling along without the economy going off the rails. But as we have seen all too tragically in the first decades of the 21st century global economy, our best and brightest who control the levers don't always succeed. The Great Depression of the 1930s still defies a standard explanation of causality. The Great Recession of 2008–2009 continues to generate learned theories that all seem to contradict the one just published. Perhaps the biggest mystery in economics is why no one seems to understand the basic forces at work.

Economics certainly sounds like science. People in the know always talk about it in terms of numbers — inflation rates, growth rates, interest rates, exchange rates, productivity levels, unemployment figures, price indices, blah, blah, blah. By the early 20th century, economics became math, the purest of the sciences. But when it comes to predicting the future levels of these indicators today (and what they mean to consumers and companies), the science can become rather subjective, kind of science-y in fact rather than slam-dunk truth telling. Even worse, the fault lines of political division have also blurred agreement on the direction, magnitude, or significance of the numbers. It's not astrology yet, but macroeconomics does seem to be a discipline in search of its very foundations.

However, economists do agree on some basic facts:

- Economic indicators constantly change.
- Indicators are sometimes predictable.
- Indicators somehow relate to the performance of the economy.
- The overall economy affects your business environment.

REMEMBER

Obviously, economic uncertainty isn't very satisfying. But economic trends are important enough that you need to keep track of them, even if your information is incomplete and the underlying theories sometimes questionable. The most important economic trends for your industry should be incorporated into the "Business Environment" and "Financial Review" sections of your business plan (see Chapter 1). What numbers should you keep your eyes on? It depends on your business.

If you sell new cars, for example, most of your buyers finance their purchases with loans that have monthly payments tied to interest rates. So low interest rates are extremely important to the overall health of the auto industry. Interest rates make or break the home-building market for the same reasons, as well as the home-loan industry that supports it. If you're a techie chasing the Next Big Thing, you need to know the specific pace of invention and innovation in your service or product niche. If you're in a labor-intensive service business, like quick-service restaurants (fast-food restaurants to the rest of us), you need good, entry-level workers. Their ready availability hinges on wages and regional unemployment levels. As an exporter, you want to examine exchange rates and the current level of the dollar against the currencies of your international target markets.

No business is immune from economic forces, and that includes yours. The following sections highlight four key economic indicators reflective of major trends in the economy that you should watch closely.

GDP

The *GDP* (Gross Domestic Product) is the total value of a country's annual production of goods and services. You should keep track of the change in GDP from year to year, because that change reflects the current overall economy. Moderate, consistent growth in the GDP generally produces a healthy economy with expanding opportunities for many businesses. A drop in the GDP, on the other hand, often leads to lower demand for products and services, an increase in competition as incumbent firms fight for survival, and lower profits for everyone.

REMEMBER

You can't always generalize based on the GDP, however; look at how your industry and your company performs within the larger economy.

Interest rates

Interest rates represent the cost of renting money — how much you have to pay a bank, for example, to use its cash for a certain period. Short-term rates apply when you borrow money for periods ranging from a month to two years (or even shorter times from "pay-day" lenders who extract exorbitant rates for those in need of cash right now, to be repaid the next pay day). Long-term rates apply to loans that extend all the way out to 30-year home mortgages. As you can imagine, the cost of money affects every facet of the economy, from consumer spending to business expansion.

In the United States, the Federal Reserve Bank in Washington (the Fed that holds the nation's bank account) pretty much sets the short-term interest rates. With seemingly everyone now having access to a credit card (or four or five), short-term rates influence shopping habits: The lower the interest rates, the easier (and cheaper) it is for shoppers to buy on credit. So if you want to start a retail business, you have to pay special attention to how short-term interest rates might affect demand by your target customers.

REMEMBER

And that also means you're likely to have to accept credit as a form of payment. Have you noticed that even that tasty little taco and burrito truck who shows up at lunch time takes your card? Innovative e-commerce ecosystem lenders like Square came up with technology that lets the little guy use a smartphone to accept payment. Different card vendors, however, offer varying terms to small firms, so you need to be careful in finding one that's best for your business.

Long-term interest rates rise and fall in the corporate and government bond markets. Bonds, as opposed to stocks, are fixed income investment products that yield a defined rate of return over a specified period of time to the lender. The value of stocks, of course, can rise or fall on a daily or even minute-by-minute basis. Long-term bond rates have a major impact on how easily consumers can afford houses, cars, and all other "big-ticket" (expensive) purchases, because consumers usually finance these items with long-term loans. Long-term rates, therefore, affect consumer demand for big-ticket items.

Inflation rates

Inflation, or a continuous rise in wages or prices, is a nasty habit that economies often suffer from. Consumers are the first to know when inflation rears its ugly head, because prices go up and money can't buy as much as it used to. And lenders aren't thrilled either: Under conditions of inflation, the payments made to repay their loans are worth less than the value of the loan when it was first handed over.

When inflation is high, companies find that resources and assets are more expensive for them as well. They have to pay more for everything from materials to employees' wages and benefits. Investors turn their attention to products that have greater intrinsic value, such as gold, real estate, collectibles, and art — tangible or hard-to-replace goods that protect them against less valuable paper money that governments might simply print more of to pay bills (or fund popular new programs that keep voters happy and politicians in office). Consumers may borrow more money, partly to pay the higher prices and partly because they can pay back today's cash with less valuable money. If the amount of goods produced remains static, but the amount of money out there increases, then the classic problem of "too much money chasing too few goods" drives up prices as customers bid more to get what they want. Lenders, including the Fed, sense the economic landscape, so interest rates go up.

REMEMBER

Not all companies suffer equally from inflation, however. If you mine precious metal, pump oil, or sell real estate, for example, you can often do quite well during a period of inflation. If you operate any other business, however, you have to balance the broad economic trend against its effect on your industry.

All these factors are a real drag on the economy over time, and inflation can lead to a recession if the government and the Fed don't attend to the problem. But let's not forget what we note earlier in this chapter: Economists are struggling with understanding how the modern global economy works today. Huge injections of liquidity (cash) into the economy following the Great Recession of 2008 didn't result in the surge of inflation that more conservative economists predicted. In fact, inflation came down to historic lows and stayed there. But then came the COVID-19 pandemic of 2020, subsequent governmental programs of cash handouts to prevent economic collapse — and inflationary surges in certain categories of goods. Go figure. No wonder they call it the dismal science.

Currency value

In today's global economy, the rise or fall of the U.S. dollar against the Euro or other currencies can have an enormous impact on your entire industry. Your suppliers, competitors, and customers may be anywhere in the world, no matter what industry you're in or how small your company is.

This has become especially acute with the rise of China as the "world's factory." Unlike most large economies in which the value of their currency "floats" according to market conditions (that is, rises or falls with global demand), that country's government has maintained tight control over its economy, particularly by keeping the value of its currency low compared to other nation's money. This was done to protect its manufacturers from foreign competition and to promote its products in world markets by keeping their costs (and prices) low when compared to local competitors. The result is that China became the world's largest exporter of goods, and its success as a low-cost provider threatened competing producers almost everywhere. China's currency manipulation policies have lessened in recent years, without question, but for many firms and industries it was too late as the damage was already done. (Ever heard of the Rust Belt?)

REMEMBER

The lesson here for your business planning efforts is that you need to keep a sharp eye out on currency values. But wait, you say; "I don't compete outside the shores of my own nation, so why would any of this economic gobbledygook affect me?" For good or bad, you do compete in the world today. Globalization has changed the playing field of commerce beyond recognition. Even with recent calls for the U.S. government to reign in free trade and impose protectionist economic policies, it is now clear that the tight weaving together of global supply chains won't result in any quick-fix solutions. The bonds are too tight, and the benefits too good, for so many.

DOES SIZE MATTER WHEN IT COMES TO CONFRONTING CHANGE?

Throughout this book, we recount the sad tales of once dominant and respected firms failing to recognize their changing environment and paying the price. These were large enterprises with deep pockets and access to necessary resources. We also note that new business start-ups, which are typically not large, fail at a high degree. According to statistics published in 2019 by the U.S. Small Business Administration (SBA), about 20 percent of business start-ups fail in the first year. About half succumb to business failure within five years. By year 10, only about 33 percent survive.

But on the other hand, there is compelling evidence that firms that recognize new trends and act on them aggressively tend to be small. So-called industry "disrupters" are overwhelmingly not the Goliaths out there, but rather the little Davids with something new in their slingshots. We're sure you can name many of these guys yourself with just a moment's thought.

So what gives with Goliath? There are both structural as well as corporate "cultural" factors at work here. Much of the academic and mass media literature tends to focus on the latter, as it makes for interesting and even fun reading: Find the perp and expose their flaws and vulnerabilities. (Egomaniacs, can't take bad news, wouldn't listen, better at organizational politics than sound planning, promoted to a level of incompetence, something to do with Mommy . . . the list is endless.) Some of these accusations are no doubt true.

But other forces confront large and established firms that don't matter that much to the new kids on the block. Most big successful firms are publicly traded, and shareholders — primarily "institutional investors" like mutual and pension funds who collectively own the company — demand stable and predictable earnings so they can reward their own clients. This tends to influence top-level corporate decision-makers to stay with the tried and true, rather than make a big bet on something whose outcome is still iffy.

You should always remember the words of America's true poet laureate, Bob Dylan: "When you ain't got nothin', you got nothin' to lose." The feisty new little firm tends to have some great ideas or radical new products that might — or might not — work, and the people involved tend to be younger without the financial demands of older employees at established firms concerned with mortgage payments, looming college tuition bills, or pension needs. Risk, after all, is a four-letter word. So here's the typical response of the big established firms to change: Let's pass on this until we know it's a sure thing (which usually is too late). You can skip to Chapter 15 for some more on this intriguing issue.

So stay vigilant. Short-term fluctuations in the value of the U.S. dollar are unpredictable. The effects of longer-term currency trends, on the other hand, are easier to predict. Be sure you understand how these might affect your own business planning.

Cultural trends

Take two frogs and a skillet. Place the skillet on the stove and bring a small amount of water to a boil. Drop one of the frogs into the skillet. The frog, no dummy that one, jumps out of the skillet, onto the floor, and out the door.

Place the skillet back on the stove, this time filled with cold water and the second frog (that first one's long gone by now; think Pavlov). As the water slowly heats, the frog sits there agreeably, never noticing the rising temperature. (Don't try this experiment at home unless you plan to have *cuisse de grenouille* for dinner.) The moral? When you ignore the slow changes that take place around you, you boil.

Cultural change doesn't happen overnight. Yes, of course, we know there might be some hot new fad in fashion that's here today and gone tomorrow (and maybe back again the day after tomorrow), but fashion is a special case. For most product or service categories, the glacial speed of these trends reflects the glacial forces that lie behind them. Most people, as we hint earlier in this chapter, really don't like change that much; we're creatures of habit who prefer the tried and true. The real danger lies in ignoring these slow-motion trend lines simply because you can always worry about them later.

Consider the cultural shifts we describe in the following sections.

Demographic changes

Demographic refers to the general profile of a specific population — anything from your company's customers to the citizens of a nation. Demographic data includes attributes that you may find on a national census form, such as age, gender, and family size.

Changes in the profile of a nation are certain to have profound effects on its economy and business. Western Europe, Japan, China, and the United States, for example, are all trying to come to terms with the aging of their populations. Their governments have to figure out how to take care of all these older people, and companies are trying to figure out how to sell them their products or services. (Flip to Chapter 6 for more info on customer demographics and Chapter 7 for a rundown on generational customer groupings.)

Social changes

A society is made up of the combined values, customs, and traditions that its people hold in common. Social behavior changes over time, of course, but people tend to give up their traditions slowly and grudgingly (boy, don't we know this in the United States today). Most American schools still give their children the summer off, for example, even though most children no longer need to work on the farm during those months.

Some still cling to a belief that women should remain as stay-at-home moms and leave the workaday world as a male-only domain. Honestly. But look at enrollments in college-degree programs for attorneys and physicians; women outnumber men today. Look at trending numbers in business schools; women are on a rapid rise. Can science and technology fields be far behind? If you said yes, that's probably a losing wager.

But what happens to customs and traditions as the population changes — as people move from place to place, as families start to look different, and as newly sworn-in citizens bring along their own customs and traditions? Think of all the opportunities for ethnic restaurants (Vietnamese, Middle Eastern, and Ethiopian, for example) as new waves of immigrants move into different regions of the country. Any change in broad social behavior, no matter how slowly it occurs, can have a dramatic effect on your company and on industries across the economy.

Lifestyle changes

Changes in the way people live their lives affect how they work, what they buy, how they play, and where they live. Decades ago, for example, the health-and-fitness craze caught on in the United States. Today, the industry includes the makers of sports shoes, sportswear, exercise equipment, tennis rackets, mountain bikes, kayaks, yogurt, diet drinks, bottled water, and many other products. Diets also changed as awareness of healthy eating habits began to sink in; fish and white meat became preferred sources of protein, replacing traditional red meat entrees. Due to dramatic improvements in healthcare, most Americans can count on a longer lifespan than previous generations. One result is that growing numbers of seniors have given a kick start to pastimes like gardening.

Other major lifestyle changes that affect industries include

- Growing gender identification equality in every area
- Work-from-home (WFH) or hybrid jobs that have reduced in-office hours
- At-home shopping, education, and entertainment as the web expanded

- Alternative family units and their definition
- Older folks continuing to work past traditional retirement age
- Younger folks seeking better work-life balance

Technological trends

Technology breeds change, and change breeds technology. In the past 150 years, America has gone from buggies to citizen travel on space shuttles and from the Pony Express to the Internet. A hundred years from now, likely only 50 and possibly less, people may look back at our era and marvel at how primitive our technologies were. Today we are truly in another great Industrial Revolution that is touching almost every corner of the business world.

Every new technology doesn't change the world overnight. Most don't change the world at all, in fact. You could produce a television show on the world's funniest inventions that pop up each week (though it would likely be better to stream for smartphone viewing). For the most part, the technologies that succeed have been evolving for quite some time. No matter how fast a new technology takes over from the old, it usually follows a *diffusion curve*, which traces how a new technology catches on in an industry (see Figure 13-2).

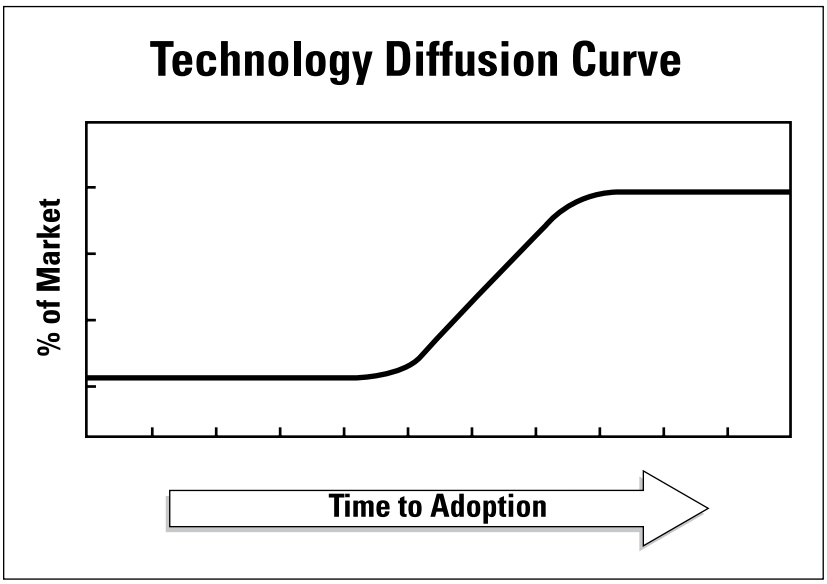

FIGURE 13-2: The technology diffusion curve points out that when a new technology takes off, it usually catches on rapidly.

The diffusion curve demonstrates that it always takes a certain amount of time for any new technology to take off. When (and if) it does hit hyperspace and catch on, the technology usually sweeps through an industry quickly, because companies don't want to fall behind. But speed of diffusion is also changing — due to technology itself. It took more than 50 years for landline telephones to penetrate 80 percent of U.S. households, but less than 15 years for cellphones. The reason is because new information is not only being created in volumes unheard of in the past, but also because it's communicated worldwide at laser-like speed (and laser-like is not an exaggeration). This is serendipity in action: The speed of transmission of new data quickens the pace of new data creation. This alone should offer insight to the value of a firm like Google.

As Figure 13-2 shows, the technology reaches its plateau when most of the incumbents in an industry adopt the new technology. The only groups left are the laggards — a topic we take up in Chapter 15, where we introduce you to the Product Life Cycle concept (no, this is not a product made by Peloton). But don't blink when an industry gets to that stage, because the search for the Next Big Thing has already begun.

Knowing that not everyone wants the latest and greatest

When technology leads to the emergence of product and service innovations, there isn't a stampede for them by everyone. In fact, some customers are downright put off by the changes. Different strokes for different folks and all that. Behavioral scientists have come up with five basic personality types that react to the new in decidedly different ways, as we describe in Table 13-1.

TABLE 13-1 Customer Personality Types

Type	Description
Innovators	Risk-takers of the world Young and well educated Comfortable with new ideas and technologies Mobile and networked Informed by outside sources
Early adopters	Opinion leaders in their communities Careful evaluators Open to well-reasoned arguments Respected by their peers

Type	Description
Early majority	Risk avoiders whenever possible Deliberate in their actions Unlikely to try new products until those products catch on
Late majority	Skeptics Extremely cautious Disappointed by other products Reluctant to try new products Respond only to pressure from friends
Laggards	Hold out until the bitter end Wait until products are old-fashioned Still hesitate!

REMEMBER

Why are customer personality types so important when you think about how to market that bright shiny new thing they came up with in the R&D lab? Because individual personality has a great deal to do with how eager people are to try out new products and services. Although some people are adventurous and willing to try anything new, others are quite the opposite. As shown in Figure 13-3, the percentage of people who represent each personality type is just an estimate, of course. But you get a rough idea of the relative size of each personality group.

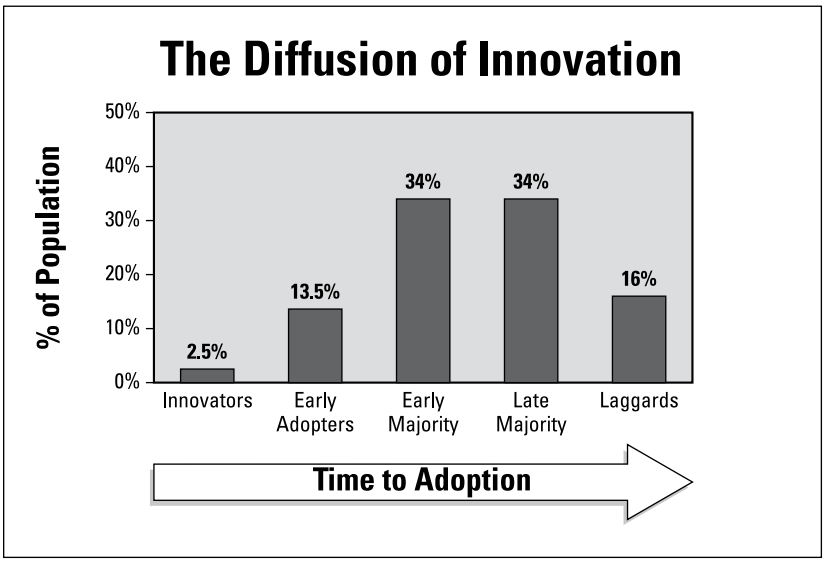

FIGURE 13-3: Product adoption occurs at different times for different personality types.

We might not be willing to bet on it, but there's a good chance you're one of the Indiana Jones innovator types, or you wouldn't be reading this book. For some firms, this has presented a problem. Why? Because these personality types tend to project their admiration for the new onto the entire population out there: "Hey, wow, look at this! I love it, it works! Let's green-light it now." And they did — and it sold, and this led to an expansion of production and in increase in expenditures. But then . . . the wall. Suddenly sales slowed or altogether died, and shelves full of those neat little new do-hickeys sat lonely and forlorn, as the bills came due while the cash register went silent.

The problem was that those shoppers who fit the innovator or early adopter type (see Table 13-1) were a relatively small segment of the overall market. The big segments — two-thirds to three-quarters of all customers — didn't really "buy" products; rather, they had to be "sold" on them. This meant the engineers and scientists had to rely on the marketing team to conjure up creative ways to convince the skeptics that this really was something superior. Unfortunately, many of the R&D folks didn't even have a marketing department up and in place; they were so convinced of the innate value of their innovation. They had to learn how to jump the wall (or "cross the chasm," as it was explained in a classic study of Silicon Valley technology adoption stories). Many never could make the leap, and died.

REMEMBER

The important thing to remember about the diffusion of innovation is that if you bring a brand-new kind of business or service to the marketplace, the innovators and early adopters are going to be easier to capture than the majority of consumers out there. The longer your kind of product or service has been around on the market, the more effort you must spend focusing on your customers and understanding their wants, needs, and motives. (For more on how to do this, go to Chapter 7.)

Tracking tech trends

REMEMBER

What do these examples say about trends in technology? Although each industry is different, a few generalizations come to mind:

- Older technologies often have time to adjust to innovations.
- Older technologies can be improved even after they mature.
- New technologies usually begin by focusing on specialized customers and markets.
- New technologies can create new customers, expanding the marketplace.
- Old and new technologies often live together for many years.

TIP

You may struggle to predict the coming of a new technology and what's going to happen when it arrives. To prepare yourself for possible changes in technology and the potential effects on your industry, review the major technologies that consumers currently use. For each technology, do the following things:

- Find out which research laboratories specialize in the technology and what technical journals and publications, print and digital, cover and report on it. Make sure that you check out academic, private, and government institutions.
- Attend major conventions and scientific meetings on the technology and subscribe to any relevant news sources.
- Monitor online blogs and company press releases on the technology and keep track of patents that innovators file in the field.
- Compare your company's capability to adapt to and apply technology to that of your key competitors.
- On a regular basis, re-examine the likelihood of a fundamental technological breakthrough and check the status of small, step-by-step process improvements in technology.

Although technologies within your industry may be unpredictable, you should track them over time and take them into account as you create your business plan. The technology advances in unfamiliar areas, however, have the potential to bite you while you sleep. When Xerox introduced its first copier in 1959, it basically stopped mimeograph machine makers cold. When Hewlett-Packard came out with its first handheld calculator in 1970, slide-rule manufacturers took a fast slide into oblivion. Kodak may have missed the digitization of photography, but the Sonys and Canons and Minoltas and others who produced those substitutes failed to recognize the incorporation of optics technology into smartphones. These pocket-sized devices spelled their doom. Today that Swiss-knife do-it-all tool has powerful camera capabilities, both still and video. Why carry a heavy camera about when your phone does just as well — and allows for immediate transmission via texting to either friends or your social media platform? No-brainer.

REMEMBER

So you want to keep your eye on technology trends beyond your immediate industry. That way, you become better prepared for unexpected changes.

Anticipating Change

You probably have a hard time keeping track of what goes on around you; never mind trying to anticipate what's going to happen in the future. The point isn't to predict the future, however; you can't. Instead, your goal should be to understand what *may* happen to prepare yourself better than your competition.

To do that, you need to estimate which of the many trends — economic, governmental, cultural, and technological — will become the megatrend that produces tomorrow's innovation and makes tomorrow's entrepreneurs rich. What trend will have an influence on your industry, your strategies, and the competition?

TIP

Start by turning to the professionals and hearing what they have to say. Scan the various sources, online and otherwise, that follow these trends. After time passes, you can judge which of them are most useful. In the business world, there's no shortage of news sources that can keep you up-to-date on what's going on, either in general or in your specific little corner. For the big picture stuff, the traditional go-tos remain *The New York Times* and the *Wall Street Journal,* the U.S. editions of *The Financial Times* and the *Economist, Bloomberg BusinessWeek, Forbes, Foreign Affairs,* and *Public Policy,* among others. All of these media have both print and digital versions available. When it gets down to industry specifics, you may want to visit Chapters 5 and 8 for lists of sources.

TIP

And don't forget that some organizations specialize in keeping their clients up-to-date about a given field of interest, including the Aspen Institute, Deloitte, McKinsey, and PwC among many others. They're not free, but they have full-time experts who constantly stay on top of current events and bring a wealth of knowledge of the past as well in order to see what the future might hold.

Sometimes trends are too unpredictable or too numerous to track, so you can't project a single view of the future that seems to make any sense. *Scenario planning* allows you to imagine several complete versions of the future and consider how each version can affect your company's fortunes. Military strategists use war scenarios all the time. So do experts in public health when they try to anticipate and prepare for the spread of a global epidemic (or at least they used to). Scenarios can help your business imagine a variety of future prospects, too.

Start with a trend — the inflation rate, for example — and think about how you can create two or three alternative scenarios for the future, based on different levels of inflation. (For more information on inflation, refer to the earlier section "Economic trends.") Try to include a fairly complete description of what your business environment may look like in each case.

Don't hesitate to introduce another important trend into your scenario. Maybe your company's future is also tied to federal regulations that the government may announce sometime in the next five years; you can put together another set of scenarios that involve those regulations. But now you have three possibilities for regulation and three possible levels of inflation to juggle. Obviously, this situation can get out of hand rather quickly.

TIP

Experienced scenario jugglers are quick to point out the wisdom of working with no more than three or four scenarios at a time. Rather than add trend after trend into a growing set of scenarios, limit yourself to three complete scenarios based on different views of your industry in the future:

- A scenario based on an optimistic view
- A scenario based on a pessimistic view
- A scenario based on the most likely view

You may decide that low inflation, minimum regulation, and a technology breakthrough create an optimistic scenario, and high inflation, heavy regulation, and no technology breakthroughs create the pessimistic view. The most likely view falls somewhere in between. You should include the most likely view in the "Business Environment" section of your business plan (see Chapter 1).

WARNING

You may want to create a business plan for the future by looking backward and doing what you've always done in the past. That method is easy and comfortable — and dangerous. Scenario planning isn't meant to predict the future; its real value lies in offering you new options and a wider range of possibilities to think about. Different business scenarios stimulate your imagination and bring to life compelling glimpses of your company's future.

Preparing for a Changing Future

Changes take place around you all the time. Some changes have a big effect on your company; you scarcely notice others. Some changes are obvious and predictable; others come out of nowhere. The critical questions you face are

- Which changes may actually take place?
- What do the changes mean for your industry?
- What impact do the changes have on your company?
- What opportunities and threats are created by change? (See Chapter 5 for more details.)

The impact that a trend or an event has on your business tells you how hopeful or worried you should be if your predictions do come true. A trend may be the best thing to happen to one industry and a complete disaster for another. An event may create a major opportunity for your company or have no noticeable effect at all.

REMEMBER

Review the business trends and scenarios you developed in the previous section, and place the significant events or possible outcomes you foresee in one of the four probability/impact categories shown in Figure 13-4. Each category requires a different level of planning and investment on your part:

- High-probability, high-impact events demand careful preparation.
- High-probability, low-impact events call for routine planning.
- Low-probability, high-impact events require contingency planning.
- Low-probability, low-impact events suggest routine monitoring.

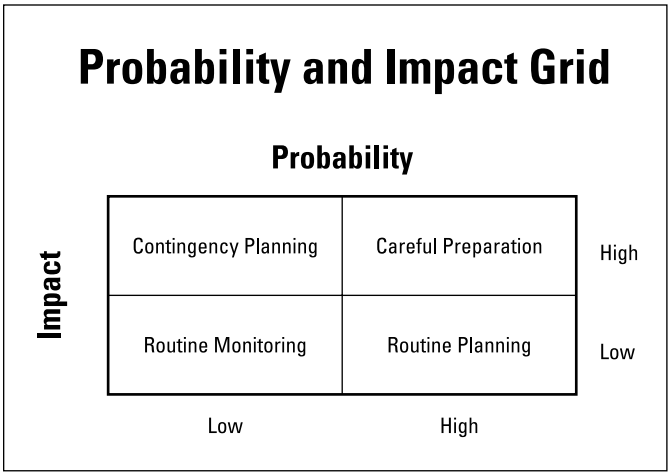

FIGURE 13-4: The Probability and Impact Grid divides events into categories based on how likely they are to occur and what effect they may have.

TIP

If you need help figuring out which trends and scenarios belong in which categories, you always can call in the experts — but you'd better be prepared to open your wallet (and that's not a guess). But first, see what you can do on your own. Assemble a group of your colleagues and maybe one or two of your best customers for a brainstorming session on the future of your company. You may be surprised by the insights that come out of your get-together when you start the ball rolling. Here's what you do:

1. **Give the group members a fixed amount of time to review the trends and scenarios that you come up with and to throw in any new ones of their own.**
2. **Have someone make a list as the group generates ideas.**

3. **Put the complete list of trends and scenarios in front of the group.**
4. **Rank trends and scenarios, based on their potential to affect your company's future.**
5. **Rank these trends and scenarios again, this time based on the probability that they will actually occur.**
6. **Divide the trends and scenarios into the four probability/impact categories (refer to Figure 13-4).**

The Probability and Impact Grid tells you where to concentrate your investment in time and company resources. Placing the trends and scenarios that you generate into probability/impact categories gives you a place to begin. Don't go chasing after every trend. You should prepare for change, allocate time, budget resources, and plan for possible events based on a practical combination of probabilities and potential impact on your business. We bet your business plans will be much better off if you take a chance on this simple exercise.

IN THIS CHAPTER

- Exploring a low-cost leadership strategy
- Applying differentiation strategies
- Zeroing in on a focus strategy
- Using strategy to establish your market position
- Coming up with your own strategy

Chapter 14
Thinking Strategically

In this chapter, we help you formulate a strategy for your company that gives life to your basic mission and puts you on the road to goal achievement (see Chapter 4 to find out more about missions and goals). We introduce several basic kinds of strategy that different businesses can apply across many industries. These off-the-shelf strategies include efforts to

- Be the low-cost provider
- Differentiate your products
- Focus on specific market and product areas

We also talk about several other general strategic alternatives and answer a variety of important planning-related questions, such as these:

- What does it mean to become more vertically integrated as a company?
- What are the pros and cons of outsourcing a part of your business operations?
- How should a company act as the market leader or market follower?

Because you live and work today in a dynamic environment characterized by near constant change, we also hand out some tips on how to create a strategy built around flexibility, so that you can pivot fast to a Plan B when unforeseen circumstances suddenly hit (see Chapter 13 to get a sense of what we're talking about).

REMEMBER

If you're a seasoned business planner, you already realize the need to create a strategic blueprint for your business. You can't have something as important as this simply sloshing around your overcrowded brain, hoping you don't forget the important parts. You should include a summary of your strategic blueprint in the "Company Strategy" section of your business plan.

Applying Off-the-Shelf Strategies

Maybe you think your company's situation is absolutely unique and the issues you face are one of a kind. In the fine details, every company is different. Of course, if you look through a microscope, every snowflake is also unique (well, almost all). But snowflakes have a great deal in common when you stand back and watch them pile up outside. Companies are like snowflakes. Although all the details give companies their individual profiles, companies and industries in general have remarkable similarities when you step back and concentrate on their basic shapes.

For a long time, academic observers who analyzed and reported on corporate planning defined three generic approaches to strategy. The *generic strategies* are important because they promised off-the-shelf answers to a basic question: What does it take to be successful in a business over the long haul? The answers, we were told, would work across all markets and industries.

REMEMBER

This was more or less true for decades past and remains so today in many instances. But as we point out countless times in this book, the business world has been transformed. Globalization and technology have left few stones unturned in the commercial environment, and the range of strategic choice has been expanded. This is of particular importance for businesses that compete in "service sector" industries that offer intangible goods. This sector now dominates output in the United States (and most other advanced economies). Unfortunately, much of the classic advice about management excellence is based on observations and analyses of firms competing in "production sector" industries — those making tangible, physical goods. The old rules of the road don't automatically apply to service businesses. Be sure you keep this distinction in mind as you think about how to plan that world-beating strategy for your own business.

REMEMBER

Successful companies recognize the trade-offs involved in pursuing one strategy versus another and deliberately choose not to pursue a strategy in order to focus on the desired goal. For example, you may find it difficult to offer the highest-quality product and the best service and still have the lowest price. The professors suggest that a company choose which generic strategy best fits its business goals and make business choices according to that strategy. Generic strategies boil down to the following standard approaches (highlighted in Figure 14-1):

- **Cut costs to the bone.** Become the low-cost leader in your industry. Do everything you can to reduce your costs and deliver a product or service that measures up well against the competition.
- **Offer something unique.** Figure out how to provide customers with unique products or a valuable service and deliver your product or service at a price that customers are willing to pay.
- **Focus on only one customer group.** Focus on the precise needs and requirements of a narrow slice of the market, using either low cost or a unique product to woo your target customers away from the general competition.

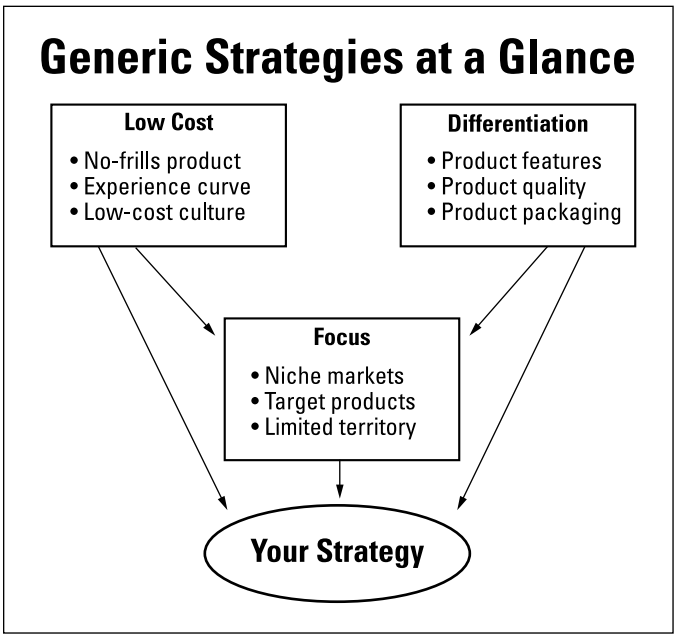

FIGURE 14-1: Generic strategies involve deciding whether to become the low-cost leader or to provide unique customer benefits.

Cutting costs and offering something unique represent two generic strategies that work almost universally. After all, business, industry, and competition are driven by customers who base their purchase decisions on the value equation — an equation that weighs the benefits of any product or service against its price tag. (Refer to Chapter 8 for more information on the value equation.) Generic strategies simply concentrate your efforts on influencing one side of the value equation or the other.

Leading with low costs

Becoming the low-cost leader in your industry may sound pretty straightforward. In reality, it requires the commitment and coordination of every aspect of your company, from product development to marketing, from manufacturing to distribution, and from raw materials to wages and benefits. Every day you find ways to track down and exterminate unnecessary costs. Hear of a new technology that simplifies manufacturing? Install it. See a region or country that has a more productive labor force? Move there. Know of suppliers that provide cheaper raw materials? Sign 'em up.

A cost-leadership strategy is often worth the effort because it gives you a powerful competitive position. When you market your company as the low-cost leader, you call the shots and challenge every one of your competitors to find other ways to compete. Although the strategy is universal, it works best in markets and industries in which price drives customer behavior — the bulk- or commodity-products business, such as the large-scale purchase of grain, sugar, or oil, for example; or low-end, price-sensitive market segments such as those who patronize FMCG (fast-moving consumer goods) limited goods retail chains such as Dollar General or Dollar Tree.

The following sections describe the ways in which you can carry out a cost-leadership strategy.

No-frills product

The most obvious and straightforward way to keep costs down is to invoke the well-known KISS (Keep It Simple, Stupid!) principle. When you cut out all the extras and eliminate the options, you can put your product together on the cheap. A no-frills product can enjoy success if you can market it to customers who don't see any benefit in (or are even annoyed by) the "bells and whistles" in your competitors' products that drive up costs and prices — the upscale fashion house with personal shoppers at the customer's beck and call and, of course, a glass of chilled champagne and canapes readily available.

In addition to removing all the extras, you can take advantage of a simple product redesign to gain an even greater cost advantage. Home-builder firms replaced plywood with pressed board, for example, to lower the costs of construction. Camera makers replaced metal components with plastic. And of course, you can follow the example of those hip West Coast techie firms with their cool open-space offices — which coincidentally cut down on the amount of floor space per employee and reduces the rent.

REMEMBER

As the old saying goes, "You get what you pay for." And companies that choose to compete on the basis of price typically sell products that don't sport the highest quality, the most features, or the best service in the marketplace. Is the target segment you're after large enough to support this strategy? Will the cost-cutting tarnish your reputation for other products and services you offer? You must decide whether the strategic trade-off is worth it.

Stripped-down products and services eventually appear in almost every industry. Some obvious examples today include the following:

- No-frills airlines, such as Spirit Airlines in the United States, or Ryan Air in Europe and AirAsia in — well, you guess.
- Warehouse stores, such as Costco and Sam's Club, which offer a wide selection, low prices, and hardly any customer service.
- Online educational providers like University of Phoenix and American Public University System, which offer college degree programs to students via digital technology — without the cost of expensive classrooms, dormitories, or rah-rah sports teams with their "fight on for old whomever" songs.

Experience curve

Companies often attain (or fall short of) cost leadership based on the power of the *experience curve*, which traces the declining unit costs of putting together and selling a product over time (see Figure 14-2). This is one of those concepts that apply mostly to production sector goods rather than intangibles like legal services or educational training programs. The curve measures the real cost per unit of various general business expenses: plant construction, machinery, labor, office space, administration, advertising, distribution, sales — everything but the raw materials that make up the product in the first place. The combined total of these costs tends to go down over time when they're averaged out over all the products that you make. (You can refresh your knowledge of "economies of scale" in Chapter 5.)

There is, however, an implicit experience curve effect for intangible goods firms, such as online retailers or online securities firms selling stocks and bonds. Astute programmers in these lines of business learned long ago that building in the ability to scale a software product (that is, reproduce it exponentially at essentially zero additional cost) was often required before investors would plunk down the necessary start-up dollars. The difference was that the benefit of lower cost didn't derive from the firm's learning as it brought in more and more customers; rather, it was assumed that growth would occur so an ability to handle expansion was hard-wired into the original bits-and-bytes design.

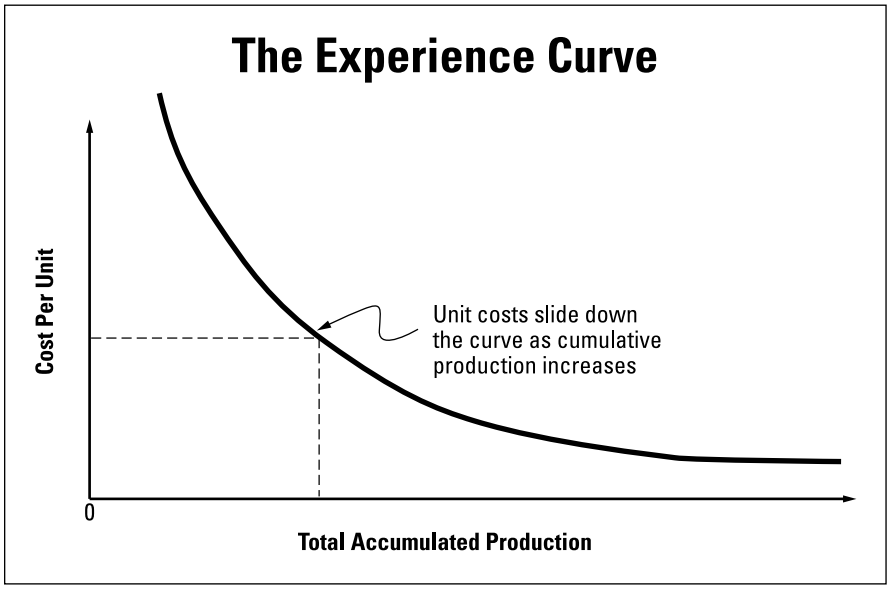

FIGURE 14-2: The experience curve traces the declining unit costs of putting together and selling a product as total accumulated production increases.

The underlying causes of the experience curve include the following:

» **Scale:** *Scale* refers to your fixed business costs, which are fixed in the sense that the amount of your product that you make and sell doesn't affect the costs. (Fixed costs usually include such things as your rent, the equipment you buy, and some of your utility bills.) The more products you produce, however, the more immediate scale advantage you gain, because the fixed costs associated with each unit go down automatically.

Think about widgets for a moment. Suppose you rent a building at $1,000 a month to house widget production. You add that rental expense into the cost of the widgets that you make so you don't lose money. Perhaps you turn out only ten widgets in the first month. No matter what they cost, you have to add

$100 rent ($1,000 divided by 10 units) to the price of each widget if you want to break even. But if you can boost production to 100 units the next month, you add only $10 in rent ($1,000 divided by 100 units) to the price of each widget, reducing your rental costs per unit by a whopping 90 percent. Scale is good for business and your bottom line.

- **Scope:** *Scope* works a little like the scale effect, although it refers to the underlying cost benefit that you get by serving larger markets or by offering multiple products that share overhead expenses associated with business areas such as advertising, product service, and distribution. (Chapter 15 provides more information on your product portfolio.) These expenses aren't exactly fixed, but you do gain an automatic scope advantage if the ad you run reaches a larger market or if your delivery trucks deliver two or three different products to each of your sales outlets at the same time.

  We might add that economies of scope are an opportunity for service providers (as opposed to strictly tangible product manufacturers) to benefit from scale. A general hospital that offers patient services in obstetrics and pediatrics as well as general surgery and ophthalmology can use a centralized IT system, food or laundry service, and front door admission personnel to serve all the patients in the facility regardless of their specific ailment. However, a specialty health provider like a surgery center, which does no more than surgical procedures, must maintain all these services for only the limited number of patients it cares for.

- **Learning:** As you *learn,* the overall cost of doing business goes down. Remember the first time you tried to tie your shoelaces? Big job. A lot of work. Now you can do it in your sleep. What happened? The more you tied your shoes, the better you got at it. The same is true whether you work on a factory floor, at a computer workstation, or in a conference room. You (and your employees) get better at something the more you do it. And there's another benefit here as well: Doing the same thing repetitively calls attention to the task and triggers innovation. Tying shoelaces — who does that anymore? Now just press the Velcro together to secure the fit. Moms and dads everywhere were relieved.

A general rule suggests that all these underlying causes result in what's known as an *80 percent experience curve.* Every time you double the total number of products you produce, unit costs go down by about 20 percent — or 80 percent of what they were before. This isn't voodoo; it comes from the accumulated cost reduction from all of the above. Lots of empirical studies support this finding.

REMEMBER

The cost benefit you get out of your company's experience varies and depends partly on your industry. Some industries don't benefit from experience effects at all. In industries where the basic costs of raw materials are high, for example, you don't have much room to gain a big advantage through experience. If only a few

suppliers control a critical input to your operations, they might not give you a volume discount since they know you don't have any other place to turn. And as noted earlier, many service industries may not get much of an advantage from experience, either. It doesn't matter how good hairstylists become at what they do; it still takes them about an hour to wash and style each customer's hair, so company costs don't change. (In fact, service providers might get a bit more bored or sloppy in their work after doing the same thing hour after hour. Do you really want to be the last patient the surgeon operates on that day?)

Low-cost culture

You can sustain low-cost leadership only if every part of your company commits to keeping costs under control by reducing or eliminating expenses and unnecessary spending. This kind of commitment doesn't occur without the owners' leadership.

Perhaps more than any other strategy and business plan that you can pursue, the push to be the low-cost leader in your industry succeeds or fails based on how well you carry it out. Knowing where and when to bring in cost-saving technology may be one important aspect of your drive, for example. But at the heart of your plan, you absolutely need to figure out how to structure the company, reward your employees, and create the spirit of a "lean, mean fighting machine."

PLATFORM OR PIPELINE?

The generic, low-cost strategy as applied to retailing has been transformed by the rise of the Internet. The reason, of course, is that the economics of a web business are often vastly superior to those of traditional firms. The latter are often termed "pipeline" businesses. That is, they operate brick-and-mortar physical stores, fill them with merchandise and employees, and then open the door to customers. And in the back of that store, and in countless warehouses as well, is inventory. These are the goods waiting to be moved to the retail shelves and tables and bins from which buyers select. And the goods get to the warehouses and storage areas from the retailer's various suppliers, whose trucks, trains, ships, and planes are constantly making deliveries from their own manufacturing facilities. This is the pipeline. The goods typically are purchased by the retailer on arrival, and carried as inventory on its balance sheet. These are costs, and they can weigh down the ratios that the financial community uses to evaluate the strength of the firm as well as its enterprise value to owners (shareholders).

An online "platform" business is a whole different kind of animal, however. Some firms operate as one-sided platforms; others as two-sided. Let's say the business founders created a website showing images of the goods; you scroll through them, make your

choice, and then hit buy and provide details of payment, shipping address, and the like. If the vendor is a one-sided platform, it arranges shipment through its own storage facilities where it holds the inventory of goods it sells. The economics are improved over physical store retailers as the showroom is virtual, so no rent to pay, but there are still inventory and logistics costs involved to get the product out the door and to you, the ultimate consumer.

A two-sided online platform simply destroys the economics of the previous versions. Why? Not only does the vendor operate virtually — no physical stores — but there is also no inventory and its associated costs. Say what? Did you just get scammed when you bought something online from that scoundrel? Of course not. What the online firm did was provide a platform for you — the buyer — to view the goods, make the selection, and then order. But on the other side of the platform is the supplier of that little thing you bought: This firm makes the good, or perhaps holds it physically in its own warehouses and supply depots. What the "retailer" did was simply act as a dating app of sorts, the person in the middle who brought the two of you — buyer and seller — together and oh, by the way, extracted a little sliver of the price you paid as its compensation for being such a gracious go-between. When you purchased, the order went through a so-called EDI, or electronic data interchange, and was sent directly to the supplier who then did the fulfillment work to get you your goods from its own inventory.

Let's get back to economics here. What benefit does the online operator of the two-sided platform have? Not only no physical stores and far fewer employees, but also no inventory to carry on its books. In Chapters 11 and 12, we tell you how to compose an income statement, balance sheet, and other financial reports. You might want to take a look at those; online firms that successfully operate two-sided platforms have enormous accounting advantages over their old-fashioned rivals due to the cost savings they can extract by this model. And you don't have to stop at Amazon and other online retailers out there. Look at Airbnb.com, or Uber.com, or eBay.com, or Facebook.com — and countless others today. These firms are following the same principle: providing a two-sided platform to both buyers and sellers (the latter the suppliers in the gig economy). They have been the big — and we mean really big — winners so far in the new dot.com economy of the 21st century. And their business model is taking over the world.

If you're planning your own little retailing start-up out there in online-land, be sure you give extra thought to just what kind of strategy you will pursue. The Internet has redefined what it means to be low cost.

REMEMBER

Low-cost leadership means exactly what it says. First, second, or third runner-up equals failure; you don't want to be first among equals. If you can't assume the low-cost leadership position, you run the risk of playing a part in your worst nightmare: a high-stakes, cutthroat industry in which price wars threaten to destroy all the players. After all, if you don't have a clear leader, everyone's a

challenger, and when low-cost challengers decide to battle for market-share advantage, they use price as their favorite weapon. If you happen to find yourself in such a Wild West industry, take action. Look for new and different ways to compete — alternative strategies that you can count on to reward you in the end.

But be careful; sometimes the intensity of competition tempts incumbents to cross the line and seek underhanded means to avoid mutual destruction.

Standing out in a crowd

Not every company can be the low-cost leader in an industry, and many companies don't even want to be. Instead, they prefer to compete in the marketplace by creating unique products and services, offering customers luxuries that they just have to have — products or services that they don't mind paying a little extra for. This generic strategy is known as *differentiation.*

REMEMBER

Differentiation flourishes because companies can be different in many ways, which means that they can take alternative routes to success. Although the low-cost strategy we discuss in the preceding section can easily produce a win-lose situation for many companies, differentiation often creates room for more players, with each company competing successfully in its own special way. The competition remains fierce, however, even with companies offering distinctly different products or services.

Businesses that can distinguish themselves from their competitors often enjoy enviable profits, and they frequently use those extra dollars to reinforce their unique positions in the marketplace. A premium winery, for example, earns its reputation based on the quality of its grapes and expertise of the winemaker, but it polishes that reputation through expensive packaging and promotional campaigns. These added investments make it more difficult for competitors to join in, but they also raise the cost of doing business. A maker of jug wine has trouble competing in premium markets. But at the same time, a premium winery can't afford to compete on price alone. No company can ignore cost, of course, even if it offers something unique. Wine lovers may be willing to spend $15–$20 for a special bottle of chardonnay, but they may balk at a $50+ price tag.

REMEMBER

After you set your product or service apart based on what it can do, how well it works, or the way you package and distribute it, you need to develop these attributes into a successful differentiation strategy, creating a loyal set of customers along the way. Because a differentiation strategy hinges completely on the relationship you create with your customers, stop and ask yourself several questions before you move ahead:

- Who are my customers?
- How do I best describe them?
- What are their basic wants and needs?
- How do they make choices?
- What motivates them to buy a product or service?

Keep in mind that a differentiation strategy usually means you're offering something at a higher price than your customer can find elsewhere. They're not going to be willing to pay if they can't see the difference. Check out Chapters 6 and 7 for more insights on customers. The following sections describe the ways you can set yourself apart from the competition.

Product features

You often can find the source of a successful differentiation strategy in what your product can or can't do for customers. Some smarties out there have likened products to candidates in a hiring hall: The boss wants to hire the worker for a specific job. So what is your product being "hired" to do? A product's features are frequently among the first factors that a potential buyer considers. How do your products compare? Are you particularly strong in product design and development? Or is the customer selection criteria based on the need for accurate order fulfillment and delivery speed? If so, you should consider how to leverage your strength in developing new features to make your company's products stand out. (Chapters 9 and 10 help you answer these questions.)

Unfortunately, major product features represent big targets for your competitors to aim at, so differentiating your company based on major product attributes alone is sometimes hard to sustain over the long haul. Technology-driven companies — such as Apple, Google, and pharmaceutical firms — stay one step ahead of the competition by investing tremendous resources in research and development (R&D) and always offering the latest and greatest products.

Different companies create successful differentiation strategies for distinct dimensions. The auto industry is a prime example of product differentiation. The purpose of a car is to get you from point A to B. When you think of Porsche, for example, you think of performance; Volvo signifies safety; and Toyota and Honda are energy-efficient, reliable choices. Tesla indicates environmental concern. These differences allow competitors to prosper in the same industry, each in its own way, even though their products all do essentially the same thing.

Competition is a bit different in service industries. For one thing, you have to face the importance of customers' impressions when you deal with services. By definition, a service is something you can't physically hold; you can't touch it, feel it, or kick its tires. So customers face a bit of a quandary when it comes to making well-informed decisions. Figuring out what is and isn't a quality service is harder. How do you know whether your doctor is a genius or a quack, for example? Is the pilot of your flight an ace or just so-so?

Based on this lack of insider information, customer perception dominates the service industry. When customers don't have all the data, they go with what they can see. No matter what other dimensions are important, the tangibles — equipment, facilities, and personnel — play a significant part in a customer's perception of service quality. They look for any clues to either confirm or deny *a priori* beliefs and attitudes. This is especially important if your market offering is a one-time experience, like a college education, a coronary bypass operation, or a bucket-list vacation. Perception is everything.

WARNING

This is one reason why online product/service customer evaluations by prior users have become so popular with shoppers. They want guidance. Lo the firm that generates a gaggle of negative reviews and does nothing in response.

Product packaging

Customers often look beyond the basics to make the final decision on what to buy. In fact, your packaging may influence customers as much as the standard set of features that your product or service offers. You can't judge a book by its cover, as the saying goes — but many people *buy* books simply because of that cover. Remember those universities noted earlier in this chapter? Today college administrators are adding expansive food courts in the dorms and upgrading the sports stadium to professional level standards. It's like dressing up the diploma.

You can develop an effective differentiation strategy based on product or service packaging — how and where you advertise, what warranties or maintenance agreements you provide, and where you decide to sell your product or service.

With creative advertising, attentive service, and sophisticated distribution, you can make almost any product or service unique in one way or another.

Focusing on focus

The two generic strategies we talk about in the previous two sections concentrate on one side of the customer value equation or the other (check out Chapter 8 for more value equation info). A cost-leadership strategy points out the price tag, and differentiation emphasizes the unique benefits that a product or service offers.

The final generic strategy plays off the first two strategies: A *focus strategy* aims at either price or uniqueness, but it concentrates on a smaller piece of the action.

A focus strategy works because you concentrate on a specific customer group. As a result, you do a better job of meeting those customers' particular needs than your competitors who try to serve larger markets. The following sections discuss several ways to concentrate your efforts.

Niche markets

If you've traveled to nations that are struggling to move up the economic ladder, you may have noticed that many products and services you find there are basic commodities, without much variety or choice. This is not because people living in those lands don't want a broader selection. It's due to the fact that low income levels and a lack of communications and distribution infrastructure makes it difficult for sellers of upscale goods to survive. In many product and service categories, it's a one-size-fits-all market.

Countries with large populations in which household incomes are spread over many levels create opportunities for the diligent business planner to find niches. These nations typically enjoy modern communications technologies, such as TV and the Internet in addition to radio stations. This allows for relatively easy access to large numbers of people, so that the planner can slice and dice markets into countless shapes and sizes and target a relatively small group. For example, King-Size is an online seller of men's apparel — but targeted to those who are greater than 6′2″ in height and 225 pounds in weight, a group of 13 million that is less than 4 percent of the U.S. population. And then there's so-called one-to-one marketing, in which sellers are able to pinpoint just a tiny fraction of potential customers and give them precisely what they're looking for.

Limited territory

A focus strategy works especially well for the new kids on the block who want to establish a foothold in an industry in which the big guys have already staked out their claims. Instead of going after those fat, juicy markets (and getting beat up right away), you can avoid head-on competition if you focus on smaller markets, which may be less attractive to existing players. After you establish yourself in a niche market, you may want to challenge the market leaders on their own turf. Motel 6, for example, started out as a small regional chain that offered clean beds and private baths at bargain-basement prices. Now the company is a major player in the motel industry — and, of course, attracted others who saw success and said "I can do that, too." While we're not yet aware of any Motel 1s, this is what competition is all about. (Actually, we are aware of Motel 1s; ever been around a college campus?)

For small, established companies in a market, a focus strategy may be the only ticket to survival when the big guys decide to come to town. If your company has few assets and limited options, concentrating on a specific customer segment gives you a fighting chance to leverage the capabilities and resources that you have.

WARNING

Unfortunately, a focus strategy is one of the most difficult generic strategies to maintain over time. Dangers lurk both inside and outside the company. Those dedicated employees you hire can see what you're doing, and get the entrepreneurial urge to go out on their own. If your market suddenly gets bigger because you're so good at what you do, you can count on intense competition down the road from much bigger players with much deeper pockets.

REMEMBER

Your best bet is to stay focused. Small companies have the best chance of sticking around over the long haul if they rally around a strategy and business plan that concentrate their resources and capabilities. Focus your energy on serving a specific market segment better than the competition. The history of business is filled with tales of smallish companies that took on more than they could handle — and those stories didn't end well.

KOHL'S CHALLENGES THE RETAIL APOCALYPSE

The rise of Amazon and online retailing revolutionized traditional shopping in the first two decades of the 21st century. The emergence of the worldwide COVID-19 pandemic appeared to put the final nail in the coffin for brick-and-mortar department stores, as national lockdowns kept shoppers at home and in front of their PCs. Long-time vendors such as JCPenney, Sears, and numerous smaller chains have folded in the face of this twin assault; other once-powerful incumbents, such as Macy's, are on edge. The general consensus was it's only a matter of time before everything goes digital.

But not everyone got the message. Kohl's, founded in 1962 in Wisconsin, is the biggest department store chain in the United States today, with more than 1,100 stores located in 49 of the 50 states. Annual revenue tops $16 billion. While the firm has been challenged by the recent pandemic, it nevertheless has created a precise strategy that has allowed it to thread the needle and survive — at least so far. How has Kohl's done this? This is the firm's vision: "The most trusted retailer of choice for the active and casual lifestyle." Key differentiators for Kohl's are as follows:

- It is not really a department store, as it offers fewer product categories than traditional competitors (Women's, Men's, Kids, Home, and Beauty). It is an omni-channel

supplier with a strong digital presence and a choice of delivery and pickup options for its 65 million customers.

- It avoids malls (more than 95 percent of its stores are in non-mall locations).
- Products concentrate on a relatively small number of leading apparel brands.
- It has outstanding customer service and a top-rated loyalty program in the industry.
- It maintains a strong internal culture with high degrees of diversity, inclusion, and employee involvement. Kohl's leadership team is experienced and strong.
- It partners with rival Amazon, being a return center for the online giant, and provides space for leading women's beauty retailer Sephora inside its stores. Kohl's leadership team thinks that customers who come in for these needs will remain and do some shopping.
- It maintains a strong balance sheet and aims for 7–8 percent operating margins. To keep costs low, about 75 percent of employees are part-time.

By maintaining this highly disciplined strategic approach to what it offers and avoiding head-to-head battles that it knows it can't win, Kohl's demonstrates that a business strategy and plan that is carefully calibrated to the realities of its environment can succeed.

Changing Your Boundaries

Generic strategies form the basic building blocks that you can use to start assembling your company's business plan (see the section "Applying Off-the-Shelf Strategies" earlier in this chapter). But building blocks are just the beginning. Strategy should also address all the fine details that make your company and its goals unique. How do you take the next step? A successful strategy and plan depend on your business circumstances — what's happening in your industry and marketplace and what your competitors are up to (see the example of Kohl's in the nearby sidebar). These factors often determine what strategy can best serve your company.

The evolution of new strategic models

The historic changes that began to reshape business and commerce throughout the world at the end of the 20th century offered both threats and opportunities for many large firms that were "vertically integrated" — that is, they chose to handle in-house all aspects of their business from A to Z. But rapid innovation of new products and services meant that many of these firms that tried to be all things to

all comers were finding it difficult to be the go-to supplier for increasingly demanding customers. As a result, companies began to establish *strategic alliances* with companies that had complementary products that customers wanted, rather than attempting to make them everything in-house. Take a look at Chapter 16 for our description of the new "dynamic capabilities" model of strategy that addresses these concerns. Meanwhile, consider what IBM did.

Since the beginning of its production of computers in the 1950s, IBM had insisted on a strategy of vertical integration: mainframe processors, memory cards, terminals, CRTs (the visual display monitor), keyboards, printers — everything came from this one giant firm, and most of these goods were made in large manufacturing facilities in Poughkeepsie, New York. But when it entered the PC (personal computer) segment in the early 1980s to compete with new upstarts like Apple, IBM realized that its complex and bureaucratic structure would probably mean years of development time before it had a competitive product. It consequently moved all manufacturing for PCs to Florida, partnered with a small and unknown software developer in Seattle named Microsoft to provide the operating system (OS), and contracted with Intel in Silicon Valley to supply the microprocessors that powered these machines.

Rapid innovation of new products, their complexity, and high costs have caused many firms to create *ecosystem* partners to bring together all of the necessary ingredients to satisfy choosy customers who are far more knowledgeable than in the past. These firms began to realize that customers today want the best solution to fix their problems, and not necessarily a single brand to do it. Some verbal gymnasts have called the practice "co-opetition." In the tech world, one variant is called the "platform economy," whereby a company creates a digital means — an online site — to bring parties together, and takes a tiny sliver of revenue from each transaction (kind of like a dating site for nerdy firms).

REMEMBER

We know that a lot of you entrepreneurial types out there can be control freaks at times; it's part of your charm. But partnering is something that you should consider in your strategic planning. Customers today know everything, and they will quickly find out who's best. Hooking up with relevant partners is a cost-efficient way to get to the top, or stay there.

Outsourcing and offshoring

Global competition has touched nearly every market in every corner of the world. One result is that companies had to find new ways to compete with products coming from nations with lower costs, such as labor, allowing those offshore suppliers to offer lower prices. By now it's conventional wisdom that domestic firms need to streamline operations, transforming themselves into leaner and meaner tigers if they want to survive in the global jungle. One strategy that became popular as a

way to do this was to *outsource* certain activities in the value chain (see Chapter 10 for details on value chains). Outsourcing was a rediscovery of the old "make-or-buy" idea: Do the job yourself in-house — make — or turn to an external source to handle the task — buy. With globalization this extended into *offshoring*, with external suppliers located in countries like Mexico, China, India, Vietnam, and numerous others.

In each case, the idea is to take a piece of your business operations — your payroll system or your computer support, for example, or the production of a major component or even the entire manufacturing process — and hire an outsider to do it for you to save you money. This decision obviously implies that you have taken steps to ensure that quality is not compromised. But the benefit is that outsourcing can help you do what you do better. When you no longer have to worry about certain parts of your business, you can focus your energies on the operations that you do best and the activities that set you apart from the competition.

WARNING

If you decide to outsource a piece of your business, make sure to do your homework ahead of time. The companies you select as partners become a very real part of your business, so see how they fit in with the values and vision you have for your company (for a refresher on values and vision, flip to Chapter 3). Their activities affect the way you work, the way your competitors react, and the way your customers see you in the future. If the external supplier uses child labor or manufacturing processes that contaminate the environment, for example, this information can be devastating to your own reputation. So approach an outsourcing relationship like you would a marriage contract — as a serious commitment.

Leading and Following

No matter what industry you're in, you can divide your competition into two major groups: the market leaders and the market followers.

- *Market leaders* are top-tier companies that dominate the marketplace, set the agenda for the industry, and make things happen; they occupy the driver's seat.
- The *market followers,* well, follow along. They're not always small, by the way. Because of history, tradition, or whatever, they have chosen to let others go first. These companies still work hard and think big, and if they sometimes don't play follow-the-leader, then the front-runner might have to pull back.

Depending on the market situation, companies in both groups behave very differently. Whether you already operate as part of an industry or you want to join one as a new business owner, you need to understand what motivates both the market leaders and the rest of the pack. The following sections explore some market strategies that focus on industry position.

Market-leader strategies

Market leadership varies, from the absolute dominance of one company to shared control of the industry by several leading players. If you enjoy a spot among the leaders, look at these possible strategic approaches. It's kind of like playing offense, playing defense, or keeping the score tied:

- **Full speed ahead:** In this situation, your company is the clear market leader. Even so, you should always try to break farther away from the pack. You should strive to make the first move, whether you implement new technology and introduce innovative products or promote new uses and set aggressive prices. You should not only intend to stay on top, but also want to expand your lead.
- **Hold the line:** Your company certainly ranks high in the top tier of the market, but it doesn't have the commanding position of strength in the industry, so your goals center on hanging on to what you currently have. Those goals may involve locking distributors into long-term contracts to make it more difficult for customers to switch to competing brands or going after new market segments and product areas to block competitors from doing the same thing.
- **Steady as she goes:** In this case, your company is one of several powerful companies in the market. As one among equals, your company takes on part of the responsibility of policing the industry to see that nothing upsets the boat. If an upstart challenger tries to cut prices, you quickly match those lower prices. You always scan the horizon for new competitors, and you work hard to discourage distributors, vendors, and retailers from adding new companies and brands to their lists.

Market-follower strategies

Market followers often take their cues and develop strategies based on the strength and behavior of the market leaders. An aggressive challenger, for example, may not thrive in an industry that has a powerful, assertive company on top. Fortunately, you can choose among several strategic alternatives if you find yourself in the market-follower position:

- **Make some waves.** Your company has every intention of growing bigger by increasing its presence in the industry, and you're willing to challenge the market leadership head-on to do it. Perhaps your strategy includes an aggressive price-cutting campaign to gain market share. Maybe you back up this campaign with a rapid expansion of distribution outlets and a forceful marketing effort. The strategy requires deep pockets, commitment, and the skill to force a market leader to blink, but in the end, your efforts could make you the leader of the pack.
- **Turn a few heads.** Your company enjoys success in its market niche, and you want it to stay that way. So although you don't want to challenge the market leadership directly, you fiercely defend your turf. You have strengths and advantages in your market segment because of your product and customer loyalty. To maintain this position, you focus on customer benefits and the value you bring to the market.
- **Just tag along.** You can easily point out companies that have settled into complacency. Frankly, they usually operate in rather boring industries where not much ever happens. These companies are quite pleased to remain toward the end of the pack, tagging along without a worry. Don't count on them to do anything new or different in the marketplace. (If you find your company in this position, you may be quite happy to tag along, too. If not, you should think about making a change while you're still awake.)

TIP

In our consulting and training work with a wide variety of firms in many industries, we have often used a little exercise as a way to focus key leaders on what might be a problem with their strategy, and what to do about it. We ask each participant in the program to prepare a one-page obituary for the company. Yes, you read that correctly. We ask them to start as follows:

> We are sad to report that the XYZ Company unfortunately died last month after *x* years of service to its customers. The cause of death was _____. The attending physicians stated that the firm might have been able to avoid this unfortunate fate if it had done the following: _____.

We either ask each participant to complete their report individually (giving them 20–30 minutes to do this), or we place participants in small groups of 3 or 4 and give them 60 minutes. The participants then re-group, and each presents the results of their obituary, followed by a general discussion. We have found this to be a sobering experience that forces company leaders to probe deeper into what strategic problems they might have, and to consider steps to overcome them. Perhaps this is an exercise that might fit your organization as well.

Tailoring Your Own Strategy

REMEMBER

You may feel overwhelmed by all the strategic possibilities and choices you have to make in devising a strategy for your company. Stop, take a deep breath, and remember: Strategy isn't a test that you take once and have to get a perfect score on the first time. Instead, it helps you decide how to do business over the long haul. Strategy is an ongoing process, so don't be alarmed if you can't immediately see how all the pieces fit together. And don't be surprised if you need to tinker with the "Company Strategy" section of your business plan along the way. Rarely can you shape the market to fit your strategy. You have to keep a constant watch on what's happening in your chosen space and, when change rears its head, make the necessary adjustments.

Coming up with the right strategy is something that you have the chance to work on over and over again — rethinking, revising, and reformulating. If you approach strategy in the right way, you don't ever finish the task.

As you begin to shape your strategy, let the following pointers guide you:

- Never develop a strategy without first doing your homework.
- Always have a clear set of goals and objectives in front of you.
- Reflect on your assumptions and make sure they reflect reality.
- Build in flexibility and always have an alternate strategy.
- Understand the needs, desires, and nature of your customers.
- Know your competitors and don't underestimate them.
- Leverage your strengths and minimize your weaknesses.
- Emphasize core competence to sustain your competitive advantage.
- Make your strategy clear, concise, consistent, and attainable.
- Trumpet the strategy so you don't leave your organization guessing.

REMEMBER

Companies that take strategy and business planning seriously know that to hit a target, you follow the path of "ready, aim, fire" — not "ready, fire, aim." In other words, almost any strategy is better than no strategy at all. Companies that have clear strategies don't hit the bullseye every time; no strategy can promise that. But these companies succeed in the end because they subscribe to a strategic process that forces them to ask the right questions and come up with good answers — answers that help them outshine the competition. And especially in a new venture, a clear and compelling strategy can help you attract funding and employees.

IN THIS CHAPTER

- Understanding the life cycle of a product or service
- Discovering ways to expand your business
- Juggling your product portfolio
- Pondering two final questions about growth

Chapter 15

Growing Up, Growing Bigger, and Growing Old

Watching over a product or service as it makes its way through the cold, cruel marketplace is an awesome responsibility. It requires a major commitment of time and resources, as well as a great deal of careful planning. First, you have to understand what you must do to make the product a success. Which attributes and aspects should you stress? How do you make sure that people take notice (and like what they see)? How can you support and guide your product or service along the way, getting it into the right hands? You need to take advantage of opportunities as they appear. At the same time, you have to worry about the lurking threats and competitive pressures.

Does this sound a lot like rearing a child? Well, your product is your baby, and as any parent knows, you have to face one challenge after another as that little bundle of joy demands more and more. Think about how many times you've heard a parent say to those with a newborn, "You think they're difficult now? Just wait!"

Products and kids have a great deal in common — both of their worlds continually change, yet they eventually manage to grow up. A key difference for new businesses is that you must ruthlessly be willing to reinvent and reshape your product or service to respond to your markets and industry (something you may want to avoid as a parent). Most new business ventures fail, and those that do break

through barriers of resistance often do so via a quick pivot to a new path, learning from mistakes. Experience is usually not tuition free. For decades, the Dr. Spocks of the business world have poked, probed, pinched, and prodded products at all ages, and they've come up with a useful description of the common stages that almost all products go through. When you create a business plan, you have to plan for the changes in your product's life cycle.

In this chapter, we explain the product life cycle and what it means for your company. We talk about ways to keep your company growing. We show you how to expand into new markets with existing products, as well as how to extend your product line to better serve current customers. We explore the opportunities and pitfalls of trying to diversify. We talk about strategic business units (SBUs) and introduce several "portfolio" tools to help you plan and manage a growing family of products. And we also remind you that bigger is not always necessarily better in the world of business.

Facing Up to the Product Life Cycle

In business, the only constant is — you guessed it — *change.* The forces of change are everywhere, ranging from major trends in your business environment to the shifting tastes and demands of your customers and the unpredictable behavior of your competitors. (For more info on change and how to prepare for it, visit Chapter 13.)

You may think that all these factors, stirred together, create a world filled with chaos and uncertainty. We can't deny that, especially of late when change can be seen everywhere. But when it comes to growth, markets typically follow orderly and even predictable patterns. Experts have plotted some of these basic patterns, and the cycles that they've come up with aptly describe what happens in the face of all the market turmoil and confusion.

REMEMBER

One of these patterns — the *product life cycle* — illustrates what happens to a new kind of product or service after you launch it in the market. The cycle describes four major stages that a new product will likely traverse from birth to obsolescence:

- An introduction period
- A growth period
- A period of market maturity and relative stability
- A period of decline

The product life cycle is closely related to how eager people are to try out a new product or service. (For a refresher on customer personality types and the diffusion of innovation in the marketplace, head to Chapter 6.) Most product life cycles look something like Figure 15-1.

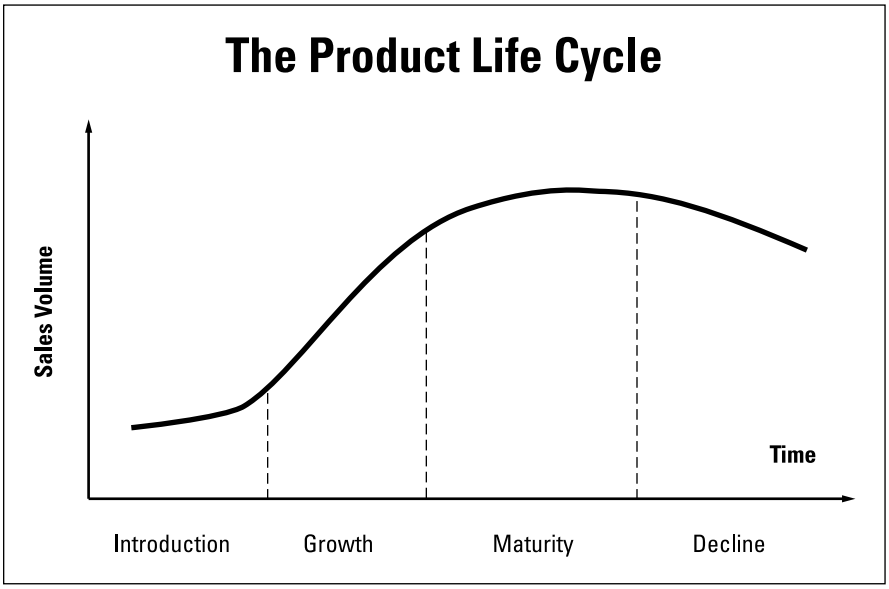

FIGURE 15-1: The product life cycle represents what's likely to happen to sales volume for a typical product over time.

The curve traces your product sales volume over time. You can think about sales volume in terms of the revenue you take in or the number of units you sell. You may end up measuring the time scale in weeks, months, years, or even decades.

Every stage of your product's life cycle presents a unique set of market conditions and a series of planning challenges. The different stages require different management objectives, strategies, and skills. The following sections discuss what you should think about at each stage.

Starting out

After you introduce a new kind of product or service in the market, it begins to generate revenue — at least you hope so. Because developing and launching something new is expensive, costs are relatively high at this stage, and you normally don't find many competitors around. Growth depends on your company's ability to make the product or service, generate market awareness, and get customers to accept and adopt it.

REMEMBER

At this stage in the product life cycle, your efforts focus on getting the product out the door or on rolling out the new service and ensuring that everything works according to plan. At the same time, you have to drum up plenty of interest as you struggle to create market awareness. Table 15-1 points out many characteristics of the introduction stage.

TABLE 15-1 Major Characteristics of the Introduction Stage

Component	Characteristics
Industry	One or two companies, maybe you're the first
Competition	Little or none
Key function	Research and development, creativity
Customers	Innovators and risk-takers, unique groups
Finances	High prices (usually) and expenses (most always)
Profits	Nonexistent to negative
Objectives	Product adoption
Strategy	Establishing a toehold, expanding the market, survival

Growing up

During the growth stage, the new product or service gains a reputation. If the product or service involves a new technology, the industry leaders agree upon standards — all the details that determine how the technology should work (see Chapter 14 for additional info). Demand rises rapidly, and sales increase. Competition increases as competing products jump into the fray to take advantage of an expanding market; "me-too" copycats multiply. Customers begin to develop brand loyalties, and companies tweak their product features to better serve customer needs — needs you can now recognize.

REMEMBER

In the growth stage, your priorities should turn toward meeting growing product demand, improving your product or service, and targeting specific groups of customers. Along the way, you have to fend off a growing crop of competitors. Table 15-2 highlights characteristics of the growth stage.

Maturing in middle age

The growth of your product or service begins to slow in the maturity stage as market demand levels off and new customers become harder to find. New competitors are also harder to find, so the competition stabilizes as the weak die off or

get acquired. Profits keep on growing, however, as your costs continue to fall. Changes in market share reflect changes in the value that customers place on the competing products, and an increase in market share for one product usually comes at the expense of its competitors since overall demand has stabilized.

TABLE 15-2 Major Characteristics of the Growth Stage

Component	Characteristics
Industry	Many companies
Competition	Growing strength and numbers
Key function	Marketing, demand management
Customers	Eager to try likely successful products
Finances	Variable prices and costs
Profits	Finally on the horizon, maybe buckets full
Objectives	Sales growth and market share
Strategy	Establishing and defending position, professional management

REMEMBER

At this stage, your attention should turn toward reducing costs and finally reaping the benefits of stable profits. Although you can easily feel comfortable at this stage, you still need to keep a careful eye on the competition — especially those pesky little disrupters who start tinkering with radical new ways to serve your market. Table 15-3 identifies the characteristics of the maturity stage.

TABLE 15-3 Major Characteristics of the Maturity Stage

Component	Characteristics
Industry	Not as many companies
Competition	Stronger, but stable
Key function	Operations, making them more efficient
Customers	The majority of buyers know what they want
Finances	Competitive prices and lower costs
Profits	At or near peak
Objectives	High cash flow and profit
Strategy	Maintaining competitive position

Riding out the senior stretch

Nothing lasts forever. Amen to that. At some point in a product's life cycle, sales usually start to fall off and revenue begins to decline as market saturation occurs. Competitors drop out of the market as profits erode. Large-scale changes in the economy or in technology may trigger the decline stage, reflecting changing customer needs and behavior as alternatives emerge. Products and services still on the market at this stage are redesigned, repositioned, or replaced.

REMEMBER

When a product's life cycle begins its decline, your work shifts to redesigning your product or redefining its market, or you can come up with new uses or different kinds of customers. If all your attempts fail, you have to concentrate on ways to get out of the market so you don't lose too much money. Table 15-4 shows various characteristics of the decline stage.

TABLE 15-4 Major Characteristics of the Decline Stage

Component	Characteristics
Industry	Fewer companies
Competition	Weakening
Key function	Finance and planning for the future
Customers	Loyal, conservative buyers — usually older
Finances	Falling prices and low costs
Profits	Much reduced; fire sales to clear old inventory
Objectives	Residual profits, cash out what you can
Strategy	Getting out alive

Gauging where you are now

Take your product or service and see whether you can figure out its estimated position on the product life cycle curve (refer to Figure 15-1). If you're stumped, ask yourself the following questions:

- How long has the product been on the market?
- How rapidly is the market growing (compared to prior years)?
- Is the growth rate increasing, decreasing, or flat?
- Is the product or service profitable?

- Are profits heading up or down?
- How fast are product features changing?
- How many competitors does your product have?
- Are there more or fewer competing products now compared to a year ago?

FROM MySpace TO LAST PLACE

In 2003, a group of young entrepreneurs created MySpace as a social networking site aimed at Millennials. There was definitely a potential market for this kind of business; in fact, a competitor already existed, called Friendster, but it was full of ads and had technical problems that led to a decline in user visits. MySpace gave users more control of their content and added more features; it quickly caught on with the younger set as a cool way to exchange greetings, gossip, and just about anything else. Within two years it was acquired by international media giant News Corp., the owner of Fox, MGM, and numerous other properties, for nearly $600 million. This was part of the firm's attempt to become more digital in its business. MySpace soon thereafter became the leading social network site in the world, attracting more than 75 million worldwide visitors per month at its peak. The future looked good.

The new owners kept the founders on board but imposed steep growth targets. Advisors from the parent began to play a larger role in management, pushing for maximization of advertising revenue. As a result the site became inundated with ads, many of which led to unwanted pages asking users to apply for credit cards or other services for which News Corp. received commissions. Innovative new features and improvements to the platform's technology were given a back seat as the parent treated it more like a media property — a business that it understood — than a technology platform, which in fact it was.

In 2004, another competitor named Facebook was started up by a group of recent Harvard dropouts. They were tech-savvy and ambitious. They targeted the same user segment as MySpace — their demographic peers — and showered them with innovative new features that they wanted. Deep pocket venture capitalist backers (VCs), with deep experience in Internet platforms and technology, readily funded the costs. Facebook was clearly a superior alternative, and MySpace began to evaporate. By 2008, Facebook had more worldwide visitors and became the leader in the United States the following year. In 2011, News Corp. sold the site to Time, Inc., for $35 million. Facebook currently has about 3 billion active monthly users and became one of the most valuable firms on the planet.

WARNING

Even if you feel confident about your product's position in its life cycle, take the time to confirm your analysis. You're likely to get mixed signals from the marketplace, and the clues you find may even contradict one another. No two products ever behave exactly the same way when it comes to product life cycle. Unfortunately, acting prematurely on the evidence at hand can lead to hasty planning and a self-fulfilling prophecy. The product life cycle concept, after all, is not a law of physics. So be sure you always double-check what you think you see to make sure you don't mistake a temporary hiccup in sales for a full-scale life cycle change.

Finding Ways to Expand

Face it — your product simply isn't going to be the same tomorrow as it is today. In Chapter 6, we tell the tale of good old Henry Ford and his famed market-leading Model T, available in any color you wanted — as long as it was black. But then other automakers began to offer choices, and we know what happened after that. You may not plan to change it at all, but everything around your product is going to change. The world will take another step ahead. The economy, technology, your industry, and the competition will all change. As a result, your current and future customers may think about your company and your product a bit differently, even if you don't.

How can you find ways to grow and prosper as a company in the face of almost-certain product mortality? You probably have every intention of creating a new business plan as your product begins to age (just like the faith you had in actually carrying out all those New Year's resolutions). But which way do you turn?

Fortunately, you don't have to invent the alternatives yourself; planning for long-term growth has been a philosophical favorite of management gurus for decades. One of the pioneers of business-growth techniques was a brilliant immigrant to the United States from Russia named Igor Ansoff. He came up with a simple matrix to represent the possible directions of growth (see Figure 15-2).

REMEMBER

The matrix captures nothing more than basic common sense: It says that if you want to make your business grow, you have to start somewhere. Consider the following ways in which you can move your company ahead:

- **You are here (existing product and market):** Continue to grow by doing what you do now, but do it a little bit better. Find ways to keep your users glued to your website for longer periods of time by adding new features, or package your product in new and different sizes to encourage usage at different times or on different occasions.

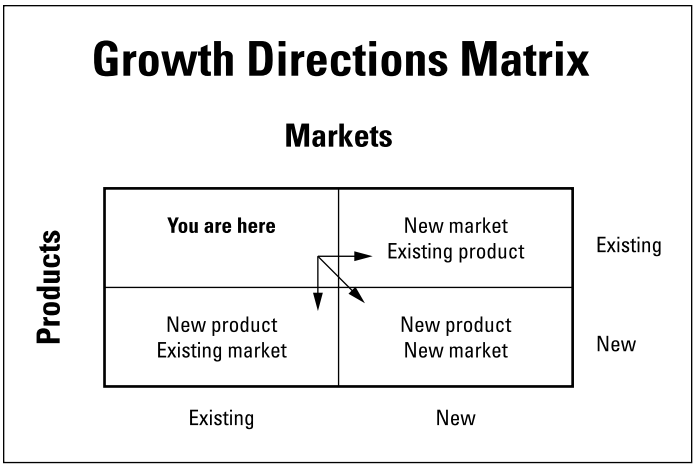

FIGURE 15-2: The Ansoff Matrix describes different ways in which your company can grow, based on a combination of products and markets.

- **New market, existing product:** Grow in the short term by finding a fresh market for your existing product, either by expanding geographically or by reaching out to completely different kinds of customers. Home Depot opened stores in Latin America; Facebook tried to make its Instagram site more attuned to teens and tweens.
- **New product, existing market:** Grow by developing additional product features, options, or even a related product family with the intention of enticing your existing customers. McDonald's starting offering breakfast menu items almost 20 years after being a strictly hamburger and fries provider. Business schools introduced "executive" MBA programs that offered prospective students a wider choice of attendance options such as weekends.
- **New market, new product:** Grow over the long term by going after new and unfamiliar markets with new and different products. Coca-Cola bought Columbia Pictures, a movie-making studio, and Harley-Davidson tried to sell branded bottled water.

TIP

Without getting bogged down in a lot of details, try to come up with a dozen different ways to grow your company. Get yourself into the right frame of mind by reviewing your company's mission and vision statements. (Don't have 'em? Flip to Chapters 3 and 4 for everything you need to know.) After you prepare, complete the following steps:

1. **Identify three things you can do right away to stimulate demand for your existing product in your current markets.**

   Offer rebates, start a sales promotion, or maybe come up with some new product uses or features.

2. **List three steps you can take in the next six months to capture new markets for your existing product.**

   Create online ads that target new customers, start direct-mail campaigns, or step up appearances at trade shows. Find ecosystem partners and share resources.

3. **Describe three directions you can take over the next three to five years that could move new products into new markets.**

   Engage in brainstorming sessions with colleagues to come up with growth opportunities, say exporting, that play into current company strengths. Or consider acquiring a company that competes in markets about which you currently have little prior experience.

WARNING

Many experts believe that any talk about developing brand-new products for completely new markets is really none of your business as a manager. These folks, drawing from piles of evidence, think that managers can't be objective when it comes to assessing totally new opportunities. Too many suffer from what's called overconfidence bias: "Hey, I'm a successful businessperson, I know how things work: Buy low, sell high." Oh, really? Stay in your lane, the experts advise, stick to what you know. They argue that you should return any excess profits to investors and let the market decide where to place bets on the future, rather than trying to guess where that might be yourself. This is not always true, of course, but it's worth doing a reality check on yourself before jumping blindly into a new opportunity simply on the belief that you're invincible. You should proceed in this direction only after you review your strengths and weaknesses and assess all the opportunities and threats in front of you. For our advice, review SWOT analysis in Chapter 9.

Same product and same market

Many big-name companies have grown and achieved success by relentlessly managing a single business, a single market, or even one individual product decade after decade. When you see a Coca-Cola sign, for example, you imagine drinking a Coke. When you pass a McDonald's, you probably picture a Big Mac. Your IT staff likely knows what Oracle and Cisco do, and the marketing folks are familiar with Salesforce.com. But these companies haven't turned into billion-dollar corporations simply by launching their flagship product and letting the marketplace take care of the rest. Companies that largely depend on a single product spend enormous amounts of time and effort to continually rejuvenate and revitalize their core markets.

REMEMBER

If you glance at the Ansoff Matrix shown in Figure 15-2, you notice that these companies invest heavily in the top-left box. How do they do this with success? They use the four main strategies we describe in the following list:

- **Encourage greater product use.** You can increase demand by encouraging your customers to consume more of a product or service every time they use it. Maybe that means getting customers to feel good about buying more or giving them a better deal when they do. Customers may do the following things:
  - Buy larger boxes of cereal because they can save money
  - Visit stores more often when they stay open longer or on weekends
  - Buy more than one product and get a discount
- **Generate more-frequent product use.** You can stimulate sales by getting customers to use your product or service more often. That may mean making the product more convenient, introducing it as part of a customer's regular routine, or offering incentives to frequent customers. Customers may do the following things:
  - Use toothpaste after every meal because of the hygienic value
  - Regularly drink wine at dinner because they've heard of its health benefits
  - Join a frequent-flyer program and take an extra trip just to build more miles
- **Devise new uses.** You can expand your market by coming up with new ways for customers to use your product or service. That may include getting customers to use the product at different times, in different places, on novel occasions, or in unconventional ways. Customers may do the following things:
  - Snack on breakfast cereal throughout the day because you make it handy and tasty
  - Rent a spare bedroom that sits empty most of the time
  - Desire a consumer version of an industrial usage product
- **Woo customers away from competitors.** You can increase demand for your product or service the old-fashioned way: Take customers away from the competition. Although the result is sometimes a fierce and unwanted response from competitors, you can do the following things:
  - Create incentives for customers to switch from competing products and give them rewards for staying with you
  - Concentrate on becoming the most attractive low-cost provider around because of your unbeatable prices
  - Focus on meeting or exceeding the needs of specific customer segments or groups

REMEMBER

Companies that manage to grow in the same market with the same product do so by continually generating new demand and maintaining or even increasing their market share. Often, these companies succeed in slowing the product life cycle, extending its maturity stage almost indefinitely. In some cases, they even manage to reset the life cycle, pulling the product back into the growth stage by inventing new and creative product uses. But steady and sustained market penetration based on a single product doesn't always work forever, and you sometimes have to look in new directions for growth.

New market or new product

At some point during the life of your company, a single product or service may not be enough to sustain an attractive level of growth. Where do you turn? The Ansoff Matrix (see Figure 15-2) suggests that the most reliable paths point to market expansion in the near term, as well as to extending your product line. These two directions for growth have the distinct advantage of building on capabilities and resources that you already have. You know what you're doing and how to be efficient in doing it, so you offer it to new markets. Product extension builds on your experience and knowledge of your current customers: They know you and trust you and will likely give you a try when you have something new for them.

New market

Expanding into a new market is something you can do rather quickly by taking advantage of your current business model and copying many of your current business activities — producing, assembling, and distributing products, for example. Another way is to see what other goods or services consumers of your offerings purchase simultaneously. In many cases customers like the convenience of a one-stop shop.

Going after new markets involves risk, however. New markets force you to conduct business on a larger scale. New markets mean wooing new customers and dealing with new competitors. When you enter a new market, you're the new kid on the block again, and you have to prove yourself at every step.

REMEMBER

You can expand your market by moving into new geographical areas or going after new market segments:

- **Geography:** The most obvious way to grow beyond your core product and market is to expand geographically, picking up new customers based solely on where they live and work. This kind of expansion has many advantages. You not only do business in the same way as before, but you also have a head start in understanding many of your new customers, even with their regional

differences. Because geographic expansion may require you to do business in unfamiliar areas or even in new countries, however, you have to pay special attention to how your company must change to accommodate the specific demands of your expanded market. Better learn about those meters and kilos, as well as pesos or pounds.

- **New market segments:** Sometimes you can expand the market for your product or service by finding new kinds of customers. If you're creative, you can identify a group of customers that you neglected in the past. Look carefully at your product's features and packaging, how you price and deliver it, who buys it, and why they buy. Also, reassess the customer benefits that you provide. Ask yourself how attractive a new market segment is in terms of its size and potential to grow. What strengths do you bring to the market? What competitors are already there? (Check out Chapter 6 for more on market segments.)

New product

Extending the number of products or types of services that you offer is something that you should plan for well ahead of time. All too often, companies develop new product features, options, and major enhancements without giving much thought to the implications for the company's future direction and growth. Instead, a customer asks for this or that special feature, or a distributor requests a particular option or accessory, and before you know it, you have additional products to support.

The good news, of course, is that you already have customers. But you also have to be sure that your customers represent a larger market that benefits from your product extension and that the additional products make sense in terms of your business strategy and plan.

REMEMBER

You can extend your product line or service by offering new features and options or creating related families of products:

- **New features and options:** The most common way to extend a product line involves adding bells and whistles to your product and giving customers the chance to choose which bells and whistles they want. The advantages are easy to tick off: You work from your existing strengths in product design and development, and you use your customers to help you decide which incremental changes to make. It sounds like the perfect game plan.

WHEN BUILDING IS MORE THAN JUST BUILDING

The construction industry is one of the more complex sectors of most economies, from advanced nations to those lower down the scale. Along with food and clothing, shelter, after all, is one of the basic needs of everyone. In the United States alone, the industry generates more than $1 trillion in annual revenue, coming from over half a million firms that employ more than 10 million workers.

But it's more than just hammers and nails — a lot more. When you think about it, the entire job — from the initial vision of a structure until final move-in and even post-occupancy servicing — is a long and complicated process that involves numerous steps along the way. It involves site acquisition, design and architectural plans, permits and approvals, pre-construction site planning, and then the actual building of the project with all of the complexities involved, from ordering materials and gathering machinery and managing their delivery, hiring workers, on-site construction management, and post-occupancy issues. And this assumes the financing of the project is in place.

Some players in this arena are one-person shows, a handyman (or handywoman) perhaps with just a hammer and saw but also skills. Need a deck added to the house? No problem!

But others in construction saw a bigger picture out there with opportunities for growth. Take the Fluor Corporation, one of the largest engineering and construction firms in the Fortune 500 ranking. It began small in 1912 in California, building pipelines and other facilities for the oil and gas industry. It later expanded these operations internationally, into places like the energy rich Middle East. It began diversifying into oil drilling, coal mining, and other mineral extraction sectors. When cyclical downturns in these markets occurred in the 1980s, Fluor introduced new services like equipment rentals, construction project staffing, project financing, and even nuclear waste and other environmental cleanup projects. Meanwhile, the core construction and engineering work was diversified into 30 industries including food, paper manufacturers, and prisons to reduce its vulnerability to volatility in the oil and gas market. Today the Fluor Corporation takes in about $20 billion a year in revenue and employs more than 50,000.

Even our Dannie the Deck-Builder doesn't have to stay small. Take Kent Sciutto, who started Turn-Key Construction Group, Inc., in the Sacramento, California region 20 years ago. The firm builds high-end custom homes as well as remodel jobs on commercial structures. Services range from assistance with selection of property (land), architectural plans, acquiring building permits, obtaining financing, doing the actual construction, and after-possession maintenance. Each of these activities offers growth opportunities beyond Turn-Key's basic capabilities.

The danger comes from losing track of the bigger picture — where you want your company to end up. Individual customers, no matter how good and loyal they are, don't always reflect the direction of larger markets. So avoid creating a bunch of marginal products that you can't successfully sell or support. Instead, plan to develop a smaller number of products with features and options that you design to meet the needs of specific market segments.

- **Related product groups:** You may create a group of products based on a common element of some sort. You can develop a product family to use the same core technology, to meet a series of related customer needs, or to serve as accessories for your primary product.

  You want the product group to look stronger in the market than the individual products do separately. That way, you reduce the risks inherent in product development, and the rewards are potentially greater. Take time to understand just how products in the group actually work together. Also, make sure you address the separate challenges that each product poses in terms of customers, the competition, your company mission and vision (refer to Chapters 3 and 4, respectively), and your company's assets and capabilities.

Before you put your plans for growth into action, make sure that they draw on your company's strengths, reflect the capabilities and resources that you have available, and help maintain your competitive advantage. Think about the following questions:

- How well are you doing in the markets that you currently occupy?
- In what ways is the expanded market different from your current market?
- What parts of your business can you leverage in the expanded market?
- What functions and activities have to change to accommodate more products?
- How well does your extended product line meet specific customer needs?
- Is your extended product family stronger than each product by itself?
- How easy is it to scale up your business to meet the expected growth?
- How will your competitive environment change?

REMEMBER

Growth can be painful. It can take a company away from its roots and change its culture. You should think carefully about the trade-offs; are they worth it personally and for all the stakeholders of the firm? Be sure you get to the end of this chapter and consider some of the downsides of growth before taking the plunge.

New product and new market

Has your company hit a midlife crisis? Do you find yourself searching for attractive new customers and hot new technologies, feeling the pinch of age? The need for rejuvenation comes to many companies at different times. A plan to move in new directions often involves diversifying the company, a move down into the bottom-right corner of the Ansoff Matrix (refer to Figure 15-2). That corner, after all, is where the grass — and the profits — always looks much greener.

WARNING

You have to weigh the potential rewards against the challenges and risks that go along with diversification. Too many companies end up looking foolish as they try to learn new tricks in unfamiliar businesses without much time to practice — and they have to face the financial consequences.

To improve your odds of success, start by doing your homework, which means researching all the new issues and new players. If this task sounds daunting, it should be. The stakes couldn't be much higher.

REMEMBER

Your chances of success improve substantially when you identify the ways that a potential new business direction is related to what your company already does. Even without the benefit of any existing product or market expertise, you can often discover aspects of a new business opportunity that play right into your company's core competence (flip to Chapter 10 for more on that). Here's what to look for:

- **Name recognition:** If you work hard to create a name for your company, you can sometimes make use of your brand identity in a new business situation. Name recognition is particularly powerful when the name has positive, clearly defined associations that you can carry over to the new product and market. Luxury-car companies such as BMW, for example, now give their names to expensive, upscale lines of touring and mountain bicycles. Many celebrities generate money through product endorsements.
- **Technical operations:** The resources and skills required to design, develop, or manufacture products in your industry — or perhaps the technical services that you offer — may be extended to bring in additional streams of revenue. Amazon realized its expertise in designing and operating a huge online sales and distribution platform could be a service others would be willing to pay for.
- **Capacity and scale:** Sometimes you can take the excess capacity that you or your company has in production, sales, or distribution and apply that capacity directly to a new business area. You reap the benefits of a larger scale of operations and use your resources more efficiently. Uber, Lyft, and Turo are on-demand ride-sharing services that give car owners a source of additional income.

» **Financial considerations:** Persistent demands on your company's revenue, cash flow, or profits may inevitably point you in a new direction. Low-margin businesses might be exited and new ventures entered that offer higher returns. Weetabix, a UK-based breakfast cereal maker with U.S. and Canadian markets, dumped about 14 percent of its private-label business and discontinued its Barbara's cereal bars line. The result was a double-digit increase in profits and funds to try out some new ideas.

WARNING

The temptation to set off in new directions and diversify into new businesses, creating or acquiring brand-new products for brand-new markets, has bewitched and bothered business planners for decades. Unfortunately, the failure rate for new business ventures can be as high as 75 percent. And the most perplexing part of the puzzle is the fact that in the beginning, the ideas and research look so good on paper. Here are some examples: Campbell Soup launched a family of juice drinks for kids; Colgate, the toothpaste firm, introduced a line of frozen foods; Coors, the beer maker, came out with bottled sparkling water; the National Semiconductor Corporation introduced digital watches; Northrup Grumman was a major defense contractor with extensive experience in airplanes, robotics, and warfare electronics — and decided to build ships for the Navy.

Surprise, surprise — all of these new venture ideas failed, most immediately upon launch. What were they thinking? Strong brands, insider contacts, surplus resources — too many firms thought that these alone would lead to success in new markets. Business planning is a serious business, and it needs to be taken seriously.

A few companies, however, manage to succeed with new products and new markets time and time again. What the Wall Street types call "unrelated diversification" and the business school texts call conglomerates work for some, if managed with precision and discipline (and perhaps a little luck as well).

Newell Corporation, now called Newell Brands in recognition that its product portfolio is all over the map, is an example. Food-related brands include Ball and Calphalon; commercial products, in addition to Rubbermaid, include Quickie and MAPA; Mr. Coffee and Oster are in the home appliances unit; Dymo, Paper Mate, and Parker are in writing; baby brands include Graco and Aprica; Coleman and Marmot are in outdoor and recreation; Wood Wick and Yankee Candle are at home in home fragrance; and finally First Alert is in the connected home and security group. Whew — in fact double whew, since there are more brands than just these at Newell Brands.

The glue that binds all these disparate businesses together under one roof is called "synergy." That's more B-School blah-blah, like conglomerate. (Both terms derive from geology. The good professors probably thought that if they coined

words from real science, then people would start to believe they were in fact real scientists. Hah! Fat chance of that.) The underlying concept of synergy was that astute planners could find unique means to generate additional value from two or more entities. This is the old "the whole is greater than the sum of its parts" logic, more conveniently demonstrated as 2 + 2 = 5. How so? Perhaps two of Newell Brands' business units purchase similar raw materials, even though they are used in very different ways at each. But by combining both units' orders into one, Newell could command a lower price from the supplier through a volume discount. Also, bringing all of the personnel of all of the units together in one firm gives Newell an enlarged pool of talent to draw from as it promotes individuals and moves them around to share their expertise and wisdom.

Newell is a shining example of the tiny universe of firms successfully managing an unrelated diversification strategy. For generations the gold standard in this class was the General Electric Corporation (see the later section "Utilizing strategic business units"). Others, like Berkshire Hathaway, run by the investment superstar Warren Buffett, were more like "holding companies." These firms were composed of numerous individual units who were acquired and left to operate on their own by the parent corporation, remitting profits to the parent that "held" them. There was little if any attempt to integrate operations of the many into a single standard approach. The benefit of this approach at diversification was primarily spreading risk. Another was that the parent could act as a kind of central bank for all the subsidiary businesses, sourcing funds at more favorable rates than if done individually.

Managing Your Product Portfolio

When you decide that you want to branch out with new products and into new markets or to diversify into new businesses, you have to figure out how to juggle. What do we mean? You no longer have the luxury of doting on a single product or service. With more than one product and market to deal with, you have to figure out how to keep each of them aloft, providing each with the special attention and resources that it needs, depending on where it stands on the product life cycle (see Figure 15-1). You need the kind of organization and management provided by strategic business units, known as SBUs.

Utilizing strategic business units

REMEMBER

Juggling additional products and markets requires a bit of preparation, of course, as well as practice. The first thing you want to find out is how many balls and bowling pins — or products and services, in this case — you have to keep in the air at one time. The following questions tend to arise:

- How many products or services does your company have?
- When you add another feature or an option to your product, will the addition essentially create a new product that requires a separate business plan?
- When you have two separate sets of customers that use your service in different ways, do you really have two services, each with its own business plan?
- When you offer two different products, each of which you manufacture, market, and distribute in much the same way, to the same set of customers, are you really dealing with one larger product area and a single business plan?

Often, these questions have no right answer, but taking time to think through the issues helps you better understand what you offer. The firm that pioneered how to do this task best was the General Electric Corporation, or at least it used to be.

General Electric struggled with questions about how to manage its many businesses in the late 1960s. The company had grown well beyond the original inventions of its famed founder, Thomas Edison; it wasn't just in the electric light bulb business any more. In fact, it was a diversified giant, with businesses ranging from appliances and aircraft engines to television sets and computers to finance and plastic. GE had to figure out the best way to divide itself up so that each piece was a manageable size that the company could successfully juggle along with all the other pieces — and be more than a mere holding company.

The managers at General Electric hit on the clever idea of organizing the company around what they called *strategic business units.* An SBU is a piece of your company that's big enough to have its own well-defined markets, attract its own set of competitors, and demand common resources and capabilities from you. Yet an SBU is small enough that you can craft a strategy for it, with goals and objectives designed to reflect its special business environment. By using the SBU concept, General Electric transformed nearly 200 independent product or service divisions into fewer than 50 strategic business units, each with its own well-defined strategy and business plan that could be managed efficiently.

TIP

Consider ways to reorganize your company around strategic business units. Each time you outline a separate business plan, you identify a potential SBU. How do you start? Because strategic business units often refer to particular product and market areas taken together, begin with the following steps:

1. **Break your company into as many separate product and market combinations as you can think of.**
2. **Fit these building blocks back together in various ways, trying all sorts of creative associations of products and markets on different levels and scales.**

Think about how each combination may work in terms of creating a viable business unit.

3. **Keep only the combinations of products and markets that make sense in terms of strategy, business planning, customers, the competition, and your company's structure.**

4. **Determine how well these new SBUs mesh together and account for your overall business.**

   If you don't like what you see, try the process again. Don't change the way you define your products and markets with SBUs — or the way you organize your business and allocate resources around them — until you're satisfied with the overall structure of the company.

Aiming for the stars

Managing a number of products or services is similar to managing a set of financial investments. Take your personal savings or retirement accounts, for example (boy, now there's an assumption). Every financial counselor tells you the same thing: You should spread out your investments to create a more stable and predictable set of holdings. Ideally, financial counselors want to help you balance your financial portfolio based on how much money you need to earn right away and what sort of nest egg you expect to have in the future. Given your financial needs and goals, planners may suggest that you buy blue-chip stocks and bonds that generate dividends right away and that you also invest in more speculative tech companies that might pay off well down the road.

Your company's products and services have a great deal in common with a portfolio of stocks and bonds — so much, in fact, that the juggling of your products and services is called *portfolio management.* To manage your product portfolio as professionally as financial experts track stocks and bonds, you need some guidance. *Portfolio analysis* helps you look at the different roles of the products or services in your company and determine how well they balance one another so that the company grows and remains profitable. In addition, portfolio analysis offers a new way to think about strategy and business planning when you have more than one product or service to worry about.

To juggle your collection of products or services (or SBUs, if you divide them up as we suggest in the previous section), start by dividing them into two basic groups, depending on the direction of their cash flow: Put the ones that bring money into your company on one side and the ones that take money out on the other side.

REMEMBER

Maybe you're surprised that you have two sides here. But because every product goes through a life cycle that likely includes an introduction stage, a growth stage, maturity, and then decline, different products naturally have different cash-flow requirements. (For more details, check out the earlier section "Facing Up to the Product Life Cycle.") You invest in products during their introduction and growth phases, and your mature products end up paying all the bills. Keep on juggling: You always need at least one mature product aloft to support the up and coming products.

Understanding the Growth-Share Grid

You could make a first attempt at portfolio analysis now, using the two basic product groups: those that make money and those that take money. All you have to do is make sure that the first category is always bigger than the second. But the two categories don't help you figure out the future. Fortunately, the bright guys and gals at the Boston Consulting Group (BCG) came up with an easy-to-use portfolio-analysis tool that provides some useful planning direction. The BCG's Growth-Share Grid (see Figure 15-3) directs you to divide your products or services into four groups.

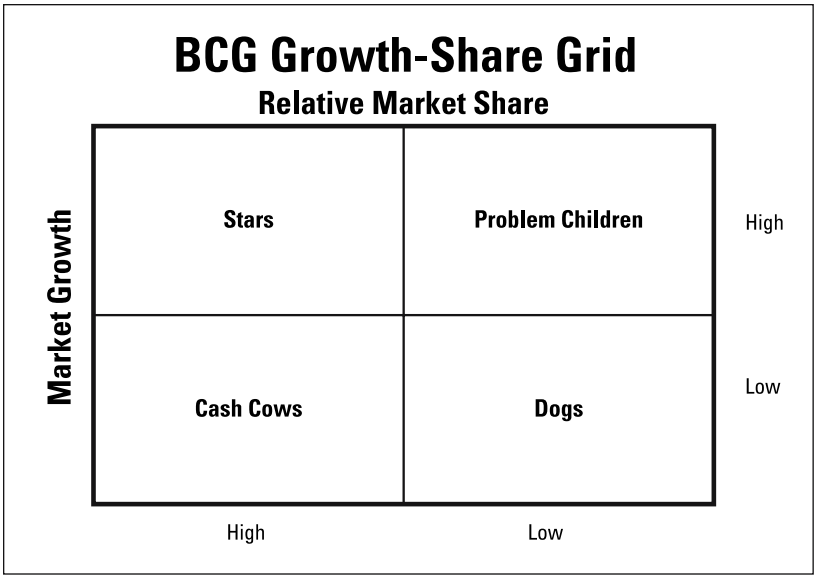

FIGURE 15-3: The Growth-Share Grid divides your company's products or services into four major groups.

REMEMBER

You base your portfolio analysis on two major factors: market growth and relative market share.

- **Market growth:** Is the product or service part of a rapidly expanding market, or does it fall somewhere in a slow- or no-growth area? You use market growth to define your portfolio because it forces you to think about how attractive the product or service may be over the long haul. The exact point that separates high-growth and low-growth markets is rather arbitrary; start by using a 10 percent annual growth rate as the midpoint, but adjust this according to what's happening in your own industry.
- **Relative market share:** Does your product command a market-share advantage over its nearest competitors, or does its market share place it down on the list relative to the competition? You use relative market share as a major characteristic to define your product portfolio because evidence suggests that a strong market-share position is closely tied to the profitability of a product. Separate your products into those that command the highest market share and those that don't.

REMEMBER

Here's a review of the four types of products and services divided up by the Growth-Share Grid:

- **Problem children:** These products have relatively low market share in high-growth markets. Problem children often represent newer businesses and are sometimes referred to as *question marks* because you aren't quite sure which path these products may take in the future. Because problem children are in expanding markets, they require plenty of cash just to tread water and maintain what market share they already have, but their relatively low sales generate little or no revenue in return. If you can substantially increase their market share over time — and that means shelling out even more cash — problem children can blossom into stars. If not, you may have to give up these products and just let them drown.
- **Stars:** These products have a dominant market-share position in high-growth markets. Every product wants to be a star. Stars usually have an expensive appetite for the cash needed to fund continual expansion and to fend off competitors that want to get a piece of the action. But their market-share advantage also gives these products an edge in generating revenue, margins, and profits. So stars usually support themselves, both producing and consuming large amounts of money. You shouldn't hesitate to step in and support a star product, however, if it requires additional resources to maintain its market-share lead.

- **Cash cows:** These products have a major market-share position in low-growth markets. Because of their market-share advantage, cash cows generate a great deal of cash without requiring much in return. Their low-growth markets are mature, and the products are already well-established. The bottom line: You can milk cash cows to produce a cash surplus and then redirect that cash to fund promising products in other quadrants of the grid.
- **Dogs:** These products deliver low market share in low-growth markets — and little else. Although many people are dog lovers, this particular junkyard breed is hard to love. Revenue and profits usually are small or nonexistent, and the products are often net users of cash. Although they require periodic investments, these marginal business ventures usually never amount to much, so it may be best to dump 'em at the pound, cut your losses, and turn your attention to more-promising product candidates.

Building your own Growth-Share Grid

Now you can put all the pieces together to construct a Growth-Share Grid that represents your portfolio of products and services. Ideally, of course, you want to see mostly stars and cash cows, with enough problem children (the risky question marks) to ensure your company's future.

TIP

But the world isn't always ideal. Fortunately, you can also use the Growth-Share Grid as a whiteboard to sketch out what you plan to do with your products to balance them in the future. Here's what you do:

1. **Sort through your company's products or services and get ready to put them in a blank Growth-Share Grid.**

   To see the grid format, refer to Figure 15-3.

2. **Place each product in its proper quadrant, given what you know about market growth and the product's relative market share.**

3. **Draw a circle around each product to represent how big it is in relation to your other products.**

   Base the size of your product circles on revenue, profits, sales, or whatever measure is most convenient. The size of the circles measures the relative importance of each product to your company today — big circles for plus size, small circles for the less so.

4. **For each product in the grid, forecast its movement in terms of overall market growth and market-share position.**

   Use an appropriate time frame in regard to your industry and its rate of change — say one to three years out.

5. **To capture this forecast, draw arrows indicating the direction of the movement and where you plan to have each product end up in the future.**

   Arrows that point outside the grid indicate that you plan to get rid of the products in question.

WARNING

The BCG Growth-Share Grid, with its quirky cast of characters and its black-and-white view of the world, is hard to resist because of how it makes the complex, difficult job of juggling several businesses seem almost effortless. After it first caught on, however, the model became so widely overused and misapplied that the entire practice of understanding product portfolios went out of fashion. Today, of course, business owners understand that portfolio-analysis tools have their place, but they have to use them sensibly. As the saying goes, if something looks too good to be true, it probably is.

REMEMBER

Before you start moving your products around the Growth-Share Grid like pieces on a chessboard, remind yourself that the following strings are attached:

- Market growth is singled out as the only way to measure how attractive a market is and to determine whether you want to be in business there. But growth isn't the only interesting variable. Markets may become attractive because of advances in technology, changes in regulation, and profits, to name a few.
- Relative market share describes how competitive you are and how profitable your company is likely to be. But market share is relevant only when you compete on the basis of size and sales volume. You can compete in other ways, including making your product unique in some way, focusing on a particular group of customers, or concentrating on service.
- The products you put on the Growth-Share Grid are linked only by the flow of cash in and out of the business. But you can think about how products and services may relate to one another and function together in other ways, including views that stress the competition or focus on market risk factors (for example, so-called "loss leader" products that attract customers to your other more profitable offerings).
- The differences between a star and a cash cow (or a problem child and a dog) are arbitrary and subject to many definition and measurement problems. Without careful analysis and a dose of good judgment, you may cast your products in the wrong roles. You may end up abandoning a problem child too soon, for example, because you think the product is a dog, or you may neglect and hurt a star product by labeling it as a cash cow that you can simply milk for money.

Asking Two Final Questions About Growth

The earlier references to GE allow us to conclude this chapter with both wisdom and warnings when you think about growth goals as part of your business-planning task. You and just about everyone else probably believe that growing your business is what it's all about. If you have investors or shareholders, that's usually why they're there in the first place. We have no quarrel with this.

REMEMBER

But two issues deserve your attention:

- Do you absolutely have to grow?
- Can you manage the outcome of growth — a huge enterprise — well?

Knowing that, yes, growth is good

The transformation of the economy in the 21st century has cast a new light on growth. In Chapter 5 we inform you of entry barriers in business — that is, those means by which competitors try to keep out any potential new entrants. But today's "new economy" has created a powerful new barrier. Ask yourself: Why do you use Microsoft for your word processing, Google for search, Facebook for social media, or perhaps Amazon for online shopping — all to the exclusion of any other platforms? Is it because we just love these rascals to death? No comment.

The herringbone tweed with leather patch and pipe folks have provided an answer by drawing attention to one barrier that's become increasingly important — and controversial — for lots of new industries today, perhaps one that you're considering entering yourself. Excuse the jargon but it's called a "network externality effect." (Yes, we know it's academese, but that's what we do.) Firms such as Microsoft and others learned that they're competing in a winner-take-all game and being first is critical, for reasons both economic as well as psychological. From we customers' point of view (POV in Millennial-speak), there is a huge benefit to having but a single network to meet our needs. How so?

Suppose that there were half a dozen equally sized platforms for creating and sharing online word processing documents. You conjure up a brilliant survey of the prospects for success in your new venture and want to send it out to trusted friends for comment. But uh-oh; some would-be recipients use your platform, others don't. In fact, you realize you have to format the darn thing in six different versions, and even then you can't shoot it to everyone because your PC is loaded with only MS Office. Microsoft became dominant because ol' Bill realized that his industry would be captured by the one provider that quickly roped in the most users. Each new user to join the network would drive up its value. Being "best"

wasn't nearly as important as being first, because after you purchased his software, installed it on your PC, and learned how to use it, the switching costs to a superior alternative weren't worth the effort. Any new buyers of the product would likely also go for MS Office because that's what everyone else had.

And what might have been the true business brilliance of Mr. Gates was offering a low price for his operating system to PC manufacturers only on the condition that it be pre-installed on their machines. After IBM agreed, other competitors joined in. You went to your friendly electronics retailer, selected and paid for a new PC, and when you got home and fired it up, presto, there was MS-DOS up and ready to go. Genius! For Microsoft, this software became the gift that just keeps giving. (Perhaps a pithier substitute for network externality effect would be the QWERTY effect. Don't know it? Google the term and you'll see.)

So, is your market one that is of the winner-take-all platform variety where first-mover benefits are powerful? If so, you want to grow as fast as possible, signing up users before they migrate to an alternative platform. This logic was seen in the behavior of venture capitalists who funded such start-ups: Spend everything and more on marketing and don't worry about profit. When you hit a certain threshold and you dominate your market, then bottom-line issues can be discussed. (Some, in fact, even paid users to join.) This doesn't mean you ignore customer needs once they're locked in, of course. This was the MySpace problem described earlier in this chapter. But by becoming the big dog in the show, everyone else has to come up with a very good reason to convince users to switch to them — and a lot of them would have to do so before that rival site becomes valuable.

REMEMBER

So yes, growth is good — even mandatory — in some types of business. The one downer to keep in mind is that digital businesses that rely on platform strategies with winner-take-all tendencies can run up against antitrust laws. Some of these firms are extremely profitable and powerful, and have attracted the attention of the politicians and pundits. In the United States today — and Europe, too, for that matter — their market power has become a critical concern for public policymakers. There are deep and ongoing discussions to legislate restrictions on how these firms do business or, in some cases, perhaps even to order them broken up into smaller units.

Managing growth wisely

For much of the last half of the 20th century, there was near universal consensus that General Electric was the best-managed large firm in the United States. We note some of GE's contributions to strategic management in this chapter. Under the dynamic leadership of the firm's charismatic CEO Jack Welch, GE in 2000 became the world's most valuable public firm; *Fortune* magazine dubbed him "manager of the century." GE competed in 14 different large business segments

and was a leader in all of them. This diversity, it was claimed, allowed the firm to overcome cyclical issues that affected firms that "stuck to their knitting." The market capitalization of GE was more than $600 billion in 2000.

Through its innovative and effective management practices, the firm showed that the conventional wisdom regarding unrelated diversification strategies — that is, avoid them — didn't seem to apply to it. Many informed observers, in fact, regarded its internal management training center as a Top 10 business school. GE managers were sought and poached by companies everywhere.

But nothing is forever, a theme we repeat often in this book. Mr. Welch's last day as CEO was September 9, 2001. The new CEO, Mr. Jeff Immelt, took over just one day prior to the 9/11 tragedy. As the world irrevocably changed, many of the hidden problems with GE began to surface as new realities sank in and digital commerce began to flourish. These were compounded when, following the Great Recession of 2008, an overreliance on the firm's finance subsidiary, GE Capital, led to huge losses and write-offs of assets. Many management experts now wrote that as a decentralized conglomerate, GE was "too big to manage." Each business line and division operated autonomously with decentralized budgets and duplicate, triplicate, and often even more repetitive infrastructures; an aggressive culture of winning often pitted units against one another in the dog fight for promotion up the corporate ladder. Without strong centralized governance and management oversight, compounded by continuous investor pressure to improve its market value, GE's performance floundered.

Mr. Immelt was removed as CEO in 2017. Assets and whole lines of business were sold off to pay down debt. GE's revenue level and market capitalization dropped to the point that GE was removed from the list of firms that comprised the Dow Jones Industrial Average, the traditional metric used to measure stock market performance in the United States. GE had been the only firm that had been on the list since its inception more than 100 years prior.

REMEMBER

So the final question: Are some firms too big to manage? Will the artificial intelligence (AI) revolution provide us the necessary tools to achieve success regardless of organizational size and scale? Growth is not always its own reward. Be careful what you wish for — and have a good parachute just in case.

5 Putting Your Business Plan into Action

IN THIS PART . . .

We help you put your business plan to work. We look at ways to organize your company and develop the procedures and systems that allow you to carry out your plan as efficiently and effectively as possible.

We talk about ways to encourage leadership, develop business skills, and create a company culture to help you achieve your plan. We especially prod you to remember that you are now competing in the 21st century, and external pressures on the business firm mandate that you consider and act on issues of inclusion, diversity, social responsibility, and environmental sustainability if you want to attract both the employees you need and the customers you want. None of this will occur if you don't internalize and then implement meaningful leadership in your organization.

IN THIS CHAPTER

- Understanding why organizational structure matters
- Designing an organizational structure that works
- Building dynamic capabilities into your organization

Chapter 16

Shaping and Shape-Shifting Your Organization

Congratulations — you should be close to completing your business plan! You've already done the vision thing and data digging to flesh out the details of the many parts of your plan. Now you need to figure out how to organize the parts so they work together as a unified whole. If you need a little nudge, go to Chapter 1 for a refresher on why you started your plan in the first place and the Appendix for an example of a business plan.

Recognizing That Form Follows Function

Your next big step is arranging (or re-arranging) all your company's resources to put your plan into action. If you wanted to design a house, office, or specialized facility, rather than your company, you likely would consider the words of the famed American architect Louis Sullivan:

> *Form follows function.*

Just because structures are all meant to hold people doesn't mean that all structures have a similar design. This is why hospitals don't look like hotels, and hotels aren't like prisons. If the basic function of each type of structure is different, it requires a different form in order to achieve its purpose.

REMEMBER

You spell out what your company intends to do — its *function* — in your business plan. Now you must design a *form* for your company to support that function. The form your company takes consists of two basic interacting components: people and technology, the latter being machinery, communication devices, software programs, tools, and so on.

That form can be as simple as you and a few partners doing everything that needs to be done, sharing files on your laptops. Or it can be as complex as a huge organization with multiple functional areas, scores of offices and factories spread over different continents, and numerous levels of management from a work-team leader on the ground to the CEO at the top.

Many business scholars (oxymoron?) consider the first significant book on strategic management to be *Strategy and Structure*, published in 1962, which found that organizations that designed a structure first and next created a strategy to fit it were on the road to failure — they were putting the proverbial cart before the horse. In essence, Professor A.D. Chandler Jr., the author, reinforced Louis Sullivan's mandate that form must follow function. Earlier chapters in this book show how to create your business plan — your function. Here and in Chapter 17, we help you understand what you need to do to carry out your business plan by designing the appropriate form. Let's get to it.

REMEMBER

Don't assume that you already know everything about your business plan. Because you're so close to all parts of it, you can easily miss the big picture. Step back and pay special attention to the broad sweep:

- Read your company's mission and vision statements as though you're seeing them for the first time. (Check out Chapters 3 and 4 for vision and mission statement info.)
- Consider the goals and objectives that you set for your company. (See Chapter 4 for help.)
- Review the strengths and weaknesses of your business, and consider what they say about your company's opportunities and capabilities. (Chapter 10 helps you look at your company objectively.)
- Think about the ways in which your company provides value to customers. (Chapters 6 and 7 show you how to assess your markets.)

Putting Together an Effective Organization

REMEMBER

If everybody in your company can fit comfortably around a work bench in the garage, you likely have a smooth organizational structure in place; you can, after all, connect three or four people in only so many ways. But the mere fact that a structure is fairly simple doesn't make it something you can ignore. Whether you have 2 or 2,000 employees, the way you design your organization plays a major part in your business-planning success. No matter how big or small your company becomes, everybody involved still needs to know what their jobs are and the fundamental purpose they try to serve.

Where do you start? You can slice and dice the basic components of your organization in several ways. Two sometimes contradictory purposes, however, usually dictate the logic: effectiveness and efficiency — that is, doing the right things versus doing things right (we first discuss these in Chapter 4). The following sections cover the most common structures that result from how you manage this trade-off.

Choosing a basic design

If you are a new or small company, the simplest way to organize is to put a trusted person at the top — the founder if a start-up, an owner or talented manager if the organization is compact — and have everybody else do whatever needs to get done. The "lean" start-up has become a cliché by now. Efficiency and effectiveness are rolled into one due to size. If there's a need to discuss a problem or report on some new data, no problem. All hands on deck; just call everyone together and start talking. So what then are the trade-offs of tiny-ness? Here are the pros and cons:

- **Advantages:** You can usually get someone to do a job whenever it needs to be done. Because everyone is together most of the time, and face-to-face communication is relatively easy, all of the staff quickly coalesces around priorities. The design is cost-effective.
- **Disadvantages:** The basic design works best only if your company has a few people. If your company is any larger, the person at the top finds it more difficult to keep track of everybody. It's harder to do an all-hands-on-deck when the staff starts to get spread over multiple sites, even with the use of online conferencing tools.

WARNING

The basic design isn't always efficient. More voices can lead to personal conflicts and clashes of communication style. When the small firm begins to expand is when danger signals usually arise. Whether or not folks realize it, they are, in fact, creating the cultural norms that will identify the firm in the future. Tread carefully.

Focusing on a functional model

Business success typically results in organizational growth, including in head count and the variety of tasks that need to be done. This growth tends to happen more with firms making tangible products than with digital enterprises; the personnel-to-revenue ratio of the latter is typically much less as scaling is built into platform software. Yet, for both kinds of firms, product or service providers, the effectiveness versus efficiency trade-off becomes more apparent. Let's investigate.

If you organize your company around business *functions*, you divide people into groups that center on what activity they do. You take all the engineers and put them together in one area, lump the marketing geniuses in another, and so on. You still need to make sure that some sort of general manager coordinates the various activities of the functional groups, of course. Here's how this method stacks up:

- **Advantages:** A functional organization works well if your business involves only one type of product or service and if the business outlook is stable for the foreseeable future. The organization is efficient, because people excel at their particular tasks, and they perform each function in only one place, creating opportunities for scale benefits. Also, every employee knows exactly what they are responsible for and the metrics by which their performance is evaluated.

WARNING

- **Disadvantages:** Unfortunately, a functional organization can easily turn into a bunch of separate silos standing side by side. The silos, each housing a different functional area, can be difficult to connect together. Operations, for example, wants to make the same single product over and over again, whereas Marketing wants to sell different products to different customers. Each function may be efficient by itself, but the functions taken together aren't terribly flexible or effective.

  This is particularly true when markets shift and changes are necessary: Each different functional area fights to isolate itself, casting blame on others and resisting outside intervention. Your general managers have to shoulder the responsibility of keeping communication open. Not easy.

Divvying up duties with a divisional form

If your company is big enough to be in more than one business, the best approach may be to organize by divisions based on a variable other than functional activity, such as a particular product, or a market, or a geographic area. If your company is huge and diversified, your divisions may cover strategic business units, or *SBUs*,

which are specific product-market combinations. (Refer to Chapter 15 for additional information on SBUs.) Here are the pros and cons:

- **Advantages:** An organization made up of divisions that you base on products, markets, or SBUs encourages you to focus all your energy and resources on the real businesses you're in. Managers inside the divisions can concentrate on their own customers, competitors, and problems, and each can respond more quickly to market signals. This leads to better effectiveness.

  Top-level managers at HQ can oversee how the divisions work together and maintain basic coordination from there. HQ also can transfer promising divisional staff to other divisions, creating opportunities for lower and mid-level staff to develop and expand their managerial skills and competencies. This allows for in-house promotional ladders rather than having to recruit external candidates for higher-level responsibilities — and depressing current staffers who feel passed over.

- **Disadvantages:** Because the separate divisions within your company often represent entire businesses, they sometimes compete with one another, fighting over scarce resources from HQ, and sometimes even over the same customers. In the worst case, the company risks becoming little more than a loose federation of parts rather than a singular and focused enterprise.

  Also, separate divisions usually mean replication of overhead costs, because each division invariably has its own set of overlapping management layers and business functions (research, operations, marketing, service, sales, and finance). As a result, your company becomes less efficient.

Sharing talents with the matrix format

The functional and the divisional forms of organizational structure are based on effectiveness (the scope of your operations) versus efficiency variables (that is, their scale). For many organizations, especially ones competing in international markets, a matrix format is a superior way to structure. In a matrix organization, everybody works under two centers of authority and basically wears two hats. One hat may be functional: A person may be in field sales, reporting to the regional manager responsible for all functions in the area. But another hat is divisional: The product division managers at company HQ have control of their products wherever they may be sold, so that the field sales guy also has to report to them on some issues. At least the theory says this is the best way to structure the firm when its activities are so diffuse. Let's see the pros and cons:

- **Advantages:** The logic of the matrix format is that separating responsibilities by function creates focused effectiveness; doing so by division generates

scaled efficiency; and bringing them together in a matrix structure gives you the best of both worlds.

- **Disadvantages:** A matrix organization can be tricky to manage — and sometimes even disastrous. The format violates an important management rule: Don't give people two bosses at one time. Tension is bound to occur between the manager responsible for a given product or service, and the functional manager who oversees a given task. Each of these people might have their own incentives. The production manager at division HQ might want the field salesperson to sell, sell, sell — and thus drive up volume and generate scale savings in production. The area sales manager, on the other hand, might want that field salesperson to sell anything to a local customer, as overall sales volume is what gets them a bonus. The poor guy in the field is caught between two competing forces, and it's sometimes easy for the wrong one to triumph.

Dealing with too many chefs in the kitchen

REMEMBER

After you decide *how* to organize your company — functional, divisional, or matrix — you have to decide *how much* you want to divide it up. Ask yourself a simple question: If the people at the bottom of the org chart have suggestions to make, how many people do you want the suggestion to pass through before it gets to the top for consideration? In other words, how many management levels should you have?

The number of tiers in the management cake depends a great deal on how big your company is and how you organize it. In the earlier section "Choosing a basic design," we explain the benefits of smallness in an organization — the ability to communicate to everyone at once and rapidly mobilize all resources toward goal achievement. But as the firm begins to grow, managers can handle only so many people directly if they want to do a good job.

One way to deal with this is through technology: robotics and AI (artificial intelligence programs that set standards and make decisions). Although still in its infancy, this trend has the potential to radically alter the role of the middle manager — if not absolutely obliterate it. And don't forget another trend: remote work (WFH, work-from-home). This, too, will present challenges for firms as they grow.

Some organizations have grown without installing layers of managerial oversight — because the nature of the work is one in which individual creativity is critical. In work environments like universities, research labs, and the creative industries, personnel desire autonomy above any other benefit, including salary. In these cases, an increase in company size might not necessitate more managers:

The span of the control number is already high (that is, number of workers to managers), and close supervision doesn't appear to effect results that much. In fact, it may be counterproductive.

REMEMBER

Being lean and mean can be good for some firms but problematic for others. Do your homework before choosing the structure and allocating "decision rights" to lower staff levels. Whatever your specific company situation, keep in mind these general rules: The more management levels you have in place,

- The more control is given to lower levels of company management
- The longer it takes and the harder it is for information to reach top management
- The less flexible your organization is in the face of change

Finding what's right for you

WARNING

Why do small companies that initially get a toehold in the market end up stumbling soon after? Believe it or not, the biggest reason is that they have trouble handling their own success. A recent study found that the steeper the revenue growth curve at the start of a firm's life, the greater the probability the firm would fail. A major stumbling block turns out to be an unwillingness or inability of the founding leaders to change the organization or their behavior as their small company grows bigger.

This is a classic pathology of entrepreneurs, by the way. The personality traits that drive success — single-mindedness, ambition, persistence — can get in the way after a corner has been turned. Close attention to detail can become control freakishness; strong self-confidence can become an unwillingness to let go and allow others to decide. Similar problems often impact family business firms. The founder may want to create a legacy for the children, which is both understandable and good. But family dynamics can be brutal if they aren't acknowledged and managed before they interrupt sound business planning and decision-making.

REMEMBER

Be sure to explore all your options as you go about creating or re-creating your organizational structure. Try to come up with a design for your company that makes sense to you and the market realities in which you compete. The structure should also make sense to your major stakeholders, including the investors and lenders who have a financial interest in your business — or family members if they are involved. (If you need a refresher on stakeholders, refer to Chapter 2.) Only then can you put together an organization that allows your company a chance at long-term success and makes it easier for the company to fulfill its business plan. The business boneyard is full of once promising little firms that unnecessarily died in childhood. You don't want your company's name on one of those sad tombstones.

Thinking and Organizing for the Future

This chapter has given you numerous ideas and guidelines for structuring your business if it's a new venture, or reshaping it when your markets shift. We also emphasize that change — constant change — is the new normal as we continue to grope our way through a worldwide Industrial Revolution (see Chapter 13 for more on this topic).

A powerful new model for dealing with change is called "dynamic capabilities." This approach was designed specifically for organizations faced with constant change and consists of three components (see Figure 16-1):

- **Sensing:** This is the first step and focuses on how organizations can detect future trends that will have a major impact on their business.
- **Seizing:** Step two pertains to the methods by which a firm can capture value from the trends before competitors move in.
- **Transforming:** The last step addresses the fact that the speed of change is not about to slow down anytime soon, and provides guidance on how a firm can best organize itself to be agile and prepared to move quickly when the next opportunity knocks or major threat looms.

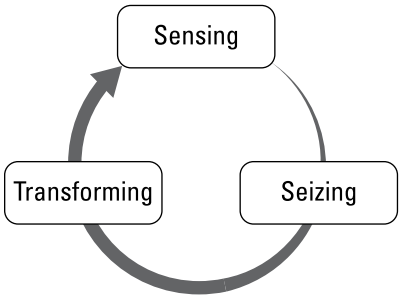

FIGURE 16-1: Dynamic capabilities.

Chapter 13 provides insight about how to peer through the gray clouds to see what might lie beyond. For example, who do you have overseeing a digital strategy or monitoring new ideas on the Internet — some office bureaucrat who's still learning to surf the web, or a kid who actually lives on the web daily? Who allocates resources to new ideas that might pop up — someone intimately connected to another part of your organization who might see the new idea as a threat to their position of authority?

Chapter 10 raises the concept of a business model — that is, just how a firm can capitalize on its unique advantages to create value. If your firm can spot a new trend before the competition, what's the point if you can't rapidly own it before the others move in? Can you overcome internal resistance to abandoning the old model and adapting to the new?

TIP

Here in this chapter we review methods to best structure yourself to meet current market demands. But you have to be able to transform these in the face of market shifts. One way is to outsource as much of your needs as possible, so that you don't have to waste time and money trying to shed assets that no longer are appropriate to your challenges. This has led to what some call the "virtual corporation" — that is, a basic core idea at the heart of the enterprise but without the heavy anchors of offices, factories, warehouses, or even employees that prevent rapid change. Too many firms have seen the future but aren't able to break free from their past to embrace it.

REMEMBER

The pace of change is simply too fast to permit the old and more static perspective that assumed trends evolved at a more leisurely trot. Globalization and technology have driven a spike through the heart of steady-as-she-goes thinking; disruption is the name of the game today; and firms need to be agile in order to change and survive.

We think the dynamic capabilities model is a nifty way to weave together the key components necessary to succeed in the hyper-charged global economy of the 21st century. Give thought to how you can adapt your own organization to sense, seize, and transform — and do it again and again and again. The key? Organizational leadership, our friend, leadership. Go directly to Chapter 17.

IN THIS CHAPTER

- Promoting leadership in yourself and others
- Acquiring the necessary business skills and traits
- Establishing your company culture
- Nurturing your company vision and moving forward

Chapter 17
Leading the Way

One key to success in business is seizing opportunities. If you ask successful business owners how they made it, they usually list two things: They had a solid business plan in place, and when they saw their opportunity, they stuck to that plan. One thing they usually don't mention, at least not publicly, is that they also were lucky — they were the right person with the right idea at the right time. But having a plan when the fickle finger of fate strikes is what separates them from those folks who got hit by the lightning of luck — and soon perished. Luck always helps; luck plus planning spells success.

Right now, your business plan represents an opportunity. One of the biggest mistakes that companies make is not taking full advantage of the business plans they work so hard on. We've seen companies use their plans to raise loads of money and put together a dynamite management team — only to toss the plan into a top drawer once the check arrives. Six months or a year later, the owners wonder why their business is sputtering. We've watched entrepreneurs with great ideas and a sound business strategy never get their companies off the ground because they fail to follow through with their plans. Putting your business plan together isn't enough; you have to lead the way and put your plan to work. This chapter can help.

Encouraging Leadership Roles

In reviewing your completed business plan, what do you see as the most important parts of your company? Maybe you think of your business mainly in terms of the products that you offer or the services that you provide. Is the image that first comes to mind a cool website flashing your logo, or a building with your name posted prominently on the front? Perhaps you also think of the organization itself, your way of doing business, and the reputation you want to cultivate. Your company is a combination of all these things and more. But most importantly, the people in your firm — including you — define your business.

Leading from the front or the back

REMEMBER

If you want people to follow you into the bright future laid out in your business plan, you have to lead them. One famous leadership maxim says, "Lead from the front — don't ask underlings to do something that you wouldn't do yourself." This sounds inspirational, but its application only goes so far. Sometimes you have to lead from behind, persuading the people in the organization that it's their responsibility to be out front if they want to succeed. This formulation of leadership was described by Nelson Mandela, universally recognized as one of the world's great leaders of recent times. He wrote that a successful leader was like a shepherd: "He stays behind the flock, letting the most nimble go out ahead, whereupon the others follow, not realizing that all along they are being directed from behind."

So which one is it? What does it really mean to be a leader, and how can you encourage others to take on leadership roles? These are tough questions. In fact, there really aren't any easy formulas that we can pass on to you that will turn you into a business leader. There are literally not hundreds but thousands of books and articles today on this topic. Why so many? Probably because no one has yet found the definitive answer.

But another reason that the topic of leadership is so popular is because it's so important. Leadership is the ultimate resource that creates successful businesses (and many other endeavors as well). Let's begin, though, with an important distinction: leadership and management are two very different things. In this book we give you (we hope!) a comprehensive guide to improve the odds of success in your business venture by providing management know-how. These skills can be learned. Leadership, on the other hand, is a competence that some are born with and some never acquire because of their personality quirks. But that being said, there are still some tips and insights that can put you on a high road if you're willing to be honest with yourself and undertake the changes that are required.

Looking at leadership styles

Effective leaders lead in many different ways, depending on the circumstances at hand. The charismatic leader is often associated with start-ups. This is an individual who can inspire, rouse colleagues to reach a higher level, excite everyone around with their enthusiasm and passion. When a business firm has found its groove and is moving forward at a decent pace, effective leadership often shows itself in people who are steady in their composure, competent in their work, and very good at shepherding colleagues with a gentle but sure touch — more the guide by your side than the sage on the stage.

These are generalizations. Just look around, and you'll see what we mean. Though there is a relationship of some kind between leadership style and a business situation, it is not ironclad. Think of Winston Churchill, who usually tops or is near the top of a list of "greatest leaders in modern history" (boy, do we Americans love those top ten lists). What do we find? A politician who failed consistently, but when the situation finally arose that aligned his temperament with the required decision, he met the challenge and prevailed.

REMEMBER

But you can't always just sit and wait for that moment of destiny to arrive. Rather, when you find yourself in different business situations, and you will, you do have to be prepared to alter the way you lead. Business rarely gives you a second chance. Consider the following leadership styles and behaviors:

- **The advisor:** If you want your people to take on responsibility over time, you have to let them go off and try to accomplish the tasks you give them on their own. And you also have to be willing to accept less-than-perfect outcomes; success sometimes comes only with experiences that involved failure. Make sure your people know how to ask for help when they know they need it — and that asking is not an admission of incompetence or shame.
- **The colleague:** As you bring people into your company and develop strong working relationships over time, your leadership may become almost invisible. On the surface, you behave more like a colleague — one among equals. In this case, you lead in subtle ways and often by example. If you demand the best of yourself, others excel in your shadow. If you meet deadlines, your employees strive to meet them, too.
- **The boss:** Sometimes, you simply have to tell people what to do, either because they don't know how to proceed or because you have definite ideas about what should happen next — that's why you're the boss and they're not. Even when you lead as the boss, however, remember that you get the most out of people by giving them good reasons to carry out what you ask of them. No one likes to be dictated to, but most can be persuaded and educated by a thoughtful and courteous discussion void of acrimony.

We leave it up to you to determine what your base point leadership style is — and whether you have the ability to alter it as the situation determines. One tip: The best leaders are able to do this.

Developing Business Skills (And Having the Right Personality Traits)

Your employees are responsible for turning your business plan into reality. You can't just pick any bunch of random people who are willing and able to work (not if you want your plan to work, that is). The people you bring on board must have the right skills and personality to do what you ask them to do.

Evaluating personality traits

Personality characteristics have been studied by psychologists for generations now. There is a consensus that individuals who are in organizational settings (like a business firm) can be evaluated according to five major traits that are indicators of how well they will fit in and perform:

- Emotional stability
- Extroversion
- Openness
- Agreeableness
- Conscientiousness

In general, people who demonstrate these traits tend to perform at higher levels in an organization than do those who have deficiencies. Though not everyone in your firm might need to shine in all of the so-called "Big Five," any evidence of a strong negative score should be a red flag. For example, someone who is in sales but has a highly introverted personality might not be the best fit. A person working in accounting or finance who isn't terribly conscientious could lead to problems.

TIP

A variety of tools can be used to measure how well someone matches up against the Big Five. Here are a couple of online sites that can be consulted, but you can check out others as well:

- https://openpsychometrics.org/tests/IPIP-BFFM/
- www.truity.com/test/big-five-personality-test

Distinguishing appropriate skills

REMEMBER

Good personality traits are important for people who work in your business. But they also need appropriate skills. You want your people to be tops in their own functional areas of responsibility, whether they work in engineering or operations, accounting, or sales. Yet today, they often need additional skills that are different than they were just 10 or 15 years ago. This is due to the revolution in business enabled by technology and globalization. Employees in business now need to have more general abilities and competencies that allow them to succeed in the company you want to build for the future. In short, the people around you should excel in one or more of the following activities:

- **Managing information:** Employees should be able to deal with an avalanche of information on almost every imaginable aspect of your company and industry. Although it's not always an absolute necessity, having a good working knowledge of digital sources and tools is very important today. Another skill is data manipulation — not being a coder perhaps, but definitely being able to understand quantitative data when it's presented.
- **Thinking independently:** Employees should be able to tackle business issues as they crop up. If you want to get the most out of your company, your associates have to take initiative, think on their own, and come up with answers to the business problems they face every day.
- **Working in teams and communicating effectively:** Employees should be able to get work done as part of a group. The need for speed in a complex business world makes it hard to get anything big accomplished without pooling resources, talent, and expertise. Collaboration counts.
- **Dealing with change:** Employees should be able to complete tasks in different ways, take on new responsibilities, and adapt to unfamiliar situations. Industries don't stand still anymore, and if you want your company to keep up, you need people around you who can keep pace with a constantly changing business world — accepting the reality of change rather than always fighting it.
- **Acquiring new skills:** Employees should be able to keep on learning. If you want your company to move forward, your employees have to move ahead as well. You should provide avenues for employees to continue their professional education and encourage them to master new skills.

Creating the Right Culture

Business media today seems to report an endless cycle of accusations and controversies surrounding a clash of cultures in organizations. Younger employees — Millennials and Gen Xers raised in a different environment than prior generations — have brought a different standard of excellence to the workplace. Business leaders who ignore this, or flaunt the current expectations of acceptable behavior, often find themselves in hot water. In some cases, ranking executives have been terminated.

Organizational culture has been the focus of increased scrutiny of late as business firms learned the hard way that a toxic company environment could hurt. The CEO of one firm caught up in scandal stated: "There's a high cost to a bad reputation." If you're starting up a new venture, you need to ensure that the values of your firm take hold in the way you want. If your business is already in operation, you need to know what values currently drive behavior — and if they are not aligned with your business plan, then you need a strategy to change them.

REMEMBER

Your company culture comes from the common attitudes, beliefs, and behaviors of the people involved in your organization. In that sense, company culture resembles a nation's culture. But remember: People aren't born working for your company. In most cases they arrive with a prior set of deeply embedded notions of how to act. This is why testing new employees on the Big Five personality traits or some comparable evaluation is important (we discuss personality traits earlier in this chapter). It's difficult to get people to change (duh!) — especially as they get older and past behaviors become more hard-wired.

When you attempt to curate a company culture, by either establishing one for a newly formed firm or pushing for change in an existing company, you bring together people of different backgrounds and try to give them a common outlook. Unfortunately, you can't simply command people to have a particular point of view. They find ways to resist if they believe they are right and you are wrong. This is why leadership plays such a powerful role in the formation or change of organizational culture. There is ample evidence that the strongest company cultures often thrive when they have effective leaders, or erode when leadership begins to fade.

You have to think hard about the values that you want to define your business. That's why we raise these early, in Chapters 3 and 4. You also need to ensure that your own behavior as a leader always reflects those values; to those who work with you, you're the boss 24/7, not just 9 to 5. And whether you like it or not, everyone around you will be looking for the slightest hint at what constitutes behavior that's acceptable or not. If something you do is perceived to have crossed a line, it will flash through your organization like a laser.

We've worked with some older business leaders who believe their younger employees are simply going through a phase. Over time, these gray hairs intone, youth will adjust to the realities of the business world. (We hope this doesn't describe you.) But let's admit it: A lot of young people today weren't dealt the best of hands, and they want something better for their work life and future. They demand that the people around them — be they above, below, or at the same level — live up to the standards that are so easily preached but not always practiced. And they're not shy about broadcasting their opinions. It's easy to dismiss proponents of "wokeness," but even a cursory review of their desires often reveals a powerful foundational truth: They want a better and more just world. Why would you argue with that?

The demands on business firms today go beyond good products and services; these are givens, the ante just to get into the game. They now also include positive organizational policies regarding diversity and inclusion in the workforce, socially responsible behavior, and appropriate concern for the environment. Common business terms that encompass these policies are *CSR* and *ESG:*

- CSR — corporate social responsibility — has been promoted for generations, as citizens came to recognize the central role that business plays in American life and how the internal policies of business firms can and should extend well beyond the bottom line.
- More recently, ESG has expanded this recognition. Advocates want businesses to demonstrate respect for the environment (E), social issues (S), and also enact internal firm governance procedures (G) that are transparent and equitable for all stakeholders. These are not unique issues for U.S.-based companies, BTW ("by the way" in Millennial-speak). In fact, European nations have mandated that businesses operating there comply with ESG standards by law. Failure can have severe financial penalties.

REMEMBER

What all of this boils down to is that you need to be deeply concerned with your organization's culture. You need to be absolutely sure that the values you publicly express are internally consistent with your goals and objectives as a business, and carried out by everyone in the firm, starting with you:

- Are women, people of color, and other such groupings of people given equal opportunities for recruitment, training, and advancement in your company? Are they treated with respect by all?
- Do the procedures you install in the workplace contribute to sustainability in the environment? Are there cost-effective changes you can make in this area that could lessen the degradation of the planet?

- What mechanisms do you use to ensure that the voices of all your colleagues can be heard? Do you communicate important information clearly and openly? Are channels available for employees to signal concerns, without fear of retaliation or retribution?

TIP

Some firms have found it useful to have an outside source conduct a periodic "climate survey." This is a means to get an unfiltered perspective on the culture of your firm as it is perceived by the people who work there. If there are discrepancies between the reality on the ground and the noble-sounding values found on your vision and values statements, you have a problem. The survey will also give you a guide for change.

Following Through with Your Vision

REMEMBER

In the end, your business plan represents the ultimate vision of what you want your company to become, right down to the last market initiative and financial projection. A company vision creates a sense of shared commitment and direction (see Chapter 3 for more info), and your business plan is a terrific way to communicate your vision to everyone who has a stake in your company. To keep your business plan a living, breathing document that conveys and refreshes your company vision, make use of the following suggestions on a regular basis:

- Reproduce your mission and vision statements on your website, in company newsletters, employee handbooks, and even on business cards. We've even seen these inscribed on the walls and doors of the firm, visible for all to see.
- Refer to your business plan whenever appropriate — during marketing strategy meetings or new product development forums, for example. Show how decisions made in functional areas of the business align with your firm's vision, values, and mission.
- Use the plan as a yardstick to evaluate all programs and initiatives.
- Use your business goals and objectives as the primary guide when you conduct employee performance evaluations.
- Actively enlist feedback from everyone in the company when you prepare to assess and revise your business plan. Don't let a small group of insiders capture it for themselves only.

"All parents reach a time when they must let go and trust that the values imparted will live on within their children. That time has nearly come for me and for Whole Foods." John Mackey, co-founder and CEO of the Whole Foods grocery chain, made this statement when he stepped down. You, too, are likely not to be with your organization forever. Will you leave a legacy of value, or one of ashes?

Bringing Your Plan to Life (And Making a Final Check)

REMEMBER

First impressions count. Get it wrong the first time, and it's hard to recover. After you put your business plan down on paper (virtual or real), take the time to read it — and we mean *really* read it. Don't just check for typos and bad grammar; remind yourself of what it actually says and is supposed to do. If you're seeking funding from a financial institution or a venture capital (VC) group, trust us — they will read it in excruciating detail. They will look for the inconsistencies, flawed logic, or incomplete information that too often creeps into business plans. You don't want to embarrass yourself before your judge and jury. You may find it useful to have a trusted advisor review your plan — someone not too close to the business — so you can receive some objective feedback.

With this book, you're now prepared to be on the winning side with your venture, be it something new and exciting, or a re-think of how you will succeed in your ongoing business. Whatever it is, we're with you, dear reader. Go forth and conquer!

6 The Part of Tens

IN THIS PART . . .

We review ten (or so) very good reasons to construct a business plan in the first place.

We list the ten (or so) most important questions to ask yourself about your business plan while you work on it.

Finally, we point out the ten (or so) things you never ever want to be caught doing (while business planning, of course).

IN THIS CHAPTER

- Recognizing a stale plan
- Revising your plan when the business environment changes
- Avoiding growing pains

Chapter 18

Ten (Or So) Signs That Your Business Plan Needs Refreshing — or Worse

How often should you review your business plan? This is going to depend on your own situation and degree of confidence in what you're doing. We know of some business leaders who literally have a copy of the plan with them constantly, checking in with it as they assess the changes around them. These people tend to be in markets that are undergoing constant disruption due to technology or other transformative factors. But for others, a revisit to the business plan perhaps once a year seems to do the trick. This schedule is appropriate for firms in industries that are more stable, and its purpose is similar to an annual checkup at the doctor's office — a proactive review to ensure that all's going as planned and the firm is remaining aligned with its goals and objectives.

You're probably somewhere in between these two extremes. Regardless, at some point you definitely need to upload the document and give it a good look-see. Here are ten (or so) warning signs that your business plan needs attention.

Your Business Goals Change Abruptly

Even the best business plan requires adjustments as conditions change. But if your company drastically changes course, you need to meet with your management team and look at your business plan from the bottom up. Take the time you need to do a complete review and update your business plan to reflect a rational course change that addresses the problems you've identified. See Chapter 4 for more details on setting business goals and objectives.

You Don't Meet Your Plan Milestones

Your business plan sets out a strategy and action plan for meeting your goals and objectives. Deadlines are one of the engines that propel your business forward. What do you do if the company begins to miss deadlines and important projects start to fall behind schedule? Sit down with your staff and figure out why the schedule you set for your company isn't working. Identify the source of the problem, including aspects of your current business plan that may not be realistic. With the help of your team, brainstorm solutions that can get you back on track. If you can't catch up, revise your planning schedule so that employees don't become frustrated.

New Technology Makes a Splash

Technological innovation can alter your business landscape entirely — changing what your customers want, how your business operates, and who your competitors are. A shift in technology can make existing products obsolete and create a market for new products or services almost overnight. So when a new technology appears on your business horizon, say by someone in the industry introducing digital capabilities, you need to reassess your business plan — fast. Sit down with your management team and consider how this new technology should change the way you do business or the customers you serve. Lay out plans for how you can use the new technology to your advantage. Check out Chapter 13 for tips on how to manage changes in your business environment, including changes in technology.

Important Customers Walk Away

Do you know our definition of a customer, found in Chapter 7? Someone who doesn't have a better alternative! Customers always keep an eye out for a better product or service or a better deal. Losing a few customers is part of doing business. But if you start to notice that a lot of your customers are going elsewhere, something's wrong. Your competitors may be stronger than you think; your efforts may be falling short; or the market itself could be changing. Whatever the reasons, the defection of important customers is an alarm signal you can't afford to ignore.

TIP

One way to get more information: Ask departing customers why they want a change, kind of an exit interview. And talk to your salesforce for further insights. After you research and gather tips and information, adjust your business plan accordingly. Flip to Chapters 6 and 7 for tips on understanding your customers.

The Competition Heats Up

You need to know the competition if you want to compete successfully. So if an important new competitor sets up business in your market, you should revisit your competitor analysis and adjust your business plan accordingly. Keep in mind that competition isn't necessarily a bad thing. It usually forces you to focus on what you do best and develop ways to do it as efficiently as possible. But to respond effectively to a new competitive threat, you need the right plan in place. Check out Chapter 8 to refresh your knowledge of competitor analysis and how to monitor the other guys out there.

Product Demand Falls Sharply

If you see an unexpected drop in your current sales figures, move quickly to diagnose the problem. There may be a mismatch between the features you offer and the benefits customers want, a problem with quality control, or a breakdown in customer service. Or perhaps the competition has moved ahead of you. Don't panic. Take time to identify the reasons behind the change in sales and revise the appropriate parts of your business plan — product design, operations, and marketing strategy, for example. Flip to Chapter 9 for a review of your business capabilities and an analysis of your company's strengths and weaknesses.

Revenues Go Down or Costs Go Up

WARNING

A clear sign of trouble is when margins begin to slip. That is, the difference between sales revenue and costs starts going south. But all too many business owners ignore the warning signs until it's too late. Why? Because for most businesses, things don't usually go wrong overnight. Costs rise gradually; revenues slowly drift downward. By the time the warning bells go off, they don't have time for a simple fix. You should revisit your business plan — namely the financial plan you have in place — at the first signs of a profit squeeze. See Chapter 11 for more information on financial statements.

Company Morale Slumps

The morale of the people who work for you is critical to your success. If morale slumps, you may see productivity and quality decline as well. If matters begin to deteriorate, people start leaving. If the problem is truly serious, your best workers start heading out the door. At the first sign of grumbling among your staff, talk to the key people around you and find out exactly what's wrong. Perhaps your planned goals and objectives are unreasonable, which creates frustration rather than motivation in the company. Subordinates see problems and wonder why you aren't addressing them aggressively. Or maybe your employees see a mismatch between your stated mission and your plan of action, creating confusion and indirection. Perhaps you don't have procedures in place to recognize and reward a job well done.

Review and revise your plan to calm the company waters — and be sure you communicate to the staff that you are aware of the situation and are taking action to make improvements. Check out Chapters 16 and 17 for new ways to communicate your business plan and motivate your employees.

Key Financial Projections Don't Pan Out

Face it: Predicting the financial future of your company is part science and part guesswork. Plenty of situations can come out of the blue to disrupt even the most conservative financial projections. If your projections begin to look a little wobbly, don't wait until they topple. Sit down with your key staff members to review all the assumptions that went into your original projections and make a detailed list of the things that may change your forecasts. Work up a revised set of financial projections based on the new reality. If necessary, revise your action plan as well. For more info on how to create financial projections, see Chapter 12.

Too Much Growth, Too Fast

You don't hear anyone complaining if your business is booming. But many business owners don't realize that companies can grow too fast — and that can spell trouble if they haven't prepared. Product quality or customer service can suffer, for instance, or manufacturing may not be able to keep up with demand. Employee burnout follows. Some companies even find that their basic organizational structure no longer fits their new size. If you experience similar growing pains, look at your business plan to identify the parts that need to change in order to accommodate the good news — and your increasing size. See Chapter 15 for information about how to best manage your company growth.

An Unwanted Surprise Pops Up

All of the signs described in this chapter are important and should be tracked and managed. But there's one more that simply can't be avoided: Your share price suddenly tanks (if you're a publicly traded firm) or your business goes into the red (that is, costs exceed revenues). This is a three-alarm fire that needs immediate attention. Sometimes, of course, a negative earnings report is expected and even built into your business plan, typically at early stages when the firm is fighting to get a foothold and survive. Investors know this and factor it into their own evaluation of how you're doing.

REMEMBER

But it's when the red ink is a surprise that the red flags go up and alarm bells ring. If this does happen to you, for whatever reason, you need immediate triage. Investors need to be contacted; managers and staff at the firm informed; and perhaps customers and suppliers reassured. Any time lag in getting the news out only multiplies the worry among your stakeholders. And, when you have a clear sense of what caused the surprise, you obviously need to revisit your business and make appropriate changes. Pronto.

IN THIS CHAPTER

- Looking over the planning you've done
- Making the necessary changes to your business plan

Chapter 19

Ten (Or So) Questions to Ask about Your Plan

The planning process is done. Your plan is ready. Or is it? Before you unveil the final draft of your business plan, ask yourself and your trusted advisors the simple but important questions in this chapter.

Are Your Goals and Mission in Sync?

The goals you set for yourself are the results that you absolutely, positively intend to achieve. To a large extent, your goals determine how you set priorities and how you run your company. (They also play a big role in your success.) Your goals have to be consistent with one another so that you don't run in different directions at the same time. In addition, your goals should be tied to your company's mission so that you always head in the right direction. For more info on your mission and goal setting, flip to Chapter 4.

Can You Point to Major Opportunities?

Opportunity only knocks once, the saying goes. So you need to hear the knock when it comes. Your business plan should highlight the major opportunities that you see heading your way (in technology, markets, or distribution, for example) and outline the actions that your company intends to take now to be in a position to take advantage of those opportunities down the road.

TIP

Have a trusted associate or acquaintance read your forecast to see whether the same opportunity seems to jump out. Chapter 5 talks about ways to spot business opportunities.

Have You Prepared for Threats?

You may be tempted to put on rose-colored glasses and see a bright and sunny future ahead. Now's the time to take those glasses off and get real. Your plan stands a better chance of success if you paint an objective picture — including the bad news along with the good. That way, you're prepared for the imminent dangers that come with starting a business. Make sure that your business plan acknowledges the biggest threats that loom on the horizon (a market slowdown, new regulations, or increasing competition, for example) and offers concrete ways to prepare for them. Chapter 5 points out how you can identify and prepare for threats. If you recognize threats before your competition does, you can often turn a threat into a real business opportunity.

Do You Know Your Customers?

REMEMBER

Customers are the lifeblood of any business. The more you know about your customers — who they are, how they act, and what they want — the more you know about your company. Customers tell you how to succeed in the marketplace. Your customers are so important to your company that you can't afford to leave them out of your business plan. You should answer three questions:

- Who is buying?
- What do they buy?
- Why do they buy?

Your plan should explain how your company intends to serve customers better than any of your competitors. Check out Chapter 7 to get better acquainted with your customers.

Can You Track Your Competitors?

Your competitors are around to make life interesting. They always try to woo your customers away, promising products or services that have better value (more benefits, lower prices), and you can't ignore them. You have to be able to identify your competitors — how they do business and where they plan to go in the future. Competition represents a big piece of your business environment. Your business plan should cover what you know about your competitors and — more importantly — how you intend to keep track of them on an ongoing basis. Chapter 8 talks about the methods you can use to keep an eye on the competition.

Do You Know Your Strengths and Weaknesses?

Business plans typically concentrate on a company's strengths. Yes, they're worth boasting about, but you also need to consider your weaknesses. You may find it hard to be objective in making an honest assessment of what your company does well and what it can do better. But your company's strengths and weaknesses determine your odds of success as you look ahead. Strengths and weaknesses refer to your company's capabilities and resources — how well they match up with the capabilities and resources that you need to have in place to be successful.

In your plan, list your company's capabilities and resources — from management skills or research expertise to operations and distribution strength or a loyal customer base. But be sure to describe how each of these capabilities or resources is either a strength or a potential weakness, given your business situation and the industry in which you compete. Turn to outside people if you need objective feedback. Chapter 9 helps you discover your company's strengths and weaknesses.

Does Your Strategy Make Sense?

Sure, you should know where you want to go, but you also need to know how to get there. Strategy is what makes your business plan happen. Make sure that your business strategy pulls together your company's strengths and weaknesses, the opportunities and threats that your company faces, and your business goals.

It should be clear, from beginning to end, that you base your business plan on an overall strategy that makes sense. Your company should have a strategy that you ground in reality and that makes reasonable assessments and assumptions about what's happening and what's about to happen — a strategy that logically and rationally looks at what you can accomplish and how long it may take. Flip to Chapter 14 for more information on strategy.

Can You Stand Behind the Numbers?

Too many high-flying companies have come crashing down in recent years, victims of unrealistic and sometimes even phony numbers on the balance sheet. Make sure the numbers you outline are rock solid. Think of all your financial statements as your company's report card — one that answers some big questions. Do your customers love you? Are your competitors afraid of you? Are you making the right business choices? An income statement presents the bottom line, the balance sheet shows what your company is worth, and the cash-flow statement keeps track of the money.

Your current financial statements tell everybody how well you're doing. But many people are more interested in your financial forecasts, which say what you expect the numbers to be in the future (these are your *pro forma* statements). Just because your forecasts include official-looking numbers, however, doesn't mean that the predictions will necessarily come true. If you want to paint an honest picture of your company, your business plan should include a realistic financial portrait, based on assumptions that you believe in and numbers that you trust. Chapters 11 and 12 paint a financial picture for you.

Are You Really Ready for Change?

Everything around you — from technology to competition and your market — is going to be a little different tomorrow, no matter what business you're in. To keep up, you have to think two or three steps ahead. You must look carefully and

continually at what may happen in the world and how it may affect your company. Although your business plan paints an honest picture of how you see your company, the plan should also acknowledge the fact that you don't have a crystal ball. So present some options. Include one or two alternative business scenarios, asking — and answering — the question, "What if . . .?" See Chapter 13 for more on scenario planning.

Is Your Plan Concise and Up-to-Date?

Ultimately, a business plan is a tool for communication. Make sure yours gets the important messages across. Your plan should certainly capture all the essentials about your company and its situation, but remember that none of the information can be of use to anyone if your business plan is too long, impossible to read, or outdated. So take time to read over your plan. Is it easy to understand? Is it easy to navigate? Do you know where to find all the details?

TIP

Have an advisor read your plan and ask the same questions. Objective feedback can provide you with invaluable perspective.

What's the Worst That Can Happen, and How Will You Deal with It?

REMEMBER

We've given you lots to think about in the warnings earlier in this chapter. But there's one more that should be on your list, and maybe at the very top: What is the one worst thing you can imagine that might happen to your business — and what's your plan to deal with it? This might be intensely personal to you, especially if you're still a relatively new and small firm: What if you are no longer in the picture tomorrow? What happens? Can anyone else step into your shoes and carry on? Other similar questions: What if your key customer drops you tomorrow? What if you get hit by a lawsuit by a customer, supplier, or anyone else tomorrow? What if a key supplier says it won't provide you any more goods? So ask yourself: What's the worst-case situation, and what's my Plan B?

IN THIS CHAPTER

- Reviewing the pitfalls to watch out for
- Fixing mistakes made in your plans
- Including planning tasks you've neglected

Chapter 20

Ten (Or So) Business-Planning Never-Evers

This chapter lists ten (or so) of those easy-to-make, "I can't believe I did that" planning miscues. We list them so that you have a better chance of not making these mistakes yourself. But if you happen to make them anyway, at least you know that you're not alone.

Failing to Plan in the First Place

We're probably preaching to the choir here, because you're already reading this book. But neglecting to plan is a business sin so grave that it always merits a short sermon. Planning isn't easy. After all, you don't come across any right or wrong answers, and nothing's guaranteed. But the planning process leaves your company better prepared to face an uncertain future.

Although a business plan may not solve all your problems, it helps. Planning makes you a better manager and makes your company, no matter how large or small, more competitive and more likely to succeed over the long haul. And in case you need a cross-reference to a chapter with more information on the business plan, we suggest you read, well, this entire book.

Shrugging Off Values and Vision

Perhaps you find it invigorating to jump right into the thick of things. You're itching to line up your products and services, seize the opportunities in front of you, and face down your competitors one by one. This situation is the business version of a roller-coaster ride, and we can't deny its appeal: ups, downs, and hairpin corners. But roller coasters end up right back where they start — and so will your company, if you don't stand back and spend some time on the values and vision that set you off in the right direction.

REMEMBER

You set up your company's values and vision statements to remind you where you want to go and what you want to become. Together, these statements are your business compass, so you don't want to start your journey without them. Check out Chapter 3 to put together your statements.

Second-Guessing the Customer

Everybody knows the cliché "The customer is always right." Well, it isn't considered a cliché for nothing. Whether you're trying to satisfy an individual customer face-to-face or attempting to figure out what an entire segment of the market needs and wants, you ignore what customers tell you at your own peril.

REMEMBER

This idea seems so obvious that we hardly find it worth repeating. But you may be surprised by how many companies approach the marketplace with a "We know just what you're looking for" attitude. Just remember that if you don't listen to your customers, your competitors will. Chapter 7 gets you closer to your customers.

Underestimating Your Competition

Sometimes you can get so involved in working on your own product or service that you forget the other people out there who are working to develop and market the same product or service. As the competitive heat intensifies in your industry, your competition gets smarter and grows in numbers.

Keeping tabs on your competitors is just as important as listening to your customers. After all, if you want to stay ahead of the pack, you have to know what the rest of the pack is up to. The more you know about your competitors, the better equipped you are to beat them at their own game. Flip to Chapter 8 for more competitive advice.

Ignoring Your Strengths

Why does the grass always seem a little bit greener in the other company's yard? It usually isn't all that green when you get up close and look carefully, of course. But you face a real temptation in the business world to think that other companies have all the right answers, the better way of doing things, and the correct approach.

Oh, you can always learn from your competition — no doubt about it. But what works for one competitor isn't necessarily the best way for you. So don't forget to catalog your company's unique strengths and use them to your advantage in the marketplace. Turn to Chapter 9 to spot your strengths.

Mistaking a Budget for a Plan

Putting together your company's budget is one of the most critical steps in the business-planning process. A budget, after all, is where you make all the really big decisions about how much money to spend and where to spend it. Your budget plays a large role in determining what your company plans to do in the months and years ahead.

But don't ever mistake your budget for your business plan. The bulk of your plan is all the work that you do up front, before you begin to put your budget together. All the analysis of your industry, customers, competitors, and yourself helps ensure that your financial decisions are the right ones — the ones that move your company closer to your larger business goals. Chapter 12 provides tips on putting together a budget.

Shying Away from Reasonable Risk

Some people jump out of airplanes; others refuse to ride a Ferris wheel. Some of us don't mind betting the farm; others have trouble buying a lottery ticket. But no matter how you feel about risk, no business venture is risk-free, especially in today's competitive markets.

Doing business means taking risks, and creating a business plan can help manage those risks. Don't shy away from making a bold business move — after you do your homework, assess the risk, and deem it a reasonable step to take. A good entrepreneur is a reasonable risk-taker. Chapter 5 clues you in on how to maximize opportunities and recognize threats.

Allowing One Person to Dominate a Plan

TIP

Nobody has all the right answers (at least, no one we've met). So no matter how big or small your company is, don't create a business plan alone. Even if you're the only one running the show, get other people you trust involved in the planning process — at the very least, find trusted advisors to review what you've done and provide an outside perspective. (Flip to Chapter 1 for a discussion of who you should involve in your business-planning process.) If you run a bigger company, involve as many people with different points of view as you can in your planning process. The more viewpoints you get, the stronger your business plan becomes. Just be careful not to let the process become too democratic: Chaos doesn't promote progress.

Being Afraid to Change

All people end up making changes in their lives. Sometimes you don't have much choice in the matter. Most people, however, prefer to go on doing the same things that they've always done, especially if they do them well. Companies aren't much different. Changing the way that you do business or the kind of business that you do isn't easy, and change is particularly hard if you already enjoy success. But a good business plan alerts you to changes that your company should make before the industry, your markets, or your competition forces you to make them — changes that allow you to be more responsive to customers, more competitive, more efficient, and more successful and that follow the company vision. Chapter 13 starts you down the road of managing uncertainty, and Chapter 16 provides a concise model for how to do this.

Forgetting to Motivate and Reward

A business plan isn't useful if it never gets out of your head or off the page. Your business blueprint has to be translated into the efforts and activities of all the people in your company — and it has to make sense. Chapter 16 points out ways to bring your plan to life and communicate it to others.

You have to link your strategy to your vision; link your vision to the company mission; and link your mission to the goals and objectives that you set. Take these pieces of the plan and link them to the way in which you motivate and reward the people around you. Chapters 3 and 4 discuss vision, mission, and goals and objectives, and Chapter 17 points out ways you can become a more effective leader.

Faking It


REMEMBER

This may sound weird to you this far into our book. But if there's one overwhelmingly false move you should never make when it comes to both composing and communicating a business plan, it's this: Don't fake it. If you aren't going to take the assignment seriously, then don't do it at all. Because if you do, it will become instantly transparent to everyone who really counts in your audience of readers (or listeners). This includes key partners, colleagues, and financial supporters, current or potential. You might not think so, but they'll see through you like a freshly polished piece of glass. And you will have revealed something about yourself and your business leadership traits that you will likely never recover from. Integrity is earned, not given as a birthright.

Appendix

A Sample Business Plan

Sometimes, you must see something up close and personal before you really understand what it's all about. Viewing a real, live business plan should get you much closer to putting your own plan down on paper.

Your written business plan says something about all the important parts of your company. After all, you want to convince people — and yourself — that your company knows what it's doing. If you want to persuade people of anything, however, they have to actually sit down and read what's in front of them. You want to be clear, concise, and to the point, and it doesn't hurt to spend some time with your prose, either.

Here we show you a sample business plan. By reviewing the plan in some detail, you can learn a bit about how to construct a business plan of your own. We wish to acknowledge the generous cooperation of Mr. Kristian Groth and Ms. Cora Lucaz of Suite 07 for their willingness to offer this sample business plan for your perusal.

SUITE 07 BUSINESS PLAN

I. EXECUTIVE SUMMARY

Suite 07 intends to **solicit and establish a revolving private investment fund** of up to 200M DKK (Danish Kroner, approximately $31 million) that will enable it to expand its unique expertise and talent in the residential luxury real estate development market through a dynamic and innovative new business model. This model will **create superior financial and personal benefits for both its clients and investors.** These mutual benefits will be achieved through a comprehensive reimagination process by which Suite 07 purchases, renovates, and then sells or leases high-end prestige properties to a small and highly defined set of customers who currently have no available alternatives for their specialized shelter needs. Moreover, once buyers or renters take occupancy in these unique dwellings, Suite 07 can provide a customized package of private concierge services and benefits that sets the firm apart from all other competitors in the industry. Suite 07 will in effect create "signature" homes that define the structure as a unique, one-of-a-kind dwelling — and whose value will reflect that signature. Multi-family building units will be sold to individual buyers, or if the units are leased the entire building will be sold to institutional investment funds once an 80% rental threshold is reached. Suite 07's private investors will be rewarded from the proceeds.

The result will be superior financial yields for those special investors of refined taste who value distinctive assets, and a transformative lifestyle experience for clients seeking luxurious home environments unavailable from any other sources currently operating in the market. This investment opportunity will not last long as we believe there will be strong initial demand for such a unique concept. The luxury real estate market presently is ripe for such a disruptive new model, and Suite 07 is the perfect vehicle to bring this to fruition. The rationale for this conclusion is detailed below.

II. COMPANY OVERVIEW

Suite 07 is a property development firm engaged in architectural renovation, construction management, interior-exterior design, decorating, and property management catering to high-end residential home buyers and renters in the European single and multi-family housing market. The firm was started in 2017 in Copenhagen, DK where it is currently headquartered and has completed several highly successful home renovation projects in that city since then. Suite 07 will

transition its headquarters operations to Milan, IT in 2021 in order to establish itself in the acknowledged heart of the European home design and decoration market. While it will continue to focus on Nordic region projects for the coming two to three years, Suite 07 intends to create a foothold in selected major cities in the wider European theatre, and eventually plans to extend its capabilities into the large and lucrative US marketplace within five years.

III. BUSINESS ENVIRONMENT

1. THE MARKET

Market conditions for the aspirations of Suite 07 in the luxury housing segment are at the moment highly favourable. Moreover, there are strong indications that these conditions will remain in place for some time into the future. While the Covid-19 pandemic has created serious financial problems for many people in many parts of the world, a recovery does seem likely and underway. Moreover, those in the higher end of the wealth and income spectrum have fared far better than most during the health crisis. Savings rates are at all-time highs, interest rates are historically low, and upscale buyers have a very positive outlook. This is in conjunction with very low levels of inventory in the luxury housing segment. Combined, the result is a once in a generation opportunity for value creation by those firms best positioned to provide the market with what it desires. We believe that Suite 07 is clearly the top candidate to achieve this today.

Housing is one of the fundamental requirements of people everywhere: food, clothing, and shelter are always invoked by social psychologists as the three primary "needs" of all peoples, in comparison to aspirational "wants." These needs, of course, apply to the world's wealthy as much as anyone else. This segment, however, is much better positioned than most to indulge its dreams and fantasies in terms of housing — to fulfil aspirational wants. Suite 07 is not nor ever will be a mass market supplier; rather, it has positioned itself squarely in the "class" sector of the housing market — a position which it intends to develop vigorously as the firm evolves and grows over the next five years (2022–2026).

There can be no doubt that the universe of wealthy clients for high-end luxury real estate has grown substantially in the recent past. For a number of economic as well as political reasons, the rise of the "1% class" of the world's citizenry has been dramatic of late. While this trend has been observable for decades now, its pace has accelerated impressively in the past five to ten years. This trend is one that Suite 07 is perfectly positioned to exploit.

Overall, the luxury real estate market in Europe has expanded vigorously since the end of the Great Recession of 2008–2009. This region has experienced the highest growth in high-net-worth individuals compared to all other regions of the globe (HNWI — those with more than $1M in assets). For ultra-high net worth individuals, Europe again has an impressively large number of representatives in this segment, nearly 60,000 as of 2020 (UHNWI — those with more than $30M in assets). Buyers domiciled in Western Europe and Russia were the largest component of both these groups who were considering purchase of luxury property in Europe over the past five or so years. Additionally, and despite the distances involved from their home countries, an increasing number of Asian buyers are entering the European market as well as some from North America. Not only are these buyers attracted by the unmatched intangible historical value of the Euro region, but also rising economic and political tensions in these buyers' home regions are likely to result in an expansion of potential customers for the offerings of such firms as Suite 07.

The initial target market for Suite 07 is the Nordic Region of northern Europe. These nations — Norway, Denmark, Finland, Sweden, and Iceland — with a combined total population of approximately 28 million — have traditionally had economically vibrant middle classes with low levels of both poverty and wealth at the extremes. As such, these countries have long been characterized by their relatively narrow distribution of wealth among citizens — that is, there is not a sizable difference between rich and poor as is found in most all of the other advanced economies of the world (this is confirmed by Gini coefficient data).

However, while this is certainly true, market data supports a strong and continuing demand trend in the high-end real estate market that extends not only to Europe in general but also to the Nordic Region specifically. Suite 07 at this point is targeting the niche markets of Denmark and Norway.

The combined population of these two countries is slightly greater than 11 million. The largest cities in each — Copenhagen and Oslo — together have approximately 2.4 million residents. The combined number of households in the two nations is 5.2 million (2.7 in Denmark, 2.5 in Norway; this compares, for example, to 5 million households in Sweden, 8 million in the Netherlands, and 41 million in Germany).

In Denmark 61% of citizens own their own homes, and 77% in Norway. The remainder are renters or transients (such as students). European nations are among the oldest average populations of all nations in the world; Denmark and Norway, with an average age of 42 years each, are no exception. Given the population trends of both countries, household size averages only 2.1 individuals for the two nations.

Both Denmark and Norway are above global averages, however, in terms of individual wealth. For median wealth per adult, Denmark ranks 6th in the world ($377K p/c) and Norway 15th ($276K p/c), according to 2020 data. The number of millionaires in Denmark is estimated at 307,000, and at 177,000 in Norway. Both countries are projected to see sizable increases in this demographic over the coming five years.

Suite 07 will use a very conservative 1% target of potential high-end customers in the metropolitan areas of Copenhagen and Oslo for market penetration projections. This percentage yields a market of approximately 25,000 individuals and 12,500 households. Annual residential migration is estimated at 10% of this number (again a conservative estimate); this yields a total of 2,500 potentially addressable clients per year, or 1,250 households who are in the market annually for luxury housing accommodation.

If the migration percentage is reduced by half, to 5%, the addressable market is still over 1,200 people and over 600 households. (We should also note that these target audience estimates do not consider in-migration by ex-pat buyers from other nations. While the absolute numbers are likely low — perhaps 100 to 200 individual buyers annually — they nevertheless expand the universe of potential buyers that Suite 07 can serve.)

Suite 07 will strictly avoid the mass market and specifically target only this narrow sliver at the top end. Based on the data above, the firm **approximates that 800 to 1,000 single-family homes and luxury apartments in the combined Danish and Norwegian marketplace constitute the addressable market for Suite 07 per year over the coming five-year period.**

Furthermore, it is projected that Suite 07 can capture between 5% and 10% of this cohort annually, or approximately 50 to 100 customers. While Suite 07 does not intend to service this volume of clients initially, the total is indicative of the specific market potential for Suite 07 at both this time and the near future. It provides a large enough pool of applicants for the firm to be selective in who is given access to its offerings, as well as to generate a sufficiently high scale to validate revenue and cost projections. Moreover, as Suite 07 further enhances its image, expands its word-of-mouth reputation through social influencers, and scales its capabilities, it will be able to capture a larger share of this market. Controlled growth is definitely an objective of Suite 07 and all available market data clearly indicates that the firm's projections are eminently achievable.

Wealthy Danes and Norwegians are aging, their family size is shrinking, and they are in search of new housing options. **In conclusion, this target market is well within the range necessary to achieve Suite 07's long-term goal of becoming the premier niche luxury housing supplier in the metropolitan Danish and Norwegian marketplace.** Everyone at Suite 07 is dedicated to achieving exactly that. This business plan will explain how this goal will be accomplished.

2. CRITICAL SUCCESS FACTORS FOR COMPETITORS IN THE LUXURY HOUSING MARKET

The ability to succeed in the luxury property development and renovation market is first and foremost a function of the professional design and construction skills of incumbents; the work they perform must be of the highest quality. **However, another success factor lies within an ability to access potential clients in this small niche segment of the housing market.** This capability is a function of marketing skill. If a firm has growth ambitions, it must rely on more than word-of-mouth testimonials from prior satisfied clients. **The ability to create a strong brand is very critical to success in the high-end luxury home market.** In addition to a past record of excellence, brand building can be accomplished through exceptional advertising, promotion, and public relations skill — knowing which media, including social media, are most opportune for the targeted market and knowing how to gain positive coverage in those media. This is a specialized capability, often dependent on time-tested relationships, that few construction and renovation firms can master easily.

An equally critical component for success in this narrow luxury market is the ability of a firm to cultivate and maintain ecosystem partnerships with companies whose own brands and stylistic reputations add to the overall ambience and perception of the final product. This includes suppliers of building accoutrements and fixtures, as well as construction materials. Many of these goods are simple commodities, but the best alternatives are highly differentiated. In some cases, these are one-of-a-kind works of beauty that cannot be matched. The willingness-to-pay factor is fundamental for clients in the high-end segment, and these buyers will not tolerate substandard results. Yet while buyers of top-end luxury properties expect the best, often they are unaware or unable to make appropriate choices themselves. The curation and selection of appropriate goods for the luxury home, therefore, is more an art than a science. As such, the ability of the property development firm to supply top-end fixtures, furnishings, and materials is critical. Only few individuals have the innate ability to grasp what works best in any given building design or concept question; formulas and algorithms do not work here.

The suppliers of these components, fixtures, and construction materials, in turn, desire that their products are featured in the highest quality and most stylistic homes. They too require an association with the best in order to enhance their own image and brand. **Accordingly, a builder-renovator who can create the appropriate symbiotic partnerships with this singular group of suppliers has a distinct advantage in the marketplace.**

3. THE COMPETITION

Barriers to entry in Suite 07's targeted market are relatively low. Construction firms can obtain a license to practice with relatively few problems. As such, Suite 07 would not be the only supplier of custom homes in its chosen markets. Indeed, there are likely more than 100 such competitors in Copenhagen and perhaps half as many if not more in the Oslo metropolitan area. However, the majority of these firms are one-person operators — that is, an experienced builder who utilizes a contracted crew of subordinates for the actual construction work. Most take on only one or two projects per year, and most of these builders focus only on new home construction; they do not provide architectural or home decorating services directly if at all.

Additionally, many operate in price ranges below the luxury home values of 6M DKK (c. $1 million) and up that Suite 07 targets. In summary, the luxury home building industry in the Nordic nations is fragmented and there are no dominant firms.

In the home restoration space, there are far fewer incumbents, and most are led by architects, few of which maintain in-house construction and remodel capabilities. These tasks are typically outsourced, and none of which we are aware provide interior design and decoration functions or post-sale benefits as an integral part of their portfolio of services. Representative example firms are Norm Architects and Vision Arkitekter in Denmark, and Design og Estetikk and LOGG Arkitekter AS in Oslo. These companies have fine reputations for their projects and have done admirable work. The large number of historic buildings, in Copenhagen especially, can keep these firms relatively busy. But again, it is a fragmented industry with no dominant incumbents.

Our conclusion is that not one of the potential competitors to Suite 07 can compare with the breadth or quality of services that the firm will offer. Suite 07 brings a superior new business model to the market that is tailored to the very specific needs of a tightly defined group of buyers; it turns the prosaic process of home building and restoration into an art form. **The unique capabilities of the principals of Suite 07 ensures that its offerings are highly differentiated from all other competitors in the market.** This is reinforced through the concierge amenities that will accrue to all Suite 07 clients — a benefit that no other competitor can offer. Given the limited scale of the market in both Copenhagen and Oslo, and the fragmented structure of competition, **Suite 07 should be more than able to achieve its conservative growth targets without triggering retaliatory measures by competitors or encouraging new entrants.**

IV. SUITE 07 — THE COMPANY

1. COMPANY PRINCIPALS

Suite 07 was established in Copenhagen in late 2016 by **Ms. Cora Lucaz (today age 39) and Mr. Kristian Groth (age 46).** Ms. Lucaz is the creative director and conceptual architectural designer; she served as the leader on the firm's first three highly successful renovation projects. Cora, a Norwegian citizen, moved from Oslo in 2007 to study at Denmark's School of Media and Journalism in Copenhagen. She subsequently worked as an executive with local television and online media firms in that city.

Suite 07's other co-founder is Mr. Kristian Groth, a Danish citizen. He was an investor in the firm for its first three projects and joined full-time as CEO in January 2020. He is a seasoned entrepreneur with more than 20 years of hands-on experience, having founded and managed a successful degree-granting executive educational institution in Denmark and later a professional networking organization with branches throughout the Nordic Region, among other businesses.

Cora, as artistic director of Suite 07, has responsibility for all aesthetic aspects of the firm. This includes property selection and renovation oversight, such as choice of suppliers, construction and fixtures materials, and interior design and design partners. Cora personally oversees the architectural and interior design of all of Suite 07's projects. Additionally, in 2021 she began Cora Lucaz Design, her own atelier for the production of lighting for the commercial market. This firm is based in Milan, IT. Ms. Lucaz will recruit and supervise the training and development of several apprentices, who will eventually assist her in design and other tasks associated with Suite 07.

Kristian is responsible for the business management responsibilities of Suite 07. These include financial oversight, investor relations, property sales and leasing, and management of the concierge services provided to all clients of the firm, both home buyers and renters. In all of these activities, Mr. Groth will be advised by the Investment Committee of Suite 07. This group consists of a small circle of highly skilled financial professionals with extensive past experience in real estate finance. The Committee will evaluate all projects undertaken by Suite 07 prior to their green-lighting and implementation.

Together, these two principals offer a unique combination of skills and qualities that will enable Suite 07 to create highly differentiated, profitable, and bespoke turn-key projects for the luxury housing market in the Nordic Region. As the firm expands, other talented staff will be added to the roster as needed. Ms. Lucaz and Mr. Groth, however, will continue to provide the day-to-day leadership and vision necessary to achieve Suite 07's ambitious goals.

2. VISION, MISSION, AND GOALS

The vision of Suite 07 is to transform the luxury home restoration process into an art form that creates lasting value for both current and future occupants. Quality will never be compromised under any circumstances, and only the finest craftsmanship and construction components and materials will be utilized. Both interior and exterior property design will reflect a refined taste that suits the desires of occupants as well as the physical environment in which the property resides; close attention to sustainability will be a feature in all projects. Suite 07 will become recognized as the premier supplier to the high-end segment of its target market. It will deliver to its clients "an eccentric form of luxury" available through no other firm.

The mission of Suite 07 is to develop and deliver high-end luxury turn-key housing projects to clients in an on-time and on-budget manner. This will result in supremely delighted clients and above average returns for investors.

The goal of Suite 07 is to achieve a reputation as the most admired provider of high-end luxury housing renovation projects in the geographic markets in which it competes. The firm will initially focus on select locations in the Nordic Region and will plan to expand the number of projects under management to five or more per year within five years (by 2026); this includes single-family as well as multi-family projects. Suite 07 will then expand its services to other European metropolitan areas, and later North America beginning with the lucrative California and South Florida markets.

3. RECORD OF PAST ACHIEVEMENTS

Suite 07 has developed and sold three projects ("cases") to date. All were successfully completed, with occupants expressing extreme satisfaction with their new dwellings and Suite 07's owners enjoying outstanding financial returns. A description of each project is shown in Appendix I; photos of the projects can be viewed on Suite 07's website: `www.suite-07.com`.

FINANCIAL SUMMARY FOR CASES I, II, III

Suite 07 generated extraordinary financial returns on its initial three projects. A summary of this reveals annualized returns of nearly 70%. While it cannot be expected that similar results will accrue from the firm's transition to multi-family housing projects, they nevertheless are indicative of the potential of the firm and its capabilities as it moves forward.

Average home size per project: 253.3 square meters (sqm)

Average acquisition cost: 10.40M DKK (41,058 DKK p/sqm)

Average renovation cost: 8.58M DKK (33,873 DKK p/sqm)

Average sales price: 32.20M DKK (127,122 DKK p/sqm)

Average sales *minus* cost = profit: 13.22M DKK (52,190 DKK p/sqm)

Average annual return per project = 69.5%

($1.00 = 6.395 DKK; 1 DKK = $0.156 [as of October 2021])

The accumulated experience of Suite 07's principals in completing these three projects has given them an advanced education in the inner workings of the luxury home market and the demands and desires of clients who seek purchases therein. This has confirmed the underlying concept of property development behind the firm and has shaped how Suite 07 proposes to go forward. Suite 07 will undertake renovations, remodelling, and in some cases new constructions based on a bespoke approach to all steps of the process. Further, this past success has demonstrated beyond doubt the soundness of the innovative business model that will be implemented going forward: **Suite 07 will sell the majority of its projects as complete and total interior and exterior turn-key propositions and will only undertake projects in which the principals have personally invested. This will guarantee that both the clients of the firm and its investors achieve full and complete satisfaction** (see Section VI Finance for details).

4. SWOT ANALYSIS FOR SUITE 07

STRENGTHS • Strong brand • Proven top management team — excellent skills, talent, record of past performance • Long-term cooperation with high-end suppliers and specialized craftsmen • Ability to secure best prices from partners • Entrepreneurial spirit — small, flexible, dynamic organization — no bureaucracy • Skilled and experienced Investment Committee	***WEAKNESSES*** • No experience in multi-family renovation and property development • Little management depth beyond top leadership team; high dependence on owners' reputations and continuing presence • Undercapitalized at the present time
OPPORTUNITIES • Outstanding market growth potential • Conditions ripe for industry disruption • Many investors looking for opportunities • Key cities in Europe and the US amenable to the Suite 07 concept • First mover advantages abound • Weak, fragmented competition	***THREATS*** • Economic downturn in target markets • Rising inflation in capital markets • Political upheaval threatens the "1%" class • Suite 07 principals undergo issues resulting in their absence from participation in work • Success puts pressure on the firm to expand too rapidly, enter down-market segments

While there are risks inherent in Suite 07's business plan, a fair and balanced evaluation of the SWOT analysis reveals that the firm's opportunities and strengths far outweigh all other factors.

V. SUITE 07's STRATEGY

Suite 07 will achieve its ambitious goals and objectives through pursuit of a disciplined strategy that leverages its competitive advantages and relies on three types of construction projects targeted to three distinct segments of buyers. These are detailed as follows.

1. PROPERTY TYPES

A. CATEGORY I: MULTI-FAMILY LARGE APARTMENTS FOR LET OR SALE

Suite 07 will identify and acquire larger residential properties that can be converted into five to ten apartments of a minimum of 200–300 square metres each (2,150–3,225 sq. ft.). Upon completion of renovations and recruitment of lease tenants, these properties will be sold to a long-term institutional investor; if the project is a condominium, the units will be sold to buyers. Suite 07 will develop a property management subsidiary to market and manage the apartments (or possibly contract with a highly regarded agency to undertake this task, either totally or partially). It is assumed that a minimum of 80% of available units will be let prior to sale of the building to long-term investors. All apartments will be let as turn-key on the basis of a multi-year lease agreement; since they are fully furnished, they can normally be let at a price 25%–35% above what non-furnished apartments generate. A unit of this category, in current and expected future market conditions, should generate a monthly rent of between 60,000 and 100,000 DKK ($9,500–$15,500) if the building is located in an acceptable district in Copenhagen (and comparative rents if it is in Oslo, though initially Suite 07 will limit its renovation of multi-family buildings to Danish locales). Units renovated for condominiums will also be sold as turn-key, that is, fully furnished.

The target buyer segment for Category I rentals is *Privileged Seniors* (described in Appendix II). These Category I units will come with mandatory "Suite 07 Private Concierge Privileges" which is included in the monthly rental fee (see Appendix III). Units sold as condominiums are TBD for inclusion in the concierge program.

B. CATEGORY II: MULTI-FAMILY SMALL APARTMENTS FOR LET OR SALE

These properties are similar to Category I as described above but targeted to a different segment of renters and are typically smaller in size. Buildings identified for renovation into Category II apartments will be converted into 10 to 20 units, each consisting of approximately 70–150 square metres (750–1,600 sq. ft.). These buildings too will be sold to long-term institutional investors once approximately 80% of units are let on multi-year lease terms. It is estimated that these units can generate a monthly rent, when fully furnished, of between 25,000 and 40,000 DKK ($3,900–$6,250) if the structure is in an appropriate Copenhagen district.

The target rental segment for Category II units is *Privileged Heirs,* and these buyers too must accept mandatory "Suite 07 Private Concierge Privileges," included in the monthly lease fee. (See Appendix II and III for details.)

C. CATEGORY III: SINGLE-FAMILY HOUSES FOR SALE

Properties that fall within Category III are similar to the three successful projects undertaken by Suite 07 in the past. If an appropriate single-family residence is identified that meets the firm's strict criteria for renovation, it will be purchased, remodelled, decorated, and furnished prior to sale. Normally such a home will be a minimum of 300–800 square metres (3,225–8,600 sq. ft.) and can be expected to sell as a turn-key property for premium prices.

The property will be sold to a buyer either directly by Suite 07, or to an investor when the renovation is finalized. Each case will be evaluated on its own merits. Buyers will be in the target group defined as *One World.* These individuals are described in Appendix II.

2. SUITE 07's COMPETITIVE ADVANTAGE

Suite 07 has several competitive advantages that will allow it to achieve its goals and objectives. While the renovation of historic buildings results in a physical good, to a large degree the **success of a firm engaged in this business depends on the brand it creates.** We believe that Suite 07 has the capability to develop the leading brand in its chosen market domain. This attribute will provide the firm with access to the limited set of appropriate clients that are targeted for its offerings. Moreover, Suite 07 will also serve its investors by assuring them that they are placing their trust in the best possible alternative for their financial choice in this asset class.

As was noted above, **a key to Suite 07's strength is its relationships with its ecosystem partners and suppliers.** In the relatively small world of luxury home fixture and furnishing companies, mere transactional dealings between clients are

insufficient for long-term success; greater person-to-person intimacy is required. Over the years Suite 07 has created not only professional but also personal relationships with some of Europe's leading firms within the building materials, craftmanship, and interior decoration segments. In addition, the firm has developed a strong relationship with international media which is of substantial benefit to our other strategic partners. Examples of the brands that respect Suite 07 and regularly work with it on projects are Gaggenau, Tai Ping, Baxter, Boffi, Living Divani, Michael Anastassiades, and B&B Italia. Suite 07 has also established relations with leading brokers and agents in the market; these intermediaries are often critical in ensuring that a firm can source just what it requires at precisely the time it is required. All these relations enable Suite 07 to contract at very favourable prices and terms.

Moreover, these strategic ecosystem partners also **visibly enhance the Suite 07 brand.** They value joint projects with Suite 07 because they realize that the firm truly understands what they do and acts as more than just a property developer, but also as a bespoke design studio itself. Suite 07 fully reinforces the standards and project environment with which they want to associate their products and services.

The result is that Suite 07 has a strong competitive advantage in its chosen market domain that competitors cannot match. This advantage stems from the idiosyncratic capabilities and skills of its principals, especially Ms. Cora Lucaz. She has spearheaded the creation of the Suite 07 brand and her continuing presence constantly strengthens it. The relocation of the firm's headquarters to Milan will work to make this bond even more durable. The deep experience of Mr. Kristian Groth as a successful entrepreneur provides Suite 07 with business insight and intuitive decision making that cannot be replicated by "textbook" learning. Together, the leadership team of the firm ensures a formidable bulwark against failure.

3. TURN-KEY ONLY PROPERTY DEVELOPMENT FOR LET OR SALE

A fundamental concept behind the Suite 07 approach to business is to sell or let the vast majority, if not all, of its projects on a turn-key basis. This means that all interior goods — furniture, lamps, textiles, art, accessories, everything — are included with the sale or rental. In previous projects it became apparent that target market clients would not even consider a purchase that did not include a turn-key basis. The firm's principals came to realize that prospective buyers of their properties were far more influenced by their emotional response to the offering than any "rational" financial analysis that they might undertake. Modern economic theory has validated this phenomenon with the admission that "behavioural economics" was the driver of much of people's decision-making. As this

observation sunk in, it became the foundation of the Suite 07 vision, and the key difference between it and all other property developers. Accordingly, the firm's leadership team has decided to work only on a turn-key basis because it is in this way that Suite 07 can differentiate itself in its markets. This approach leverages the unique talents and skills of Suite 07 and as such will become the firm's signature.

4. THE SUITE 07 LAB

The competitive advantage of Suite 07 is further enhanced by its novel "Suite 07 Lab." The Lab is a creative advisory board and "think tank" that brings together on a periodic basis a group of experienced influencers, investors, and industry experts who will meet and discuss issues of pertinence to the firm's development, vision, and its specific projects. As the occasion warrants, key Suite 07 partners and clients will also be invited to attend, to lend their own specialized knowledge and perspective to critical issues and events.

Participants currently enrolled in the Suite 07 Lab include:

- Mr. Carsten Bech, director, Institut for Fremtidsforskning (Copenhagen Business School)
- Mr. Anton Bilton, real estate investor and founder of Sabine's Club (Ibiza)
- Mr. Mikkel Bulow-Lehnsby, co-founder of real estate developer NREP (Denmark)
- Mr. Luca Finardi, CEO Mandarin Oriental (Italy)
- Ms. Ruth Hald, business psychologist (Copenhagen)
- Mr. Søren Johansen, attorney and Managing Director, Altor Equity (Denmark)
- Mr. Peter Kreiner, CEO of world-renowned Noma restaurant (Copenhagen)
- Mr. David Overby, Chairman of Solstra, private equity advisory firm (London)
- Ms. Pia Søltoft, professor of philosophy (Copenhagen)

(In addition, Ms. Lucaz and Mr. Groth serve as ex-officio members of the Suite 07 Lab.)

Other equally prominent members will be announced. Not only does the Suite 07 Lab provide beneficial guidance, but it also allows the firm to further grow its professional and social network and thus quickly expand current contacts into new markets. This will contribute to the firm's competitive advantage relative to its rivals in the industry.

5. SPECIAL ACCESS PROGRAM

Suite 07 intends to fulfil its mandate as a socially responsible partner in its communities by offering a select number of its apartment units to individuals at below market prices. Recipients will be selected for the program through a transparent process overseen by the Investment Committee. Criteria for consideration will be determined by the IC but will include factors that ensure an eclectic mix of residents in Suite 07 projects; these factors will include individuals drawn from the arts, social welfare organizations, the media, and academia among other professions. Through the recruitment and retention of such individuals as tenants in Suite 07 projects, the overall ambience and distinctive character of the buildings will be visibly enhanced and will also contribute to the firm's reputation as a socially responsible member of its communities.

VI. FINANCIAL PROCESS AND SAMPLE PROJECTION

1. SUITE 07 FINANCIAL STRUCTURE AND PROCESS

Suite 07 will incorporate as a registered Limited Partnership company (LP) in the relevant jurisdiction of its projects; Suite 07 will serve as the General Partner. It is anticipated that Denmark and/or Norway will be the initial geographies. Company principals will identify the first project, likely a multi-family renovation structure in Copenhagen. Due diligence will be conducted, including an assessment of costs for renovation; a project budget will then be determined. This will then be presented to the Suite 07 Investment Committee (IC) for review, revisions as needed, and approval.

Simultaneously, company principals and/or agents will solicit capital from private sources, who will become Limited Partners. Suite 07 will retain a minority partner with a suitable prior record in capital market networks to oversee capital acquisition; this individual will serve as chair of the IC. When secured, capital from the Limited Partners will be deposited into the entity; these Limited Partners receive shares in proportion to their cash contribution. All Limited Partners will be closely vetted to ensure they share the same vision for Suite 07 as does its founders. The firm intends that its property development activities reflect the unique character of the stated vision and mission — that is, financial returns will be superior to market but they will not override the dominant goal of building and sustaining the company brand. Investors who do not share this approach will not be solicited to participate.

The Suite 07 IC then approves and purchases the target property in the name of the LP. Suite 07 undertakes renovation, develops a marketing program for unit leasing, and begins solicitation of tenants as work progresses. Select real estate agents will manage unit leasing.

When the property reaches a threshold of approximately 80% leased units, the IC will negotiate the sale of the property to a long-term investor, such as a pension fund. The Limited Partners will receive a cash reward equal to their initial investment plus a prior agreed-upon incentive fee; any remaining funds will be distributed to Partners on a pro-rata basis and the entity will then be liquidated. New property development projects will emulate the model described above.

2. PRO-FORMA FOR A REPRESENTATIVE LARGE MULTI-FAMILY RENTAL APARTMENT COMPLEX

8 units average of 250 sqm p/unit =	2,000 sqm
15% common areas=	300 sqm;
TOTAL SQM =	2,300 sqm
Acquisition cost p/sqm = 30,000 DKK =	69,000,000 DKK
Renovation cost p/sqm = 25,000 DKK =	57,500,000 DKK
TOTAL COST =	126,500,000 DKK

20% equity investment by LLC partners = 25,300,000 DKK

80% LTV = 101,200,000 DKK at 3.14% fixed rate for 30 years (360 monthly payments)

Principal + Interest = 434,000 DKK p/month × 12 months = 5,208,000 DKK p/a

Rental income p/unit 100,000 DKK × 8 units = 800,000 DKK × 12 months = 9,600,000 DKK

Costs (maintenance, insurance, tax, utility, concierge service, etc.) = 15% of rental revenue = 1,440,000 DKK

Net Operating Income (NOI): 9.60M DKK – 1.440M DKK = 8,160,000 DKK p/a

Capitalization Rate: 8.16M DKK / 164.500M DKK = 5.0%

Debt Service Coverage Ratio (DSCR): 8.16M DKK / 5.208M DKK = 1.57

Property Value (NOI/Cap Rate): 8.16M DKK / 5.0% = 163.2M DKK Year 2 valuation

ROE for LLC Partners: 40.8%

($1.00 = 6.395 DKK; 1 DKK = $0.156 – October 2021)

DETAILED FINANCIAL PROJECTIONS FOR A TYPICAL MULTI-FAMILY RENTAL PROPERTY

Grundvigsvej 14, 1864 Frederiksberg, Copenhagen

Purchase Property			square meter	Purchase	With Conversion
Building 24			640	28.000	17.920.000
Building 25			488	28.000	13.664.000
Commercial space (in basement)			117		
Roof: 204 can be utilized/ 104 OK			104	20.000	2.080.000
Basement (laundry, fitness room, etc.)			354		
				-	-
					-
SALES PRICE (including VAT [Value Added Tax] 25%)			1.703	19.767	33.664.000
Cost to purchase					
Cost to purchase (without VAT)					33.664.000
Registration fee	1.750	0,6%			203.684
Legal fee					50.000
VAT				25,00%	
TOTAL PURCHASE COST					33.917.684
Construction Cost					
Land inspection fee					-
Architect fee					500.000
Engineer fee					500.000
Suite 07 development fee					1.000.000
Construction manager fee - 12 months @ 30.000 DKK p/m			project/construction		360.000
VAT				25,00%	590.000
PROJECT PRO-FORMA COST					2.950.000
Construction cost - common room			104	17.000	1.768.000
Construction cost - housing			1.128	6.000	6.768.000
Construction cost - basement, laundry, etc.			354	16.000	5.664.000
Gårdrum			1.400	400	560.000
Furnishings - common rooms, etc.					400.000
New roof and about 70 new windows					2.990.000
Contingency				5%	710.000
Electric connection fee	painters		21	5.000	105.000
Water connection fee					-
Sewer connection fee					-
Local district heating connection fee					-
					-
VAT				25,00%	4.741.250
TOTAL CONSTRUCTION COST					23.706.250
Calculation contingencies					

The Rental Option - Pro-Forma				
	Units	DKK sqm	Rent	Amount p/m'th
		640	-	
		488	-	
rent + club fee		104	-	
	31	4.250	5.236.000	14.075
	31	487	600.000	1.613
			-	
TOTAL RENT			5.836.000	
Cost				
Taxes			120.000	10.000
Insurance			18.000	1.500
Mintenance			136.240	11.353
Elec. + water			35.000	2.917
Administration			121.094	10.091
Caretaker heating			60.000	5.000
Concierge program			360.000	30.000
Cleaning service			240.000	20.000
Events-entertainment			120.000	10.000
Hospitality Assistance			240.000	20.000
Food and health services			120.000	10.000
			-	
	1.275	1.232	1.570.333,75	130.861
Interest			4.265.666	
			-	
Acquisition Cost			62.545.664	
			-	
Renovations	65%		40.654.682	
Pre-paid deposit			2.618.000	
			-	
Net investment			19.272.982	
			-	
Interest and contributions		1,00%	406.547	
			-	
Profit after interest			3.858.119	
			-	
Return on property			6,82%	
Return on invested capital (ROIC)				
DKK/sqm buidling exclud. Business			50.768	
DKK/sqm buidling includ. Business			36.727	

Property tax + 1 year insurance				140.000
Construction power cost				50.000
Bookkeeping fee				-
VAT			0,00%	-
TOTAL OPERATING COST				190.000
Broker sale (1% of sale price)	no sale but rental		1%	-
Attorney sale	no sale but rental			
VAT			25,00%	-
TOTAL SALES COST				-
Cost to purchase property (no VAT)				33.917.684
Total renovation cost including VAT				26.846.250
Deferred tax (lowers financing cost)				-
TOTAL COST (including VAT)				60.763.934
Stamp cost (there is a mortgage deed on the property)	40.000.000	1.730	1,45%	581.730
Stamp cost	0			-
TOTAL COST				61.345.664
Property loan + PIN + development	40.000.000		3,00%	1.200.000
Additional rental income				
FINANCE COSTS				1.200.000
				-
				-
TOTAL COST (incld. Interest for construction period)				62.545.664

Foundation company	25.000.000
Foreign construction	40.000.000
	65.000.000

The above data represents a financial analysis of a multi-family residential complex currently under review by Suite 07 for acquisition. It is located in an excellent district in metropolitan Copenhagen, and the calculations are estimates based on an analysis of current 2021 economic values in the region for high-end multi-family rental properties. As such, it is representative of the investments that Suite 07 intends to undertake to achieve its goals.

3. PRO-FORMA FOR A REPRESENTATIVE LARGE CONDOMINIUM COMPLEX

8 units average of 250 sqm p/unit =	2,000 sqm
15% common areas =	300 sqm;
TOTAL SQM =	2,300 sqm

Acquisition cost p/sqm = 30,000 DKK =	69,000,000 DKK
Renovation cost p/sqm = 25,000 DKK =	57,500,000 DKK
TOTAL COST =	126,500,000 DKK

20% equity investment by LLC partners = 25,300,000 DKK

80% LTV = 101,200,000 DKK at 3.14% fixed rate for 30 years (360 monthly payments)

Principal + Interest = 434,000 DKK p/month × 12 months = 5,208,000 DKK p/a

Average unit sales price: 80,000 DKK p/sqm × 250 sqm = 20,000,000 DKK

Total sales revenue: 8 units × 20M DKK = 160,000,000 DKK

Estimated promotion, sales, misc. expense: 16,000,000 DKK

Gross return to LLC partners: 17.5M DKK

ROE: 69%

($1.00 = 6.395 DKK; 1 DKK = $0.156 – October 2021)

VII. ACTION PLAN AND NEXT STEPS

1. PROPERTY ACQUISITION

Suite 07 management will commence a search for suitable properties that meet criteria described in prior components of this business plan; simultaneously, the Suite 07 Investment Committee will begin its capital acquisition process for the first LP project, seeking approximately 200M DKK. In general, the firm will target only premium locations and buildings in designated metropolitan areas, depending on which Target Group is in focus (see the example above). In keeping with Suite 07's stated vision, only properties that are of historic character and charm are targeted for acquisition; these are properties with specific architectural qualities and potential. Suite 07 works closely with real estate brokers, agents, and a wide network of other sources to obtain such properties at the most advantageous prices. This network also ensures that the firm is first in line to obtain the true gems that come up for sale only on rare occasions.

Suite 07 will begin execution of this business plan by locating potential projects in the Copenhagen K sector for Target Group I rental prospects (see Appendix II for details on this cohort). Specifically, this encompasses the Frederiksstaden sector of the city. The firm seeks entire apartment buildings as well as single-resident villas, but only if they meet company standards; this implies a building constructed prior to 1991, not listed and not subject to city rental regulations. Given that market data suggests Target Group I buyers are currently under-represented in Denmark, Suite 07 believes there is potential for only one larger property of this type in Copenhagen at this time. (It should be noted that firm management will not prioritize renovations of single-family houses in Copenhagen at this time.)

For Target Group II renters, Suite 07 seeks unique commercial buildings in the entire Copenhagen area where logistics and appropriate commercial surroundings are already in place. The Norwegian market is also under consideration, specifically in certain areas in Oslo Vest which the firm has explored in detail over the prior two years. Suite 07 seeks single apartments, entire apartment buildings, and townhouses that meet the firm's strict building style and design criteria; strong relationships have been built with property agents in this market and the firm is assured a first-look on appropriate projects. At this point, both Target Group I and II renters are under consideration, depending on property specifics.

Suite 07 will only be involved in a single renovation or development project in one city at a time. This is to minimize risk in cost and time. As Suite 07 gains greater experience in the renovation of multi-family structures it will then expand its

portfolio of projects. At this point the firm will limit the amount invested to a maximum of 400M DKK ($62 million) allocated to a maximum of two properties. This will ensure that the strategic focus and high quality that characterizes the Suite 07 brand is maintained and strengthened.

2. BRAND BUILDING & COMMUNICATION

A key element of Suite 07's action plan to implement its long-term strategy is the ongoing reinforcement of the firm's brand. This will involve, for example, a deepening of Suite 07's Instagram profile which has proven to be a favoured platform for home decoration enthusiasts. The Suite 07 Instagram site features Ms. Cora Lucaz and her growing influence in the upscale home design and decoration marketplace. Her profile will be further enhanced through exposure in relevant print media, design houses, and with other business partners as well as respected influencers. A model for this approach can be found with Martha Stewart, Rihanna, or Diane Von Furstenberg. All of these women have achieved international renown through strategic marketing, which has demonstrably enhanced their ability to extend their influence in product and service arenas beyond their initial fields of practice.

To achieve this goal, Suite 07 will engage with an international PR and communications agency responsible for marketing Suite 07 as a top-tier brand associated with only the best possible media partners. This exposure, however, will not be attained through direct advertising; the firm will build its brand through more subtle means. Suite 07 does not now or ever in the future contemplate becoming a mass market firm. It will strictly limit its size to ensure its exclusivity and sense of uniqueness with purchasers of its offerings. Suite 07 has a clear strategy for development of its brand in new geographic venues; this strategy will be continuously refined on the basis of the experiences encountered.

3. GEOGRAPHIC EXPANSION

The Suite 07 business plan contemplates that over the coming five-year period, the firm will have completed and sold two properties in Oslo to Target Group I and II buyers, and one in Copenhagen. Suite 07 will simultaneously expand its geographic footprint through a search for appropriate properties in other large metropolitan areas in Europe, such as Stockholm, Berlin, or Milan and where target groups of Suite 07 clients appear to be available.

In 2021 Suite 07 relocated its main office to Milan to further strengthen its position in the international design industry. This move will further develop key contacts with partners to support the brand that is being created around Ms. Cora Lucaz. In the future Suite 07 will also undertake investments and obtain projects

outside Europe, principally in California where market data suggests a tight fit between the firm's vision and mission and the desires of large numbers of target group clients currently residing in that venue.

After 2026 the ambition is to move Suite 07 headquarters to San Francisco or south Florida where a larger pool of potential projects for the firm's target groups resides. Suite 07 will always be a smaller niche property development firm with as few permanent staff as possible and using the best possible partners on a freelance or project basis. Suite 07 will not pursue growth targets that draw it away from its areas of competence or that in any way might compromise the company brand of exclusivity and singularity. Ms. Lucaz and Mr. Groth will remain as the leadership team throughout this period, and beyond.

CONCLUSION

The time is right for a new property development business model and Suite 07 is the right firm to accomplish this. A convergence of trends — economic, demographic, social, cultural, and political — all point to a growing desire for a new form of lifestyle for those situated in the luxury end of the housing markets. Moreover, the recent global pandemic has altered the residential agenda of millions if not billions of citizens; the home has become the centerpiece of their lives far more than the workplace or other external venues.

This group of people wants comfort, style, grace, and an ambience in their life that distinguishes them and their prior accomplishments to their family, friends, colleagues, and acquaintances. Many have devoted the bulk of their past energies and efforts to earning their place in the current economic pyramid, but did not have sufficient time to engage in the pursuit of other aspects of life that now intrigues and compels them. Today, with economic resources in hand, they are currently seeking something different, something better, something to establish their legacy. This group of people is relatively large and they have the capability to fund their dreams.

Suite 07 is best suited to meet the demands of this extraordinary group of clients. Its signature homes will be unmatched by any other supplier in the market, and the firm will be defined as a creator of works of art. Suite 07 is perfectly positioned at the crossroads of client aspiration and organizational capability. For both potential customers and investors, it could well be the opportunity of a lifetime.

APPENDIX I

Suite 07 has developed and sold three projects to date. All were successfully completed, with occupants expressing extreme satisfaction with their new dwellings and Suite 07's owners enjoying outstanding financial returns. A description of each project is shown below; photos of the projects can be viewed on Suite 07's website: `www.suite-07.com`.

CASE I: "The Swan" (2016–2017)

The initial Suite 07 project was an aged and run-down villa in an upscale Copenhagen suburb. The home was 265 square metres plus 146 square metres of basement, comprised of separate apartments. The interior of the property was totally gutted and renovated into a single-family dwelling. The garden, garden house, terraces, walls, and garage were also redesigned, and the outer walls completely refurbished.

After one year construction was completed. Ms. Lucaz then turned her attention to a complete make-over of all interior spaces, including furniture, fixtures, floor coverings, paint, and wall art. The exterior portions of the property were also upgraded, including gardens and outbuildings. The home was put on the market and sold, as a turn-key private sale, after just one viewing, at a record price per square meter for the area. The new owner expressed extreme joy and happiness with his family's new dwelling.

CASE II: "The Garden House" (2017)

Suite 07's second project was renovation of a small apartment and garden in an historical structure located near the Royal Palace in Copenhagen. When Suite 07 purchased the property, it came with ready-made plans for a renovation. However, Cora completely reworked the design and transformed the interior 100%, including the addition of more space.

Once the renovation was completed, Suite 07 contracted with a digital design firm to create a 3D rendering of the property, an innovative marketing technique at that time. A broker was given exclusive sales rights and the home sold privately after its first showing, with no public advertising and at full price, as a second in-town home for a rural Danish resident. This sale also set a record for the highest square metre price in Denmark.

CASE III: "The Italian" (2020)

Suite 07's third project was the transformation of a large home originally built in 1908 that had since fallen on hard times. It was a two-apartment dwelling when acquired, with much of the 553 sqm being unused. Moreover, it was in a neighbourhood undergoing gentrification. Ms. Lucaz immediately spotted the innate potential, however, and undertook a total redesign and refurbishment of the property. After only six months, the home was brought back as a four-floor single-family residence with a completely modernized infrastructure and amenities. The new interior design, including all furnishings, was stunning, as were the redesigned gardens, garage, hedges, terraces, and outer walls.

The final result was featured in the Danish luxury housing media as well as in international publications and websites including *Architectural Digest* and *Elle Decoration;* these contacts were made possible through Ms. Lucaz's growing network of influentials in the industry. While this property took slightly longer to sell given its transitional location, it ultimately was sold turn-key at a very favourable price by the acclaimed luxury brokerage Sotheby's International. The Italian was one of the first properties ever sold by this firm in Denmark.

APPENDIX II

TARGET GROUPS FOR APARTMENT RENTALS AND SINGLE-FAMILY HOMES

TARGET GROUP I: "Privileged Seniors"

"Privileged Seniors" are affluent citizens in the age group of 45 + who wish to live in the city, close to cultural institutions, restaurants, and the amenities of upscale urban life. They may want to leave their current house after their children have moved out. They want to enjoy the financial resources they have accrued and partake of the dividends of a "second youth" that is now available to them.

With the absence of children and the chores necessary to maintenance of a large private home, this target group now desires to experience a more self-centred life where there is time for new hobbies, an expansive social network, travel, and the fulfilment of novel dreams and aspirations. This group is very specific about what and how it wants one's surroundings to reflect earned status at this stage of life.

This target group prioritizes investment in a property with the best location and it values high quality rather than mere residence size. Scandinavian home buyers typically expend a higher percentage of disposable income on residential investments, and this Privileged Seniors cohort can be expected to do the same. Moreover, the choice of a home is typically more of an emotionally driven decision than purely economic in nature for these buyers.

TARGET GROUP II: "Privileged Heirs"

Younger renters in the 20–35 age range are in this group. They live in the city due to their education and/or work demands. They wish to be in the centre of where everything happens, and they wish to reside in the coolest building and apartment available, in an area that is trendy, up and coming, with a bohemian flair. This target group will live alone, with a significant other, or a roommate in the apartment. This is the place where they plan to live until they are prepared to start a family of their own.

It is typically the target group's parents who invest in the property (through assistance with lease payments). They wish to make a good investment in a safe and high-quality location for their children to live in. They also wish for their children to take part in the transformational and cultural journey that Suite 07 offers as part of living in a Suite 07 property.

This parentally supported rental is made to enable the children's aspirations to be a part of the special environment that will characterize the building. They are privileged to have parents with the financial means to make such an investment. The parents wish only the best for their offspring and are willing to spend that extra amount of money to make sure that they provide them with the very best alternative on the market. The parents might themselves be in Target Group I, reflecting their own needs on their children and hoping to give them an initial boost in the real estate market.

TARGET GROUP III: "One World"

This target group consists of wealthy individuals who do not desire to reside in centre city locales, but nevertheless want to be within reach of the amenities of the city. They wish to live in a bigger home where everything is readily available to live a comfortable life. They wish to live close to the city, with a small garden, and enjoy the freedom and privacy of having an entire building to themselves. For this group, Suite 07 will create a bespoke, complete, and special world optimized for each particular family. The target group has one to two children, or perhaps is in the empty-nester stage of life. Residents want extra space and are not attracted by the hassle and chaos that follows from living in the city centre. This can be either their first or second home; some might be ex-pats who desire the relative peace and tranquillity of the Nordic region.

APPENDIX III

SUITE 07 PRIVATE CONCIERGE PRIVILEGES

Target Group I and II Individuals and families who rent a unit in a Suite 07 property will automatically be enrolled in the "Private Concierge Privileges" program (see Appendix II for descriptions of these two groups). Fees for membership are included in the monthly rental and are mandatory. A single fee per rental unit will apply, regardless of the size of the rental unit or of the renting household. The monthly amount is TBD and will be based on each specific Suite 07 property and its size and location. The Private Concierge Privileges program itself, however, will be uniform across all Suite 07 rental properties.

The program will be managed by a dedicated staff of specially trained Suite 07 personnel, and oversight will be administered personally by Mr. Kristian Groth as Program Director. Each Suite 07 rental building will have its own budget for financing the program, dependent on the number of members residing in the building. It is expected that total annual Private Concierge Privileges revenue from each building will be greater than total costs, with the surplus accruing to Suite 07 for funding enhancements to the program as well as other company-wide improvements such as the Suite 07 Lab described in Part V of this business plan.

The purpose of the Private Concierge Privileges (PCP) program is to increase the quality of life of Suite 07 property residents and to inspire participants on matters of lifestyle relevant to the current times. As well, benefits of the PCP program are designed to lessen the day-to-day demands of members when they are in residence at their home, and thus allow them to engage in a more leisurely pace and a more fulfilling enjoyment of life.

The PCP program has three primary dimensions: ***Sensing, Engagement, and Service.*** Each dimension is distinct and addresses a specific need or desire of Suite 07 members.

The *sensing* dimension consists of experiences within a member's own Suite 07 home, with an emphasis on the member's culinary involvement with food and beverage requirements. Each household will be provided with a bespoke array of benefits created in conjunction with the specific needs of the household. These could include consultations with award-winning chefs and sommeliers on menu selections and might also include appropriate health care personnel to advise on best practices for healthy dietary choices. In addition, PCP members will be given exclusive access to relevant products in these categories provided by Suite 07 partners. All of these program benefits will be provided in-house to members within their own residence.

The *engagement* dimension is designed to expand the level of knowledge and concern of Suite 07 PCP members with the world around them, both physical and intellectual. This will be accomplished by invitation to exclusive presentations and programs that cover a wide array of topics — including the arts, current events, science and technology issues, and sports and recreation discussions. Suite 07 PCP administration will arrange these presentations, and member households will be given an opportunity to nominate topics or presenters. All of these programs will take place in Suite 07 properties and attendance will be strictly limited to members only; in some cases, exclusive field trips for members will be arranged to facilitate a topical issue. Some Suite 07 buildings will reserve a dedicated physical space for these PCP presentations; this space will also be available for private member usage, determined on a case-by-case evaluation.

The third dimension in the Suite 07 PCP program is *service.* This benefit is comprised of housekeeping services such as home cleaning and maintenance. It can also include other services such as home delivery of food and beverages, or repair and maintenance of members' household goods such as clothing, home décor, and other personal items. The service benefit can also be extended to other needs, such as engagement of a taxi or automobile rental. These service benefits will be delivered through specific arrangements between PCP management and members. Suite 07 will allocate a trained full-time *Hospitality Manager* to each property with a dedicated office in the building.

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About the Authors

Paul Tiffany, PhD: Paul Tiffany was a senior lecturer at the Haas School of Business at the University of California, Berkeley, for many years. Prior to that, he taught at leading management schools in the United States as well as Europe and Asia, winning numerous awards for his teaching and scholarship. He received an MBA from Harvard University and a PhD from the University of California, Berkeley. Dr. Tiffany offers management consulting and training programs to firms and organizations throughout the United States and the world.

Steven D. Peterson, PhD: Steven Peterson, now retired, was founder and CEO of Strategic Play, a management training company specializing in hands-on software tools designed to enhance business strategy, business planning, and general management skills. He holds advanced degrees in mathematics and physics and received his doctorate from Cornell University.

Authors' Acknowledgments

Paul Tiffany: Like a good wine, a good book can improve with age if it is maintained properly. In this 3rd edition of *Business Plans For Dummies,* my intent is to provide the reader with an up-to-date guide on how to win in the sometimes brutal but always exciting new world of business that modern technology and globalization have given us. This should apply equally if you work for a new start-up or an already established firm looking for an edge. I hope this fresh review will endow you with the tools and knowledge to get the job done.

Even though my name is on the cover of *Business Plans For Dummies,* several others were behind me every tap of the key, every turn of a page, every chapter of the book. I hope my children — Ann, Barbara, Rafael, Roland, Brandon, and Mariah — realize how much I owe to them for their encouragement, sometimes silent but always there. If they are half as proud of me as I am of them, I have succeeded.

And lastly — but actually first — this book is for Janet. Like good wine, she, too, only improves with age.

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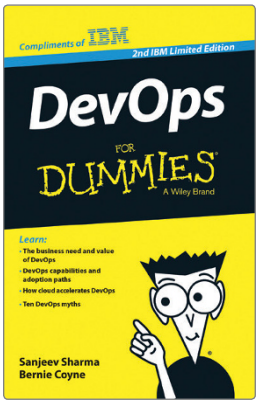

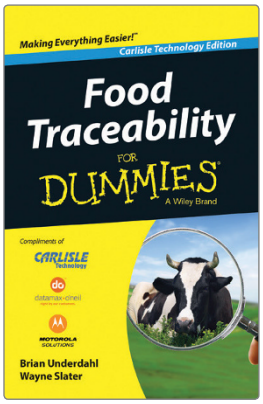

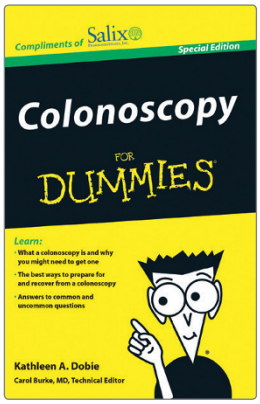

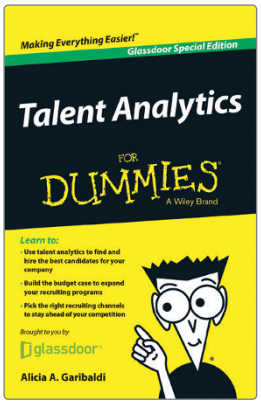

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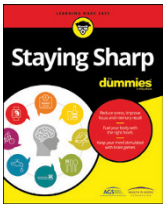

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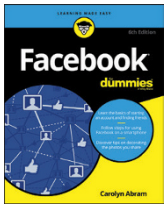

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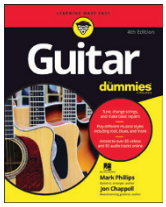

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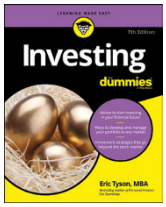

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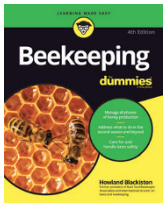

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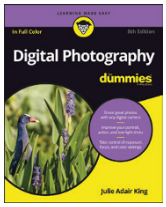

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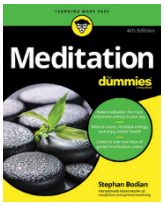

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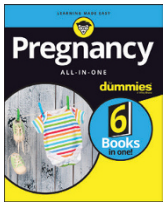

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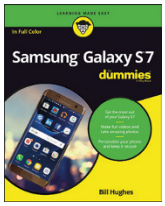

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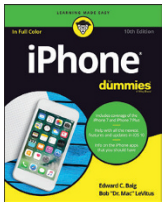

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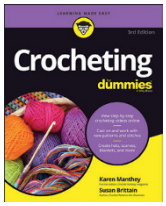

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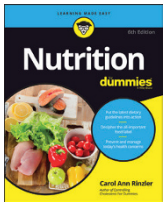

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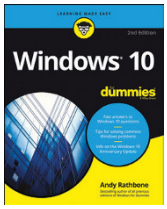

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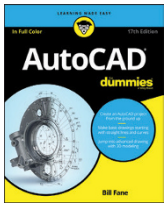

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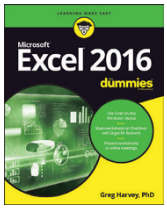

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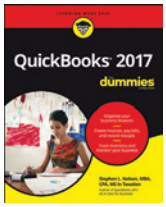

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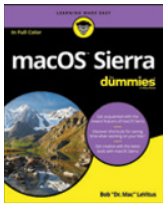

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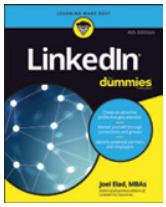

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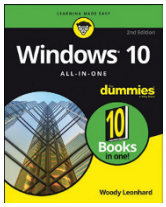

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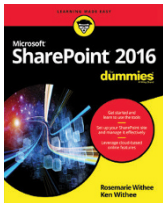

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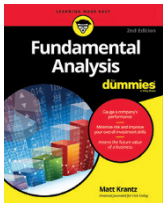

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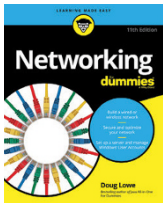

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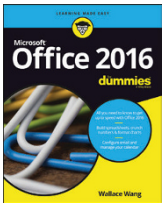

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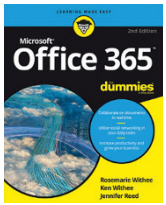

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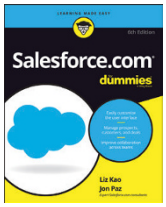

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