PROJECT EXECUTION NETWORK LLC

COBRA 3D® BUSINESS DEVELOPMENT PROCESS

no time for TOMORROW

A PRACTICAL GUIDE TO STRATEGIC BUSINESS DEVELOPMENT THROUGH PROJECTS

FIRST EDITION

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ISBN: 978-0-9961024-0-7

Library of Congress Catalog Card Number: XX-XXXXX

First Edition

Printed in the United States of America

Published By

Project Execution Network LLC
www.projectexecution.com

Forward

What you do today, when you don't HAVE to do anything, makes you what you want TO BE three years from now ... when it's too late to do anything about it!

Nearly one-quarter of all businesses reaching year four will fail by year ten. Having cleared the early hurdles of start-up funding, market penetration, and sales development to support ongoing operations, these businesses fell short of owner/investor objectives for profitability and wealth creation.

This happens for various reasons, but a common thread in many post start-up business failures is an inability to respond to disruptive changes in market conditions. These changes, both technological and cultural, present a constant stream of threats and opportunities to every business. Industries on the front lines of disruption see new business models emerging, almost overnight, from a constant barrage of mobile, cloud, geo-location, digital distribution, and social networking initiatives. Those less directly affected are nonetheless challenged to change "how business is done."

For owners and managers in a small or midsize business, the situation is particularly challenging because resources are scarce and the competitive landscape is constantly evolving. Most owners start their businesses with a clear objective ... financial independence ... early retirement ... a legacy for children and grandchildren. In the midst of all that is required to keep a business running smoothly, however, it's easy to lose sight of long-term objectives, and quite difficult for members of the management team to find time to evaluate the factors that impact business performance. As business owners and managers in the logistics, automation, professional services, distribution, retail, private equity, and defense industries, the authors of this book have been there. We learned to recognize the direct link between past successes and the forward planning efforts that made them possible, and wished for a straightforward, structured approach to help guide the business development process.

Thus began a three-year journey to identify, organize, streamline, and publish the essential ingredients of strategic business development from a small or midsize business owner's perspective. The process was enlightening, and the result ... well it's in your hands ... enjoy!

Table of Contents

Introduction 7

1.1 Getting Started....10
1.2 Natural Laws of Business....11
1.3 Three Dimensions of Business....14
1.4 Three Dimensions Define Performance....16
1.5 Operational Performance Drives Financial Results....18
1.6 Simple as A, B, C....21

Optimizing Operations 27

2.1 Competitive Benchmarking....29
2.2 Functions and Processes Defined....41

Building a Competitive Culture 51

3.1 Culture Optimization....53
3.2 Culture … A Closed Loop Process....54
3.3 Cultural Benchmarking....64
3.4 Asset or Liability?....71

Developing a Winning Strategy 75

4.1 Location, Location, Location!....77
4.2 First, Get Organized....80
4.3 Then, do the Analysis....81
4.4 Now, Assemble the Puzzle....101
4.5 Identify Risks....106

Measuring Performance 111

5.1 Thereof, Business Results!....113
5.2 Operational Performance....114
5.3 Financial Performance....126
5.4 Driving Forces of Wealth Creation....140

Investing for Success 143

6.1 Strategic Business Development Projects....145
6.2 Creating Value....146
6.3 Identifying Investment Opportunities....151

Prioritizing Strategic Projects 171

7.1 Survival of the Fittest....173
7.2 The Business Case....174

Planning Strategic Projects 189

8.1 The Project Planning Process....191
8.2 Project Management Methodology Requirements....193
8.3 Risk Management....196
8.4 Project Documentation....197
8.5 Project Phase Gates....199
8.6 Work Breakdown Structure (WBS)....204
8.7 Resource Planning and Scheduling....205
8.8 Baseline Budgeting....206

Staffing for Success 209

9.1 Project Teams....211
9.2 Team Performance....212
9.3 Staffing Process....213
9.4 Optimize Team Structure....222

Project Execution 227

10.1 Game Day!....229
10.2 Project Coordination....230
10.3 Project Communication....231
10.4 Project Collaboration....232
10.5 Project Control....232
10.6 Toolkit....234

Glossary 239

Introduction

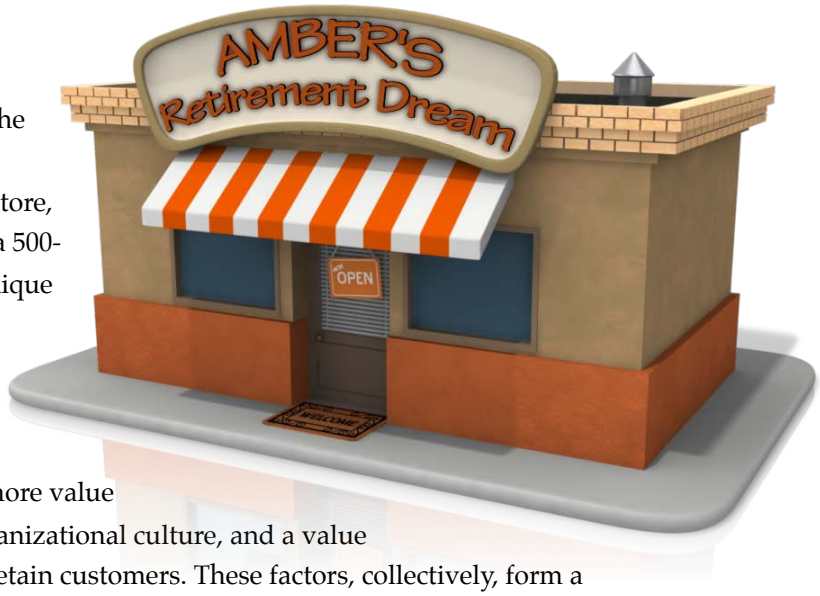
TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. The three dimensions of a business are its operations, culture, and strategy.
2. A business can only be accurately defined, planned, and developed in three dimensions.
3. Every business has either a planned or defacto business model and strategy.
4. Strategy drives (or should drive) marketing and sales activities.
5. Operational performance drives financial results.
6. COBRA metrics (cost of goods and operating expenses as a percentage of revenue, brand power, revenue growth, and asset utilization) define operational performance.
7. The *COBRA 3D® Business Development Process* helps an organization define its current (**A**s Is) situation, establish both short and long term (To **B**e) business objectives, and **C**reate value through strategic projects … as simple as **A-B-C**.
8. The ***As Is*** situation of a business is the only logical starting point for business development.
9. The ***To Be*** objectives of a business must be acted upon (through projects) before they **C**reate Value.
10. Investment opportunities (projects) must be identified, justified, and prioritized.

The *COBRA 3D Business Development Process* is a practical, structured methodology for strategic business development. This methodology applies basic business principles to help the owners and managers of small and midsize businesses define their current ***As Is*** situation, set strategic objectives for planned ***To Be*** improvements, and then implement these improvements — through projects — in a cost-effective and timely manner.

The principles, processes, and strategies used in the *COBRA 3D Business Development Process* are based on the collective experiences of its authors, which span more than 90 man years of ownership, general management, project management, marketing, sales, operations and investing experience across a diverse range of manufacturing and service industries. The result is a straightforward, repeatable process that any small or midsize business can use to identify and execute a strategy that is aligned with the investment objectives of its owners.

1.1 Getting Started

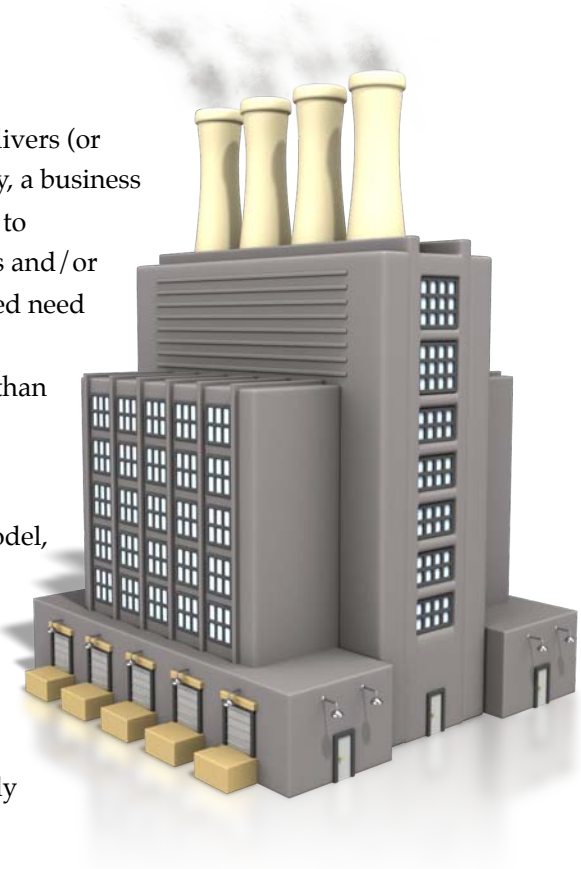


The *COBRA 3D Business Development Process* is based on the reality that every business — whether it's a five-person retail store, a 50-person service business, or a 500-person manufacturer — has a unique business model and strategic purpose from the owner's point of view. Furthermore, COBRA 3D assumes that every business has developed one or more value adding processes, a defining organizational culture, and a value proposition used to attract and retain customers. These factors, collectively, form a business's brand.

A business's brand may be clearly defined and deliberately nurtured — the direct result of a well-orchestrated strategic business plan — or it may develop naturally, over time, without the conscious input, awareness, or understanding of the business's management team. The former is a prerequisite to long-term, sustainable success, while the latter, however successful it may be today, is a recipe for disappointment or disaster in the future.

The *COBRA 3D Business Development Process* defines the current state of a business (based on operational performance and culture), identifies the long-term objectives of its owners, and establishes a winning strategy that bridges the difference between today's ***As Is*** position and the ***To Be*** objective. We start by recognizing a few basic, natural laws of business. Then, we deconstruct a business to better understand its essential elements ... ***the three dimensions of operations, culture and strategy***. Finally, we look at business development projects and how they can be used to implement the winning strategy with recommendations for prioritizing, planning, staffing, and executing them successfully.

1.2 Natural Laws of Business



A business model defines how an organization delivers (or intends to deliver) value to its customers. Typically, a business model will apply internal functions and processes to incrementally add value to supplied raw materials and/or contracted services in an attempt to fill an identified need or desire in the marketplace. To be successful, the business model must deliver value that is greater than the combined costs of all supply chain inputs and value-adding activities.

As stated earlier, every business has a business model, whether explicitly understood or otherwise. Likewise, every business has a strategy in place to address the needs of customers. Whether or not a business model and its supporting strategy are well aligned with the business owner's long-term objectives and the needs of the market is an entirely different matter.

While it's quite possible to succeed with an accidental business model and a de facto business development strategy, most owners of small and midsize businesses are simply too reliant on the income these businesses produce — and preservation of the value invested in their development — to leave such matters to chance. Yet, that is exactly what happens when a business operates for any length of time without some level of market analysis, competitive benchmarking, forward planning, and proactive brand management. Sooner or later your luck runs out.

Simplified Business Model

The process of defining an existing business model is fairly straightforward. For most businesses, the financial basis for direct product/service costs, facility costs, operating costs, and invested capital is reasonably clear. Even a complex business model with multiple product lines can be broken down into separate revenue streams and cost centers. Adding them together describes the overall business model of the company.

Regardless of complexity, the fundamental and powerful reality is that the total cost of supplies and materials, value-adding processes, and overhead must be less than the value delivered to customers for a business to survive. While this principle is very clear, it should also be clear that by optimizing value to the customer while simultaneously controlling costs, the profitability of a business is maximized.

Strategy Drives Marketing and Sales

A company's business model and overall strategy are (or should be) the key drivers for development of subsequent marketing and sales strategies and the prioritization of related tactical programs. Investments in these programs tend to be discretionary and returns from these investments quite difficult to measure. For this reason, it is simply impossible to consistently deliver value to an organization through marketing and sales investments without a clearly defined business model and a winning strategy.

Sales force automation, customer relationship management systems, training programs, and other popular marketing initiatives may seem like sound investments regardless of a business's model or development strategy. But, in fact, if you consider that a business owner's capacity to invest is limited, and his or her investment timeline is also limited, implementing any such program without first estimating the potential return on investment — and how that return stacks up against other potential investments — is a surefire way to institutionalize underperformance and an unprofitable future.

By contrast, with a clearly defined business model and winning strategy in hand, the management team can prioritize and invest in marketing and sales activities with confidence ... knowing that regardless of the precision with which they can measure results, these investments will, on average, produce maximum potential returns in the shortest possible time frame.

Anything less is shooting in the dark.

1.3 Three Dimensions of Business

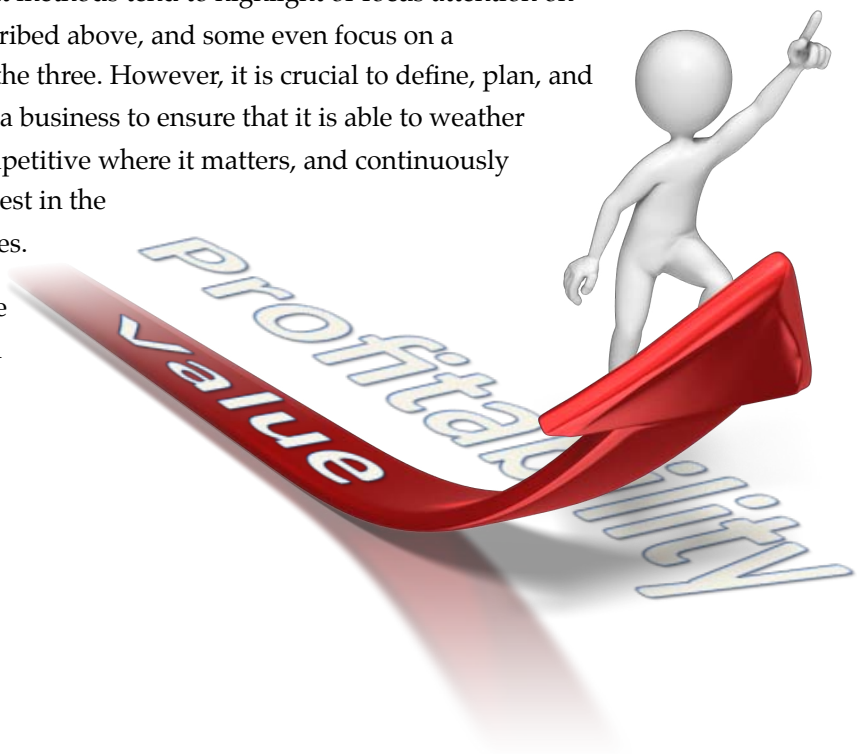
Business planning and development methods come in countless forms, with each method offering its own unique way of breaking down a business to identify potential problems and opportunities. These methods can be very generic, extremely tailored and niche specific, or somewhere in between.

The *COBRA 3D Business Development Process* is designed to evaluate the current situation of a business and identify opportunities for improvement in ***three dimensions*** … helping the business develop a **winning *strategy***, optimize ***operational*** **performance**, and build a **competitive *culture***. The ultimate goal is to achieve higher returns on invested capital, and create sustainable EBITDA growth … the basis for increased business valuation and wealth creation.

When choosing a methodology to evaluate a business's current situation, it's important to ensure that value creation and sustainable profitability are the dominant benchmarks for success. These criteria are vital to any business. Therefore, the business planning and development process must factor them into the equation as key indicators of current and future performance.

Most business development methods tend to highlight or focus attention on one of the dimensions described above, and some even focus on a combination of two out of the three. However, it is crucial to define, plan, and optimize all dimensions of a business to ensure that it is able to weather cyclical downturns, be competitive where it matters, and continuously improve, innovate, and invest in the highest impact opportunities.

With that in mind, let's take a closer look at each critical dimension of a business.



The **strategic dimension** of a business establishes its general direction, scope of supply, served markets, competitive positioning, and other key differentiators. The underlying forces that define the strategic dimension of a business and drive its performance are: The market, the competitive landscape, and the value proposition that a business delivers (or fails to deliver).

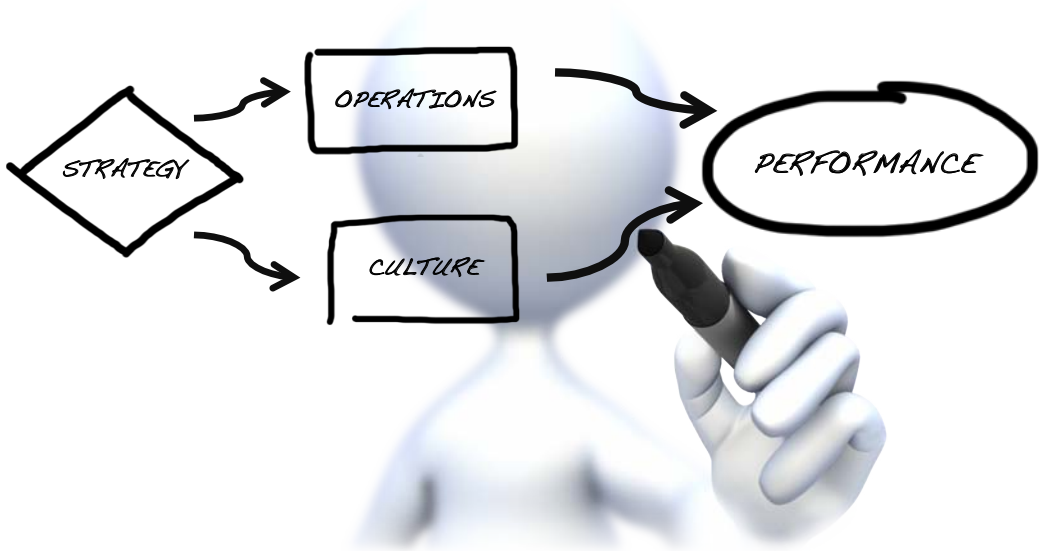
A winning strategy is analogous to the real estate adage of *location, location, location*. In other words, defining a winning strategy for a business requires that you identify the served market, product positioning, and competitive differentiation — the equivalent of *location, location, location*. This kind of strategic positioning can be powerful … the difference between building a dream home on waterfront property or on a lot next to the interstate.

Operational performance requires competitive benchmarking for all product lines and their related functions and processes. Operational performance benchmarks include revenue, margin and compounded annual growth rate (CAGR) measurements, matching cost structures to revenue streams, functional comparisons with leading competitors, and integration of functional performance with product line statements.

The key operational processes of a business must be benchmarked against current best practices and key performance indicators (KPIs) in your industry, direct competitors, and any relevant indirect competitors. This performance differential is where the company can create operational leverage — through projects — to achieve the highest possible impact on profitability and wealth creation.

The **cultural dimension** of a business can be defined as the beliefs, values, expectations, and actions of employees as they relate to the strategy of a business. How do individuals in the business think, feel and respond to change, to competitive pressures, to demanding customers? Does the cultural dimension of the business fit the industry that the business competes in? If the business is in a highly innovative industry, are the employees collaborative, innovative, and creative? Is there a team mentality?

The culture of an organization must be in harmony with its strategies. This culture will ultimately determine the legacy of an organization. That is, how and whether it will respond — both internally as well as externally — when faced with future challenges and opportunities. Because culture is a result of long-term actions and policies, it can only be impacted with definitive long-term changes to an organization's actions and policies. The process is rarely easy, but the results can be rewarding, potentially turning a long-term liability into an intangible, valuable asset.



1.4 Three Dimensions Define Performance

Strategy, operations, and culture are interdependent. An organization cannot achieve its full potential for structural, sustainable growth, optimum financial performance, and competitiveness in the face of change without a coordinated, three-dimensional approach.

For example, a business may have an optimum winning strategy, but if its culture is toxic, then operational performance will suffer. If the operational and cultural dimensions are optimized, but the strategy is flawed, the fate of the organization is ultimately at risk. It's certainly possible for a business to perform well in one or two dimensions, but without the symbiotic relationship of all three, a business is less likely to sustain that performance over time.

Need proof? Let's look at a few examples:

Hewlett-Packard: This iconic technology innovator lost approximately 40% of its market value — roughly $40 billion — between 2008 and mid 2013.[1] The company still had excellent products, and a dedicated team of professionals … but it also seemed to have an ever-changing strategy that resulted in confusion, wasted resources, and rapidly declining financial performance. This downward spiral revealed a disconnect between strategy, culture, and operations that is now being addressed with new leadership.

Another example, in the opposite direction, is Whole Foods Market, whose market capitalization has more than tripled to approximately $19 billion between 2008 and mid 2013.[2] This organization's clearly

1 Hewlett-Packard market capitalization values per www.morningstar.com.

2 Whole Foods Market capitalization values per www.morningstar.com.

defined niche strategy, combined with its precision operational performance, and a dedicated professional team, offers an excellent example of three-dimensional business performance.

Panasonic, a high profile player in the consumer electronics market, appears to be an example of a hierarchical culture competing in a fast moving market. The company lost approximately 60% of its market value over the period of 2008 to mid-2013, roughly $30 billion.[3] This company, once dominant in the consumer electronics industry, now seems to be lost in time as the technologies of its competitors have obsoleted many of its products.

The above examples illustrate the important relationship that exists between strategy, operational performance, and culture. There certainly are many less dramatic examples where a one- or two-dimensional approach to business development has resulted in flat or declining revenues in real terms, over an extended period. These *dead money* businesses are often able to maintain the status quo for a short period of time; but, they eventually succumb to the advances of more fully optimized competitors unless the investors/owners realize there is a problem and take corrective action.

Think of the relationship between the three dimensions of a business as a closed loop process control model. There is an ever-present, ongoing interaction between each dimension … with each element either conflicting with or strengthening the others in relation to the business owner's objectives. This is referred to as the *set point* in process control lingo. With this analogy, it is clear to see how variations in the relationship between dimensions can create very different outcomes:

Virtuous Circle — Continued positive feedback that is constantly reinforced, therefore enabling maximum performance.

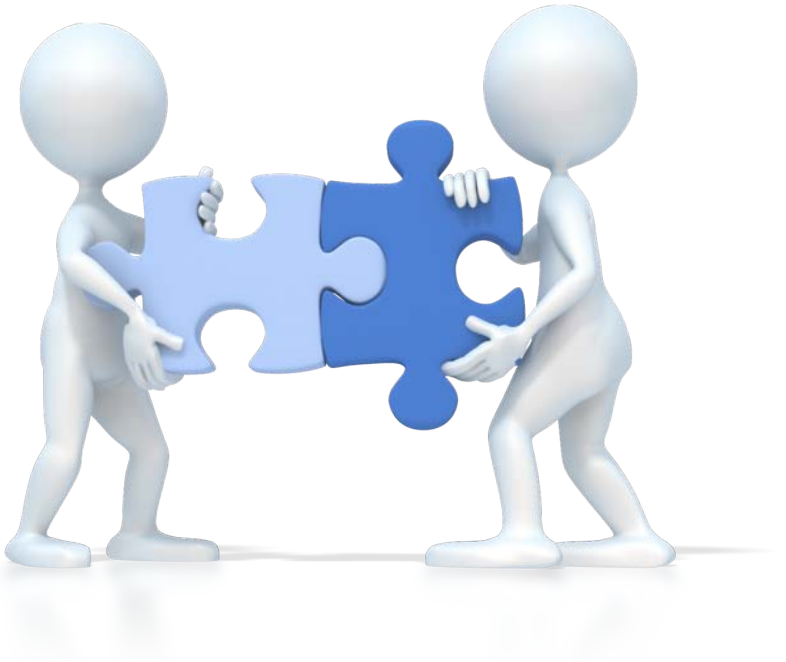
Negative Feedback Loop — Continued negative feedback/resistance impeding the performance of the business and drives sustained underperformance.

The three dimensions of our closed loop process are continuously interacting. The result of these interactions can be cumulatively positive (virtuous circle) or negative (negative feedback loop) and this is true regardless of a business's size, complexity, or industry.

3 Panasonic market capitalization per www.morningstar.com.

1.5 Operational Performance Drives Financial Results

The end result of a business's strategy (good or bad), operations (good or bad), and culture (good or bad) is its financial performance (good or bad). Excellent operational performance within a poor strategy will yield a worse result than excellence in operations within a winning strategy. Either combination of strategy and operational performance without a competitive culture will not produce sustainable results over time.



If these relationships are understood and accepted, it should be clear that a business must be modeled, planned, and developed in all three dimensions to achieve optimal financial performance.

So what is operational performance? How is it measured and then optimized?

Operational performance is the sum of all contributions made by the processes and culture of an organization to further the owner's investment objectives. These processes include day-to-day activities of the business that result in the development, marketing, sale, delivery, and support of products and services. Net *contributors* to operational performance might include processes that consistently result in on-time delivery, development of high-margin products and services, or delivery of products and services that exceed customer expectations. Net *detractors* from operational performance might include the production of products with a high return-for-service rate, a production process that frequently misses promised delivery dates, or a culture that accepts these shortcomings without question.

The *COBRA 3D Business Development Process* utilizes three sets of metrics to define operational performance. The first set of measurements is the key performance indicators (KPIs) that reflect customer buying decisions. These are the leading edge factors that customers use to decide whether to buy brand A or brand B, and once a decisions is made, the factors that drive repeat purchase decisions.

The next set of metrics deals with the total sustainable value delivered to customers or what we refer to as ***BrandPower***. The functionality of a product, the price/value proposition a product or service provides vs. competitive offerings, actual quality vs. customer expectations, and the overall customer satisfaction level of key customers are factors that define a brand's power.

The last set of operational metrics measures the overall effectiveness of the management team, the strength of its strategy and the overall competitiveness of the organization. The critical trends measured include **C**ost of goods sold and **O**perating expenses as a percentage of revenue, **B**randPower, **R**evenue growth year over year, and how well the **A**ssets of a business are utilized.

Trend lines for COBRA metrics over several years — when combined with customer KPIs and brand strength measurements — paint a clear picture of a business's current operational performance. Projects undertaken to improve them will have a clear impact on future financial performance.

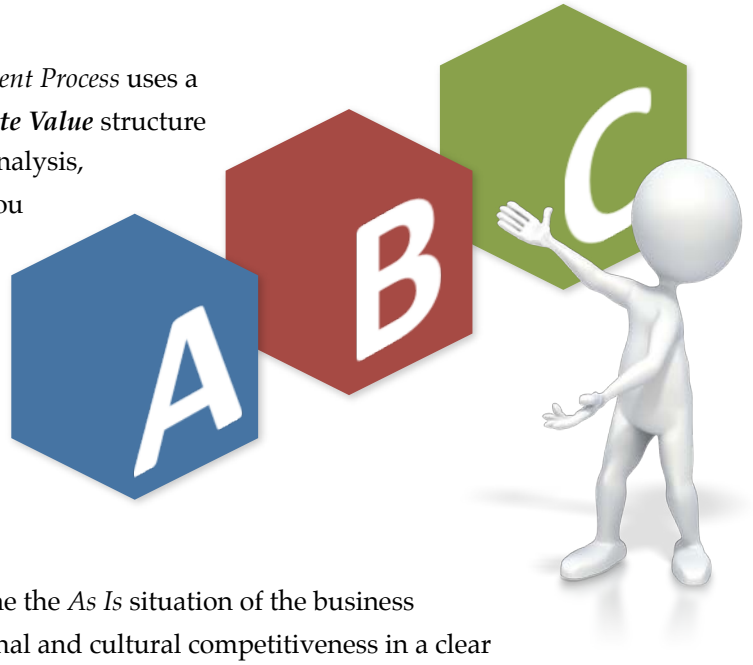
Financial performance is measured annually at an income statement level by EBITDA: Earnings Before Interest, Taxes, Depreciation, and Amortization. EBITDA is essentially the operational profitability of a business without including cost factors that can vary depending on a business's capital structure, taxing jurisdiction, or investment requirements. It is a useful tool because it provides a clear operational performance measure of a business, but doesn't capture the performance relative to the capital invested in the business.

Since annual financial performance is measured by EBITDA, the three- to five-year trailing EBITDA trend and three- to five-year projected EBITDA forward are good starting points for the valuation of a business. However, it's important to remember that EBITDA trends are simply a reflection of operational performance. EBITDA is a good financial yardstick, but financial performance itself is driven by strategy, operational performance, and culture.

The long-term investment performance of a business is defined by its Return On Invested Capital (ROIC). ROIC connects the annual income statement (profitability) with the balance sheet's invested capital (bondholder debt plus shareholder equity). EBITDA, minus depreciation and amortization, and then adjusted for taxes equals Net Operating Profit After Tax (NOPAT). NOPAT compared to the total invested capital (say, $10 NOPAT vs. $100 invested capital = 10% return on invested capital) is the annual rate of return to all investors in the business. As an investor, this performance metric defines whether the rate of return is good or bad!

If a business continually generates a higher return to investors than the cost of acquiring capital from the investors, the business is, in fact, *creating wealth*. This level of financial performance requires sustained EBITDA and ROIC growth, year over year. For most investors, valuation/wealth creation is the fundamental reason to invest and take risk!

1.6 Simple as A, B, C



The *COBRA 3D Business Development Process* uses a straightforward ***As Is, To Be, Create Value*** structure to simplify the various stages of analysis, planning, and development. As you work through each chapter in this book, make note of the small icons that appear in the upper right corner of each page. These icons correlate the content of each chapter with the underlying stages of business development planning:

The first step is to define the *As Is* situation of the business in terms of its operational and cultural competitiveness in a clear and organized way.

The knowledge, analyses, and competitive benchmarks that result from a business's *As Is* definition, in addition to insights gained through internal and external experts/resources, provide the intelligence needed to develop a winning strategy. By defining the winning strategy based on external, competitive, and internal factors driving the business, an optimized *To Be* objective can be defined. The winning strategy establishes priorities and competitive requirements for optimizing operations … and for building a focused, competitive culture.

Once the *As Is* situation and *To Be* objectives of a business are clearly defined, business development projects can be identified, justified, and prioritized. And, since these projects are properly aligned with an organization's objectives, they are more likely to *Create Value* through incremental improvements in operational performance and culture.

It Is What It Is!

The *As Is* situation of a business is *square one* in the business development process, providing a working definition of the business's existing served markets, product line competitiveness, critical functions, processes, and culture.

The assessment encompasses two realities: An external view of the business in terms of its product line competitiveness, and an internal view defined by the competitiveness of the company's functions and processes.

The external view reflects customer priorities … how they place value on various competitive offerings available to them. The perceived competitiveness of a company's products and services will almost always be the driving force in determining its profitability. A combined look at the current competitiveness and profitability of each product and service will determine whether investments are needed to sustain or improve their contribution to the business.

The internal view measures the relative effectiveness of a company's major functions, processes, and sub-processes. The operational performance of a business must be benchmarked against key competitors and the best comparable practices available globally. These analyses identify key weaknesses, leverageable opportunities, and potential threats that may impact operational performance.

The other major factor brought to light while analyzing the *As Is* situation of a business is the prevailing culture. The culture of an organization directly impacts its competitiveness, momentum, and sustainability. While the existing culture is by itself neither good nor bad, its characteristics will determine an organization's ability to compete, adapt, and implement change.

"To Be ... or ... Not to Be"

The *To Be* objectives of a business form the basis for its winning strategy. Benchmarks identified during the *As Is* analysis — along with fact-based market growth forecasts and other external inputs — establish boundaries within which a business can begin to develop a strategy to optimize operations and culture.

As the winning strategy takes shape, a view of the future emerges. This vision identifies opportunities for improvement — in three dimensions, of course — that are inherently aligned with the business owner's objectives. Management has only to justify, prioritize, plan, staff, and execute these initiatives (as business development projects) to realize their benefits.

Business Development Projects

You're busy. Your staff is busy. And like it or not, you're all pretty set in your ways!

A winning strategy provides a *road map to success* but the planning, staffing, and execution of business development projects is required to bridge the gap between the current situation and the desired situation. Otherwise, the winning strategy is simply a well-constructed paper tiger. Since time and resources are scarce, prior to turning the *road map* loose on an organization, the focus should be on the projects resulting in the most strategic impact, and the highest return on investment, in the shortest possible time frame.

Also, consider that many business projects do fail! Why? If you ask Google, you'll find 200,000,000 or so explanations, but the bottom line is this: Business projects fail because (A) they are implemented without the benefit of an overall business development strategy; (B) the organizations implementing them are resistant to change (remember culture?); and (C) the effort they require is often underestimated.

The fact is that most organizations will skip the critical steps outlined in the pages above. They *think* they know what their business needs and they embark on projects without undertaking the thoughtful analysis required to develop a realistic view of their *As Is* and *To Be* positions.

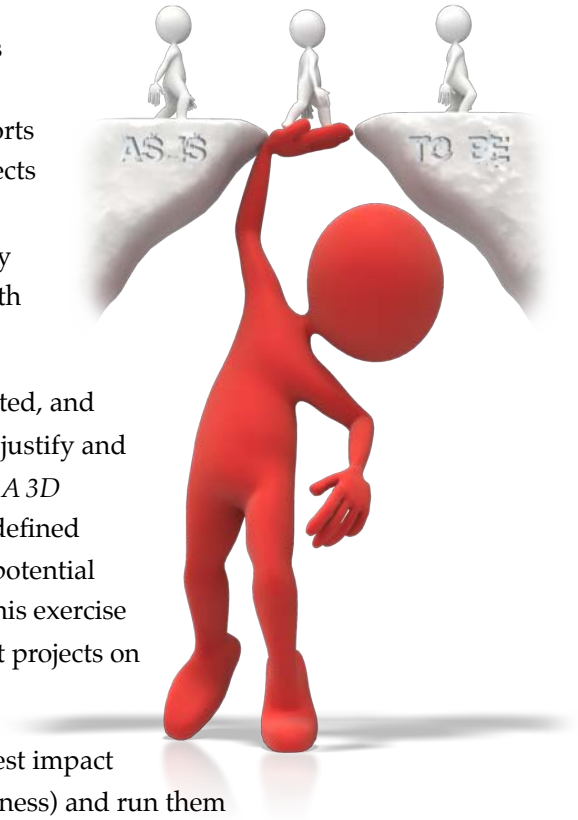
A Body at Rest ...

Projects also fail due to complacency. "We're doing fine, why change?" is a common refrain, whether driven by misconceptions ("we're busy, so we must be making money"), a lack of time (most SMBs today are staffed lean, with little or no capacity to tackle business development projects internally) or both.

However, it doesn't have to be this way. Business development projects are invaluable as strategic business development tools when planned and executed properly. They have a clearly defined beginning, end, and result. Risks are identified. And external resources can be used to supplement internal staff, reducing disruptions to daily operations while keeping costs variable.

Assuming projects are properly justified and prioritized, based on a winning strategy that is closely aligned with the *To Be* objectives established for the organization, the return on project investments will be significantly greater than costs, and should be clear to all members of the organization.

Create Value



Returns on strategically aligned investments (business development projects) create value. Failure is still a possibility — so don't be disillusioned if it occurs. Efforts taken to identify potential business development projects that bridge the gap between the As *Is* of the current business and the *To Be* of the planned business will pay dividends over time by focusing efforts on projects with the greatest return potential.

Once a set of potential projects has been defined, debated, and scrubbed by the management team, the next step is to justify and prioritize the remaining project candidates. The *COBRA 3D Business Development Process* recommends that a well-defined business case be prepared for each project to identify potential risks, estimate costs, and quantify expected returns. This exercise provides all of the information needed to accept/reject projects on the list and to prioritize those that remain.

Finally, we take the most promising projects (the highest impact projects that support the strategic direction of the business) and run them through a logical planning process (see Chapter 8 for details) to further define phase gates (approval checkpoints), milestones, tasks, resource requirements, overall schedule, and other criteria needed to execute the project.

CASE IN POINT

Regardless of size, industry, or age — a business's strategy, operations, and culture will ultimately determine long-term success or failure.

What might a film company, automotive manufacturer, electronics retailer, book store chain, and computer hardware/software innovator have in common? One answer is that after rising to leadership positions in their respective industries, they all ultimately failed and filed for bankruptcy due to deficiencies in one or more dimensions of performance. Businesses of all sizes can learn some very important lessons from their stories. Following is a three dimensional summary of these iconic companies in the years leading up to their respective bankruptcy filings:

Company	Years to Bankruptcy	Operations	Culture	Strategy	Comments
Kodak	123				Invented digital camera – but dropped to protect film business
General Motors	100				Failed to recognize the impact of a self-inflicted, toxic culture
Circuit City	59				In the right place at the right time but operations disaster
Borders	40				In the wrong place at the wrong time
Silicon Graphics	27				Took competition for granted

● Winning position ● Neutral position ● Losing position

Kodak — Created a mass market for photography, enabled Hollywood movies, pioneered the home video industry, and invented digital photography … but then failed, trying to protect legacy businesses from their own technological advancements.

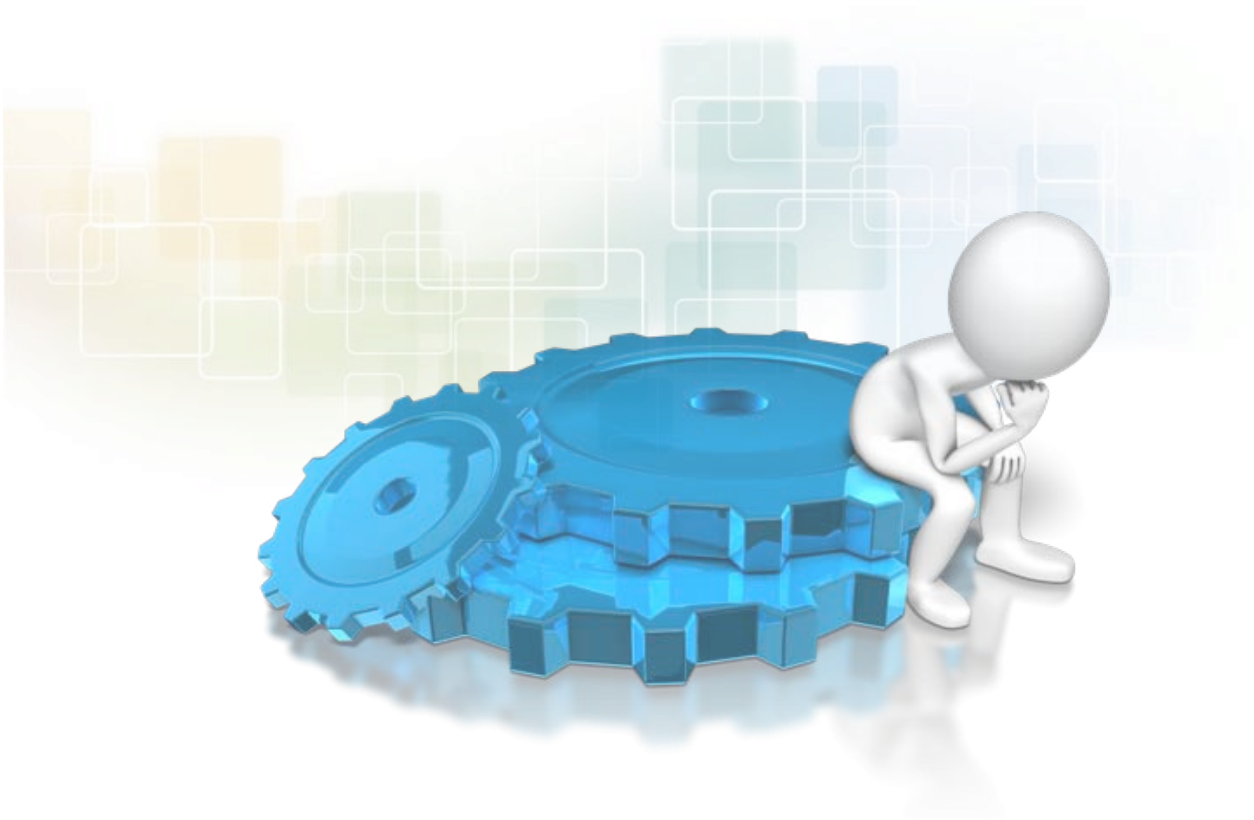
General Motors — At one time, the largest manufacturing company in the U.S. Success lead to failure when they tried to protect a toxic culture until it was too late.

Circuit City — Once the largest consumer electronics retailer in the U.S. It seems Circuit City never learned to respect (or fear) the inroads of its competitors until it was too late.

Borders — At one time the largest retail book chain in the world with 1,249 stores. Management viewed online sales as a distraction and outsourced e-commerce to Amazon. The rest is history!

Silicon Graphics — A leading manufacturer of high performance computing solutions and 3D graphics hardware/software. Then came Mac OS, Windows, and a premature product launch that ultimately failed, destroying their credibility with corporate customers.

Optimizing Operations



TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. Operations are defined externally by products and internally by processes.
2. Competitive benchmarking is the most effective technique for measuring product and process performance.
3. Product line profitability is the starting point of competitive benchmarking.
4. Product line functional benchmarking defines the sustainability of current profitability.
5. Product line served markets define a business's future growth potential.
6. The combination of product line profitability, functional competitiveness, and future growth defines product line value today.
7. Defining key business functions and their related processes and subprocesses is the starting point for process benchmarking.
8. Key performance indicators (KPIs) can then be defined for targeted subprocesses.
9. Subprocess KPIs can be compared to equivalent published KPIs to benchmark performance.
10. The best practices associated with the highest performance KPIs define high value investment opportunities.

2.1 Competitive Benchmarking

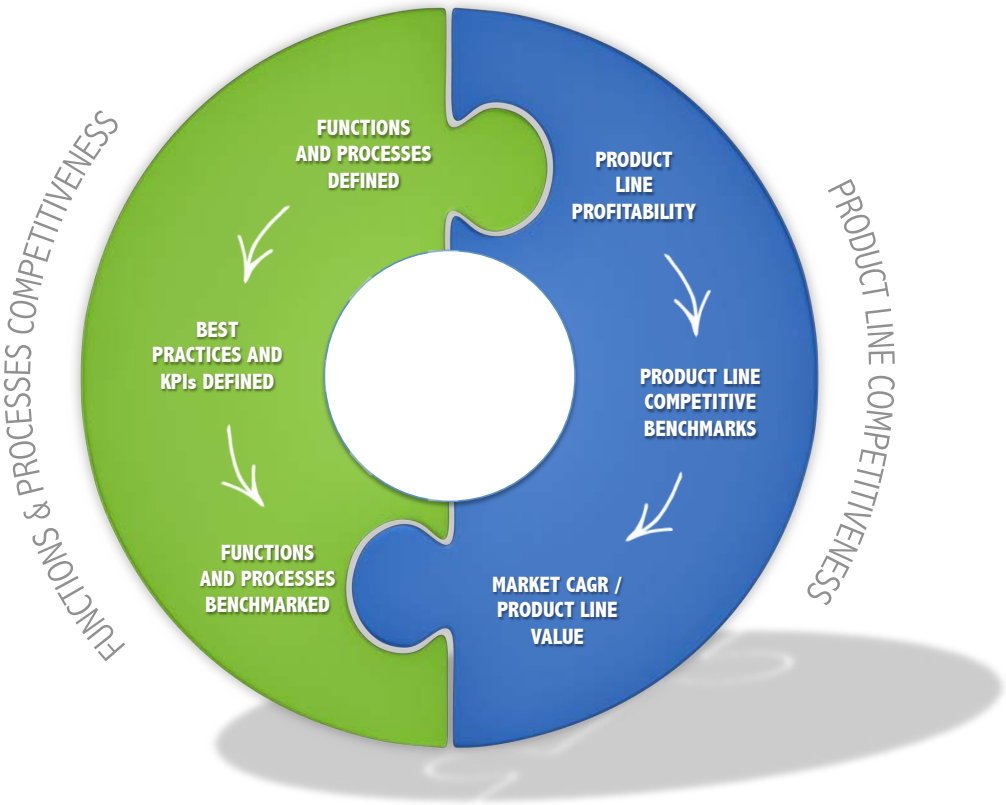
The operational performance of a business is defined externally by the competitiveness of its product lines and services, and internally by the competitiveness of the functions and processes developed to deliver them. From a marketplace point of view, everything a company does is explicit and simplified, reduced to its basic value in terms of functionality, quality, pricing, and support; and then compared to the functionality, quality, pricing, and support offered by competitors.

Customers, consciously or otherwise, make buying decisions based on their own prioritization of these factors, which we call key performance indicators (KPIs). This reality cannot be overstated. It is irrelevant how efficient internal operations are if the product or service delivered to a customer is not competitive in the marketplace. The basis for product line competitiveness is the specific functionality and other differentiating factors that customers assign value to.

The internal functions and processes used by a business to produce products and deliver services obviously have an effect on market perceptions, and many customer value opportunities are a direct result of operational performance. However, from a customer's perspective, they are only interested in the capabilities embedded in the products or services that are the result of these processes. From an internal process optimization point of view, the value of this performance is derived from the customer value. Therefore, the metrics must be implied from the external values.

This same, implicit situation exists relative to understanding competitor processes. Since it's rare for a business to have detailed knowledge of a competitor's specific processes, management can only estimate the performance of their internal functions and processes based on the product and service capabilities they present to the market. Therefore, it is usually more practical to use a broader set of functional process metrics to quantify internal operations in addition to best estimates of competitor capabilities.

The major functions and the corresponding business and operational processes of a company are best measured using benchmarking techniques and KPIs for analyses. These techniques allow the business to be competitively compared to the *best practices* of competitors, the industry, or in many cases the global business community, where major innovations are constantly evolving.



Nothing But the Facts!

Strategically, the internal and external views of a business are directly related over time. However, to develop a clear understanding of our current *As Is* and future *To Be* situations, we need to analyze and benchmark each perspective independently. This approach allows the management team to then use the priorities and objectives of the winning strategy to pinpoint opportunities for investment that optimize products, services, and operations going forward.

The process of competitively benchmarking processes and products must be based on an intense, extensive examination of factual data! Some of the *facts* uncovered will be unpopular, difficult to understand, or even downright scary! However, it is critical that the management team continuously pushes for factual verification of all inputs and assumptions, especially those that start with "everybody knows that …" or "we have always done it this way," or "of course our customers prefer …"!

In cases where factual data is unavailable or difficult to verify, subjective techniques can be used to paint a clearer picture of the current situation. Such analyses require brutal honesty — from management team members and any externally contracted consultants — as well as a consistent methodology to ensure that no bias is introduced into the benchmarking process.

There are many scenarios where benchmarking can be used to advance business objectives. These scenarios may range anywhere from strategic and competitive benchmarking to functional benchmarking against industry best practices, depending on what processes the business is trying to quantify and improve. Successfully employing a benchmarking exercise involves the following:

- Documenting existing processes or product/service characteristics
- Researching relevant product, service, function, process, and performance KPIs to be used as comparators
- Conducting a comparison of business and operational performance vs. key competitors and/or industry leaders
- Defining the steps needed to close a performance gap that exists between existing functions and processes — or product/service competitiveness factors

The ultimate goal is continual improvement. For this effort to be successful, benchmarks must be used consistently and adopted as a fundamental component of the operational improvement process. As technologies advance and processes improve over time, the ability to monitor these changes can help an organization remain competitive.

From a performance point of view, the overall purpose of defining the competitiveness of the company's product lines and operational processes is to identify the key areas for management's focus and investments. The process of defining the highest impact areas enables the company to get the maximum return on their time and investment dollars. Product line competitiveness is the basis for sustaining or achieving long-term profitability and growth in a business.

Product Line Statement

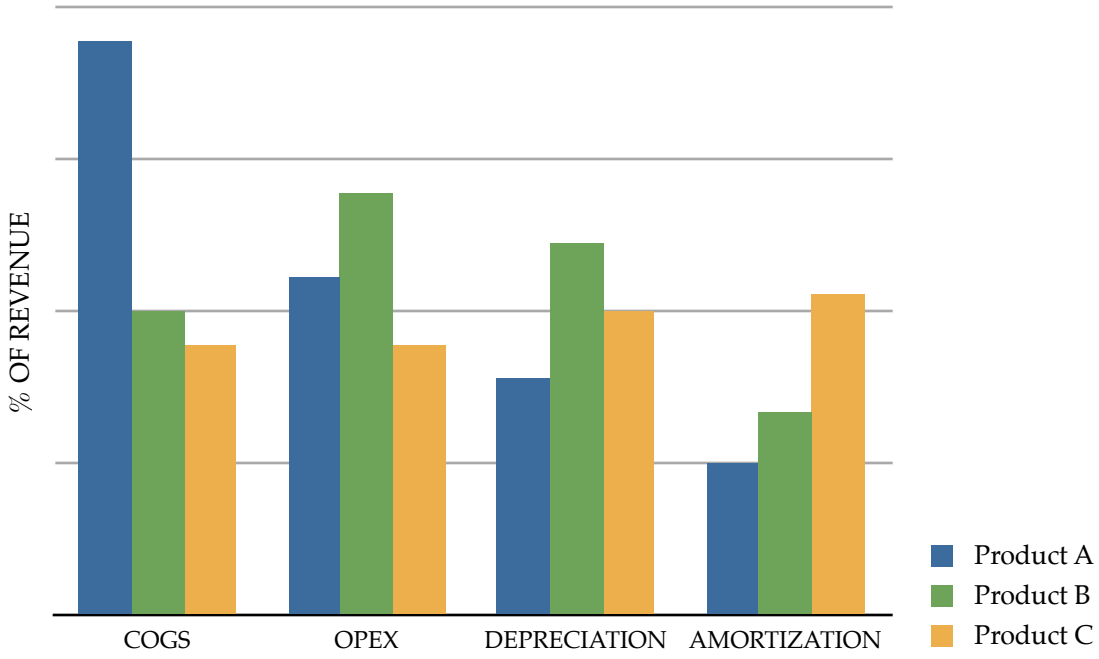


Figure 2.1: A product line statement measures the relative financial performance of each product line.

Benchmarking Product Line Profitability

Product line competitive benchmarking should be the first step taken to define the operational performance of a business. The key concept is to develop a *vertical slice* of revenues, costs, and functional capabilities for each product line. This process begins with a profitability analysis for each product or service.

This profitability analysis requires a clear separation of a company's products and services into distinct categories, or product lines, that match the organization's financial reporting structures and sales/revenue streams. Once these groupings have been defined, the competitive benchmarking process can be developed in a manner that reflects the external or customer perspective of the company.

Revenue, margins, operating expenses, and EBITDA impact must be determined for each product line to understand its relative financial performance. This process is described as developing a *product line statement* for the business.

	Product Lines	
Financial Metric	**A**	**B**
Revenue	฿90,000	฿90,000
(Cost of Goods)	฿40,000	฿50,000
(Operating Expenses)	฿20,000	฿25,000
EBITDA	฿30,000	฿15,000
(Depreciation)	฿5,000	฿8,000
(Amortization)	฿10,000	฿1,000
EBIT / Operating Profit	฿15,000	฿6,000

By separating product lines and assigning each the appropriate revenue and associated cost of goods and operating expenses (COGS/OPEX), we gain a clear picture of where each product line stands in relation to others, and where each line stands in relation to the total revenue and EBITDA of the business.

The EBITDA contributions made by each product line — as a percentage of revenue and in absolute terms — define their value financially. In many cases an EBITDA perspective will reveal a different picture than a revenue comparison, which can have significant, long-term implications for a business.

Direct product costs are the material, labor, and other related costs that go into the manufacture and/or delivery of each product or service supplied to a customer. In other words, these costs are specific to each product line and will vary depending on the unit volume provided. In essence, direct product costs are not incurred if you do not sell any products. Direct product costs are generally easy to identify and assign to specific product lines.

Operating expenses, on the other hand, require more effort and judgment in terms of how they are allocated to various product lines. The operating costs of a business generally are NOT directly tied to volume or to any specific product or service. Most businesses require a minimum level of expenditures just to keep the business operating. These types of costs are usually associated with finance, administration, general management, marketing, sales, facilities, legal, and other costs that are managed based on sustaining the day-to-day operations of a business.

Some products and services incur more operating expenses as a percentage of revenue than others. Good examples of this type of situation are cases where one product line requires a great deal more sales effort … or after sale support … or legal input. It is critical to identify situations where there are significant differences in the use of operating expenses as a percentage of revenue for each product line or service, in order to accurately capture their respective EBITDA contributions.

Revenue, cost of goods, and operating expense allocations for each product line are critical factors used to define the financial value of each product line; but depreciation (fixed/tangible assets) and amortization (intangible assets) are also important considerations. As with operating expenses, depreciation and amortization schedules must be allocated to each product line appropriately to get an accurate measure of the operating profits (earnings before interest and taxes) for each.

Once direct product costs, operating costs, depreciation, and amortization have been assigned, the profit drivers of the business will be clearly defined. Keep in mind, however, that this picture is only a snapshot in time. The relative competitiveness, growth potential, and competitive positioning of each product line will also need to be determined to get a complete picture of future profitability potential.

Benchmarking Product Line Functional Competitiveness

Product line competitiveness is based entirely on customers' views and the value metrics they place on all of the attributes of a product line. These attributes may include the basic functions of a product or service, its price/value point relative to competitive offerings, quality and reliability metrics, lead-time/on-time value, and after sale support.

Let's start with functionality. Before you can identify the functions that customers truly value, you need to make sure these customers (or customer groups) are well defined. When there are significant differences in the types of customers that buy a product (e.g. end users vs. distributors vs. original equipment manufacturers vs. systems integrators), it is essential to categorize functions separately for each group served. This concept of *served market* will help in the prioritization of functions, since there can be significant differences in the value placed on different product functions from one customer group to another.

Once the served market(s) for each product line have been defined, you can determine the percentage of revenue that each customer grouping represents, so that the overall revenue can be partitioned to establish a relative volume priority.

The next step is to define a hierarchy for the functions of each product line by weighting each function based on its perceived value to customers in each served market. This process is critical but can also be very controversial, because different opinions will likely be held within a company regarding the relative importance that each group of customers places on specific functions.

You may never reach unanimous agreement, but each customer group's preferences must be defined, debated, and researched until a general consensus is reached. Then you can establish a reliable baseline for categorizing and prioritizing product functions. If there are significant differences in the relative value of different product functions between different customer groups, further analysis is required. In many cases, these differences also imply different relative product line profitability, different levels of operating costs, or other factors that may influence the relative profitability of different customer segments for the same product line.

In any case, it is necessary to arrive at a brutally honest and *accurate to the best of your knowledge* mapping of customer groups to product line functions. Then compare your performance in each area relative to the performance of your top two or three competitors. The results of this process can be very enlightening if completed without a preconceived internal bias.

The functional competitiveness of a product line and its profitability are highly correlated. However, it's also important to evaluate other, less tangible criteria used by customers to differentiate products and services in the marketplace. Customers typically shop for *features*, but they often end up making purchasing decisions based on *benefits*.

These benefits may be real (longer service life, higher quality), perceived ("we buy X from Y because they're the market leader") or imagined (based on emotional triggers). Some may seem trivial (product X is a great fit, but it's not available in red), but all have an impact on the price/value perception of potential customers. The higher the perceived value (features plus benefits), the higher the relative price a customer is willing to pay.

For this reason, product line positioning (good — better — best) and price/value targeting decisions, while difficult to quantify, must be factored in to your competitive analysis. It is critical to understand that value perceptions have little or no correlation to actual production costs.

Product Benchmarking Worksheet

Company: MICROSOFT

PRODUCT LINE FUNCTIONS	ASSIGNED WEIGHT	US		APPLE		SAMSUNG		BLACKBERRY	
		Score	Total	Score	Total	Score	Total	Score	Total
Voice Communications	10%								
Text Communications	10%								
E-Mail Communications	15%								
PRODUCT LINE DIFFERENTIATORS									
Voice Search	15%								
Productivity Apps	20%								
Cloud Functions	30%								
SCORE	100%								
OPERATIONAL PERFORMANCE CRITERIA									
Lead time	10%								
Reliability/quality	20%								
Channel (distribution/representation)	10%								
Competitive pricing	20%								
Customer service/technical support	20%								
Technology/product innovation/appearance	20%								
SCORE	100%								

SCORING SCALE: Excellent = 9-10 Above Average = 7-8 Average = 5-6 Below Average = 3-4 Poor = 1-2

Figure 2.2: Product benchmarking worksheet

Document and Analyze

Figure 2.2 illustrates the basic structure of a product benchmarking worksheet. The competitive analysis is broken down into two major categories: (1) Product line functions and differentiators and (2) operational performance criteria.

Key product line functions need to show a clear separation between basic functions and the key competitive differentiators. It is important to make this distinction so that alternative functional solutions can be considered as competition, and also to identify how the company performs in the most basic functions of the product category. The basic functions of a product line should be very clear with little discussion needed to reach consensus. For example, the basic functions of a cell phone can be defined as voice, text, and e-mail communications as illustrated in Figure 2.2.

On the other hand, the key differentiators are subjective; they will vary based on who is doing the analysis and the served market being analyzed. For example, the personal cell phone user compared to the Fortune 500 enterprise user, will probably have different key differentiators. Selecting the differentiators requires a great deal of research, analysis, and debate to reach a clear consensus. There certainly can be more than three key differentiators. Caution should be used to limit their numbers to the fewest possible that represent 80% of the targeted served market's buying decision.

In our example, we selected voice search, productivity apps, and cloud functions as our key differentiators. We could have also chosen camera quality, battery life, screen size, or many other differentiators that customers use as the basis for their buying decisions. The choice of which differentiators to use is a critical factor in the product benchmarking process. Once the overall basis for a functional comparison is identified (core functions and key differentiators), each factor should be assigned a weight based on the perceived value to customers. The total must add up to 100% so that an accurate, weighted average, competitive comparison can be done.

The second section of the product benchmarking worksheet deals with how a company delivers, supports, documents, and prices each product line relative to its competitive value from a customer's perspective. These critical performance criteria are separate from the functional competitiveness of a product line, but have just as much value to the buyer. Critical performance criteria for this analysis should generally include the following elements, but there may be more or less depending on the product line analyzed:

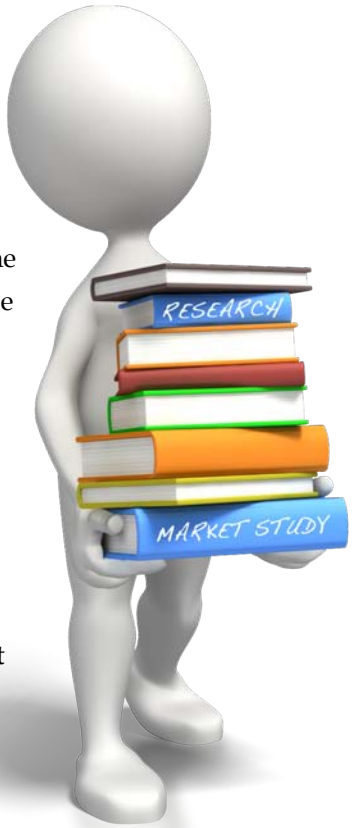
- Lead time: From order entry to product/service delivery
- Reliability: The average time a product will last without requiring service
- Channel: The supply chain segment through which a product is purchased
- Competitive pricing: The relative price point of a product on a value-to-price basis
- Customer service/technical support: The effectiveness of aftermarket support, training, parts, upgrades, repairs, service, and documentation from the customer's point of view
- Technology/product innovation/appearance: The perceived value of a product as a state of the art solution; in other words, the expected useful life of the technology and its look and feel

Once these categories are defined and the list finalized, an appropriate weight should be assigned to each factor so that an overall competitive performance analysis can be completed. It is absolutely essential that this competitive scoring or weighting be done as candidly as possible. Active discussions and debates should occur within, and sometimes outside the company, so that final weights accurately reflect the competitive position of the business.

When scoring is completed and there is a clear consensus regarding the weights applied, the company will have the essential tools needed to frame the operational competitiveness of the business.

Competitive product benchmarking against top competitors allows an organization to look at key products and services and define their position in the market. Once that position is defined, best practices can be applied to increase performance and customer satisfaction in a way that differentiates the organization from its competitors.

Product Line Forward Growth



At this stage in the product line competitive benchmarking process, you have defined the profitability and relative functional competitiveness of the company's product lines. These analyses clearly identify the current situation of the product lines, including how difficult or easy it will be to sustain the current profitability of the product line based on its functional competitiveness. Obviously, the higher the current functional competitiveness score, the easier it will be to sustain profitability in the future. If competitiveness is or may become a problem, a greater investment will be needed to regain a strong competitive position.

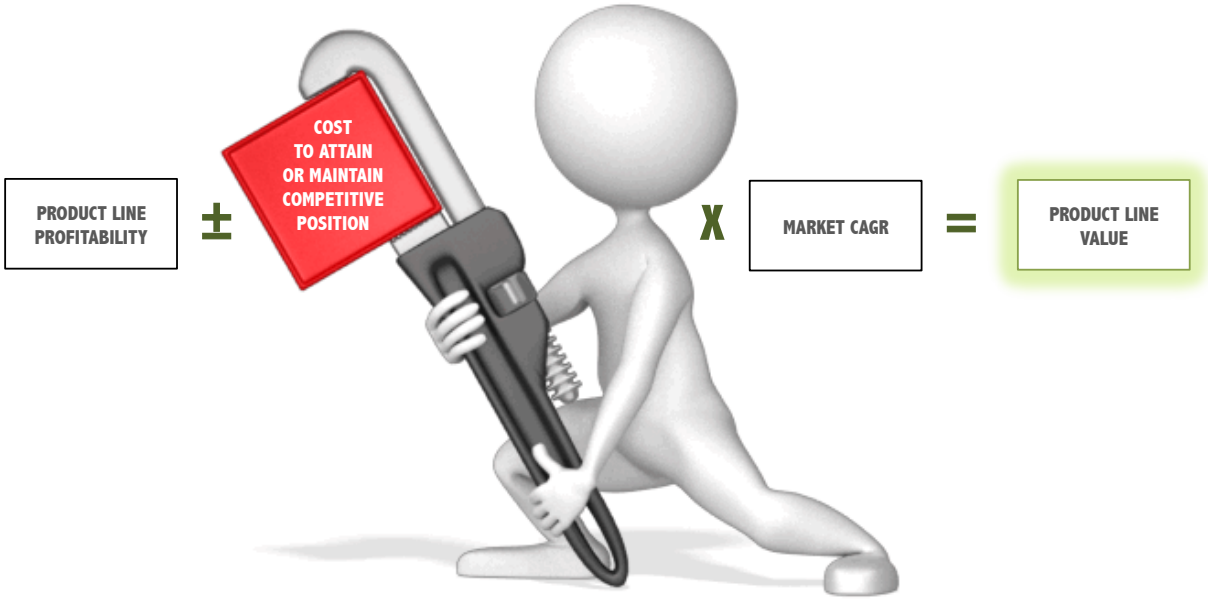
For strategic planning, it is essential to understand the outlook for growth or decline in the demand for each product line. This forward view of the Compounded Annual Growth Rate (CAGR) of the basic demand for the product line is a very challenging task. In most industries, there are many sources available where generalized market studies and industry forecasts can be obtained. However, it's rare for these generalized views of the market to have direct relevance to the individual product lines and served markets of a company.

As a general rule, it is advisable to start the forward planning process with at least two separate, independent market studies, industry forecasts, or other forms of generalized analyses of the future of the markets a business serves. These general studies, however, should not be taken at face value. Start with a very skeptical perspective as to why the market should grow at all, and then look for logical proof that end consumption within the food chain has, or will have, a fundamental basis for growth.

This *show me the proof* approach will eliminate a lot of overly optimistic projections. These overestimations of the future growth of a market are usually the source of postponing critical investments, avoiding hard choices, and delaying tough organizational decisions.

Product Line Value

At this point, you are able to integrate all of the separate product line analyses you have completed to get an accurate estimate of the value of each product line to the business. To get an estimate of future product line value (projected forward value) you can extend revenue estimates, estimated growth rates, and resulting profitability calculations for each product line into future years. Collectively, you now have a comprehensive view of each product line's profitability, current competitiveness, and future growth potential based on realistic sets of market analysis.



2.2 Functions and Processes Defined

Once the product line competitive benchmarking process has been completed, the next step is to define the process competitiveness of the business. This requires that all key functions of the organization be defined and deconstructed into major processes and then each process into subprocesses. Ideally, these functions match the financial budgeting and planning structure of the company, but it's not mandatory. It is more important that the actual, functional structure is defined. This typically involves the high level structure of the organization, such as the following:

- General management
- Finance
- Engineering
- Administration
- Marketing
- Sales
- Operations
- Information technology
- Technical support

Most businesses will have five to eight major functional areas. Often, parts of these major functions will reside in separate organizational departments. In these cases, the overall functions should be treated as a unit, but clearly mapped within the organizational structure.

At this level, the processes are too general to be effectively benchmarked. Therefore, it is necessary to break down each functional area into its major processes and subprocesses as illustrated in Figure 2.3. For example, the operations function can be broken down to supply chain, manufacturing, quality assurance, and logistics processes. These major processes must then be broken down into subprocesses. Supply chain, for example, can be broken down into subprocesses such as demand planning and analysis, procurement, receiving/put away, and inventory management. At the subprocess level of detail, there are typically good KPI metrics available for comparison.

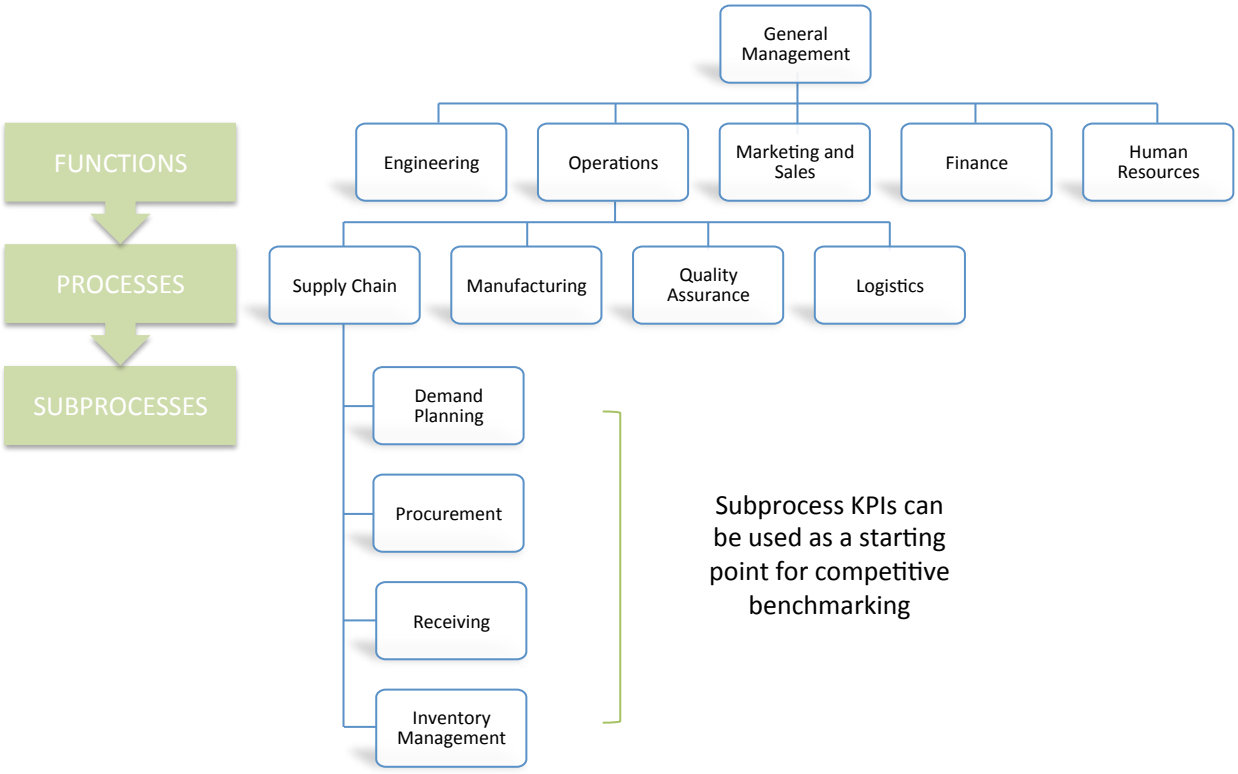
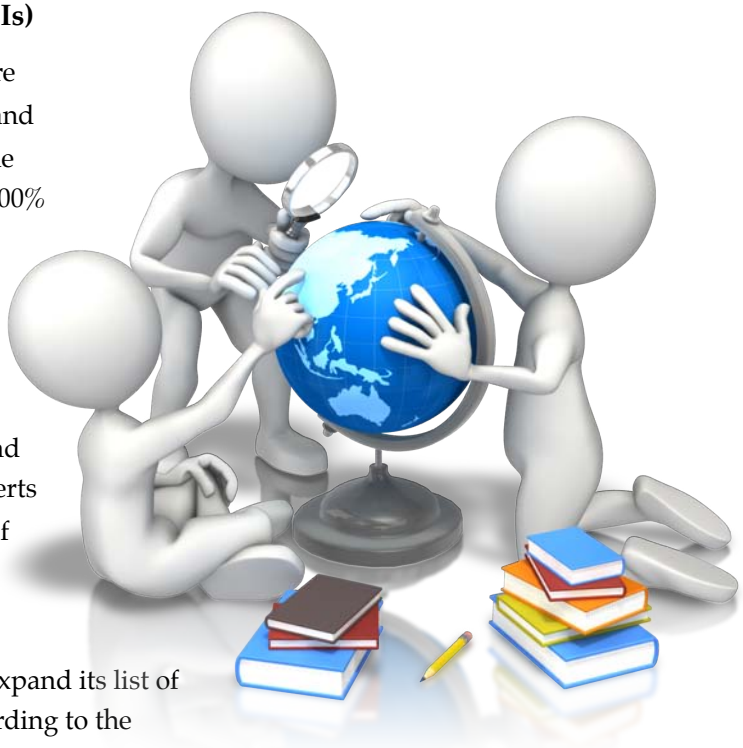


Figure 2.3: Function > Process > Subprocess illustration

By defining and comparing subprocess KPIs against competitors, industry, and sector leaders, we can construct an excellent profile of the competitiveness of the business in various functional areas and quantify any major performance gaps that exist.

Key Performance Indicators (KPIs)



Once the major business functions are deconstructed into major processes and subprocesses, it is possible to start the benchmarking process. There is no 100% standardized method for researching and defining the KPIs that will directly relate to the company's defined subprocesses. The overall effort will require research, competitive intelligence, and possibly the use of independent experts to arrive at a benchmark KPI or set of KPIs for each targeted subprocess.

One source of such information that continues to grow its database and expand its list of definitions is KPILibrary.com.[1] According to the company's website, KPILibrary.com has over 400,000 members and supports over 6,000 key performance indicators. KPIs in the library can be very useful for understanding the scope, level of precision, priorities, and processes that a broad cross section of industry has determined to be important.

Membership costs for accessing KPILibrary.com are quite reasonable, making this, and other similar services a cost-effective tool for analyzing process performance and trends. Be aware, however, that metrics presented through a third-party service will almost always require some level of interpretation and adaptation to each company's specific business. Selecting the most important and validated KPIs to use as the performance scoreboard for targeted processes and/or functions is one of the most significant decisions a business faces. The metrics chosen will lead the organization in a specific direction and over time will drive major changes in how the company delivers value to customers and owners.

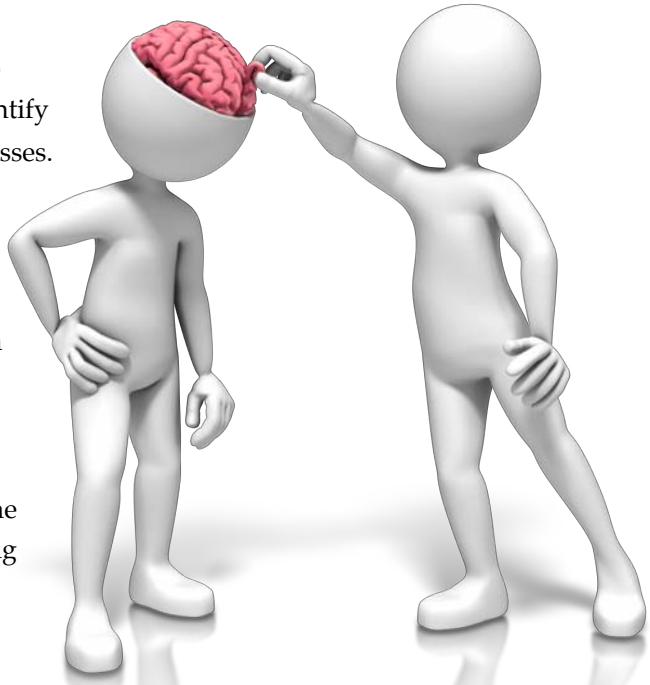
1 www.kpilibrary.com

In addition to web-based services, there are many industry and process experts, and general consulting resources available to help define the appropriate KPI metrics. Typically, these resources will specialize in one or more major functional or process levels:

- Finance and accounting
- Human resources
- Information technology
- Internet and e-business
- Manufacturing
- Testing
- Quality
- Facilities management
- R&D
- Supply chain/procurement
- Logistics
- Inventory and warehouse management
- Sales management
- Marketing management
- Customer service
- Field service management
- Specific vertical industry processes
- International business

The point is, that while it may take significant effort, it is possible to develop practical and useful key performance indicators for the targeted processes/subprocesses. The value of these metrics in helping to optimize processes should prove to be worth many times the cost and time expended to define them.

Matching KPIs to Best Practices



The next step after defining key performance indicators for targeted subprocesses is to identify best practices associated with these subprocesses.

Best practices are defined as generally accepted formal and/or informal standardized methods, procedures, and processes for performing a specified function or process. By definition, best practices are proven to be superior to previous, less successful alternatives. For example, a hand assembly process typically takes 35% less time the fourth time it is done. Lean manufacturing process optimization projects routinely yield 20% to 40% reductions in time and cost.

These best practices help you determine what level of optimization is possible or practical, and what you'll need to do to achieve the significant savings represented by the gap between the *As Is* process-based performance, and the *To Be* best practice-based performance. Typically, this difference, or gap, reveals a 20% to 40% improvement potential … certainly enough to make a major operational and financial impact on the business.

As with KPI metrics, there are numerous possible sources available to help you identify best practices for a given subprocess and the associated KPI metrics. Sources may include software suppliers, consultants, subject matter experts, academic/research experts, and industry associations. Typically, the best starting point will be a search for best practice information by functional area, such as online marketing, sales management, warehouse management, and other functionally equivalent topics. This level of search should reveal a range of potential sources that can be tapped for more detailed analysis.

Best practice research and analysis should generally be performed by the members of an organization's corresponding functional team. These internal experts are intimately familiar with current practices and are best qualified to make recommendations to management.

Using Best Practices as Benchmarks

Competitive benchmarking provides important information about a company's current position within various product spaces, or markets, and also helps an organization identify which of its functions and processes are considered to be *core* to overall performance by the industry. Best practice benchmarking, by contrast, may not reveal much about the industry or market specific competitors within the industry, but it will reveal the high-end potential for optimization.

Additionally, it is usually difficult to get directly useable KPI metrics about competitors. And even if your research does reveal competitors with a higher performance than yours, this doesn't necessarily mean that your competitor's functions and processes are the best alternatives available. In many cases, the processes used by top competitors in a particular market space are still significantly lower in performance than the global best practice.

When you also consider that the effort required to migrate from an existing practice to an new, higher performing practice will be similar, regardless of the differential in the resulting performance gains, it just makes sense to include both *direct competitor practices* and *best practices regardless of industry* as benchmarks for optimization.

As an added benefit, by including best practice benchmarks from outside your industry, you avoid the tunnel vision that often plagues mature, highly competitive industries. This willingness to think outside the box can translate into a significant competitive advantage over those in your industry taking a more commodity-based approach to business planning.

Document and Analyze

A typical example of a process benchmarking worksheet is illustrated in Figure 2.3 below.

Process Benchmarking Worksheet

Process: Marketing Management

BEST PRACTICE	ASSIGNED WEIGHT	US		COMPANY A		COMPANY B		INDUSTRY BEST	
		Score	Total	Score	Total	Score	Total	Score	Total
Market Segmentation and Qualification: Company has clearly defined served markets with industry and/or application-based segmentation market sizes, primary demand defined and CAGR logic and estimates.	15%	9	1.35	6	.9	8	1.2	9	1.35
Marketing Strategy and Master Plan: Company has well-defined, structured, written marketing strategy and implication plan based on targeted segments, channels and geographies.	20%	8	1.6	9	1.8	5	1	10	2.0
Brand Positioning and Definition: Company has well-defined brand mapping/positioning and strategy with core concept summarized and used internally and externally as the essence of the organization's purpose.	15%	8	1.2	6	.9	6	.9	9	1.35
Product Requirements Definition: Company has well-defined structure, processes, and responsibilities for providing prioritized/valued project inputs to product management.	15%	6	.9	8	1.2	5	.75	8	1.2
Channel Planning and Management: Company has clearly defined and quantified channels to market with value model of the food chain, margins and critical issues defined for each.	10%	7	.7	6	.6	6	.6	9	.9
Pricing Strategy and Policies: Company has clearly defined pricing strategy based on competitive value benchmarks and established policies for review and approval of deviations to standard policy.	25%	6	1.5	8	2.0	6	1.5	10	2.5
SCORE	100%		7.25		7.4		5.95		9.3

SCORING SCALE: Excellent = 9-10 Above Average = 7-8 Average = 5-6 Below Average = 3-4 Poor = 1-2

Figure 2.3: Process benchmarking worksheet

In this example, the major process is marketing management. For illustration purposes, we have described six subprocesses that can collectively define the major responsibilities of this overall process. Certainly, there are other ways to break the marketing management process down into subprocesses. This breakdown is shown simply to explain the overall method:

- Market segmentation and qualification
- Marketing strategy (represented by a master marketing plan)
- Overall brand positioning and definition
- Product requirements definition
- Channel planning and management
- Pricing strategy and policies

Each subprocess listed on the process benchmarking worksheet should be weighted based on its significance to the overall effectiveness of the major process. The higher the competitive weight, the higher the significance of each weighted score. Once the weights are completed and agreed upon, the next step is to assign scores for yourself, your competitors, and the best practice for each subprocess.

In many cases, competitive scores for each subprocess can only be implied based on prior experience, customer feedback, information learned at trade shows, etc. The specific inputs are less important, at this point, than the information they reveal. Consider the process benchmarking worksheet to be a living document that will be constantly updated as more information is discovered. Once a subprocess has been defined as competitively important, more and more input will likely become available as team members become aware of its importance.

It's often easier to get detailed information on industry or functional best practices and their associated key performance indicators, than it is to get information about direct competitors. Strategically, this won't matter, since the ultimate goal is to target the global best practice performance as the basis for improvement initiatives.

I Can See Clearly Now!

Collectively, the function, process, and product line competitive benchmarking results define the *As Is* operational competitiveness of the business. These benchmarking methods partition the operations of a business into logical and prioritizable components for optimization. This deconstruction of the business into definable, measurable, and comparative elements will highlight strengths, expose weaknesses, and enable high-impact actions to achieve competitive advantages and higher financial performance.

The product line benchmarking process defines the relative profitability, current functional competitiveness, and future value potential of each product line. Clarity of the profit contribution and level of investment necessary to sustain and/or improve the future profitability of each product is essential to defining a sustainable winning strategy.

Process benchmarking reveals how to go about improving the overall competitiveness of the business. Together, these two perspectives put the major strategic issues in focus and help define (along with information about the organization's current culture), the business's *As Is* situation.

CASE IN POINT

Today, thanks to the Internet, SMBs can identify and implement product and process best practices just as effectively as General Electric and other Fortune 1000 companies.

General Electric Corporation is probably the best-known example of a business exhibiting consistent, excellent, operational performance. GE was founded in 1892 and was one of the 12 companies originally included in the Dow Jones average in 1896. Unlike the corporate failures identified in the first chapter, GE has remained a cornerstone of American industry for 122 years by constantly challenging its own strategies and relentlessly pursuing the best ideas in operational excellence.

Over the last 20 years, GE management has focused its attention on learning and improving the principles of Six Sigma and lean operating techniques. Thanks to GE and others, these powerful tools have become productized and documented to the point where they are readily available, transferrable best practices for product and process benchmarking.

Six Sigma is a very straightforward concept … a simple, statistical term that measures how far a given process is from perfection. The fundamental idea is that if you can measure how many defects you have in any process, then you can systematically figure out how to eliminate them. The objective is to achieve zero defects by taking every possible opportunity to eliminate non-conforming outputs from a process. To achieve Six Sigma performance, a process must produce fewer than 3.4 defects per million opportunities for non-conformance. This technique is broadly applied in "lean" manufacturing, product planning, business process, and logistics optimization methods.

Six Sigma, lean techniques, ISO quality assurance standards, and other high impact product and process optimization skills are readily available through cloud based applications, consultants, and do-it-yourself courses that leverage the billions of dollars spent by early innovators to develop these tools. The results of these methods are effectively changing the basis for competition in retail, restaurants, healthcare, manufacturing, technology, entertainment, business services, and most other industries. The cost of implementing these powerful benchmarking and process optimization techniques can be as little as a few thousand dollars, compared to the billions invested in their development.

Building a Competitive Culture

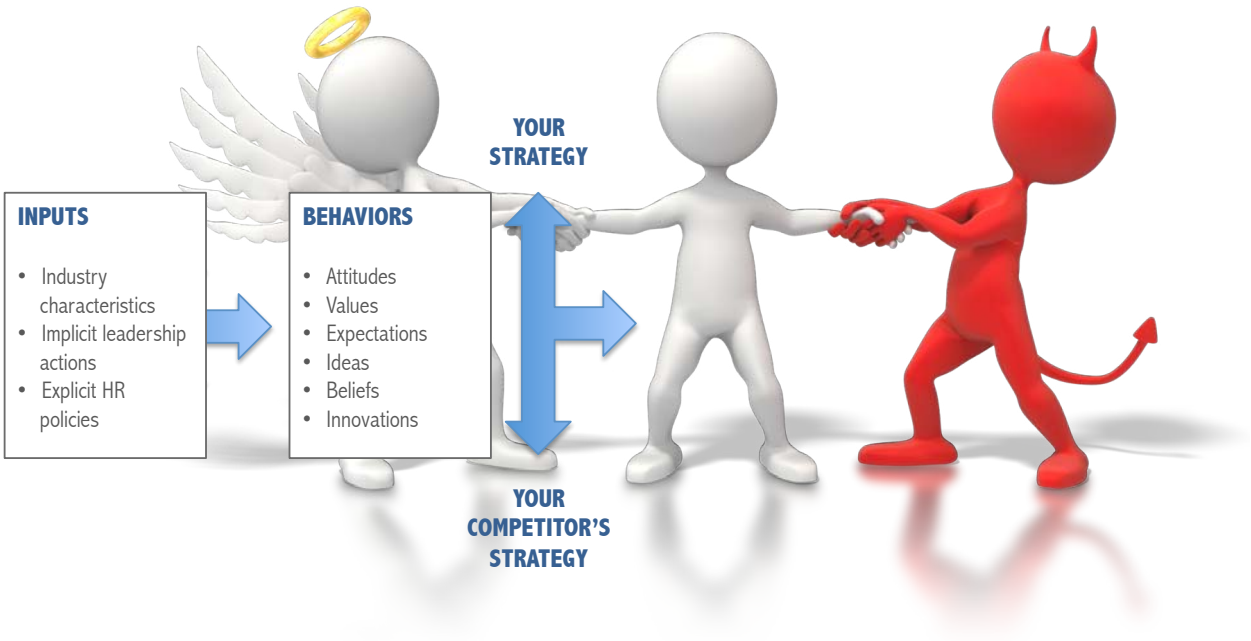
TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. Culture is a shared set of beliefs, attitudes, expectations, and behaviors.
2. Behaviors within a given culture are either positive or negative based on their alignment (or misalignment) with business objectives.
3. A business's culture is the result of actions — a closed loop process.
4. Business sectors/industries define the baseline culture for most businesses.
5. Leadership actions, not words, drive culture.
6. HR policies and investments, not words, drive culture.
7. Individuals behave based on cultural drivers.
8. Collectively, individual behaviors define culture.
9. Cultural benchmarking is an essential management and planning tool.
10. Culture is either a long-term asset (positive force) or a long-term liability (negative force) … reinforcing or nullifying a business's chosen strategy.

3.1 Culture Optimization

Culture, from a business perspective, can be defined as a shared set of ideas, beliefs, attitudes, values, norms, and expectations within a specific group, such as business sector, company, organization, division or department. In a business environment, group *feelings* or *beliefs* translate into behavior! In this sense, behavioral alignment with company objectives (or lack thereof) can have a material impact on the performance of the business and its ability to implement strategies, make changes, adapt to new technologies, react to competitive challenges, and be passionate about customer satisfaction.

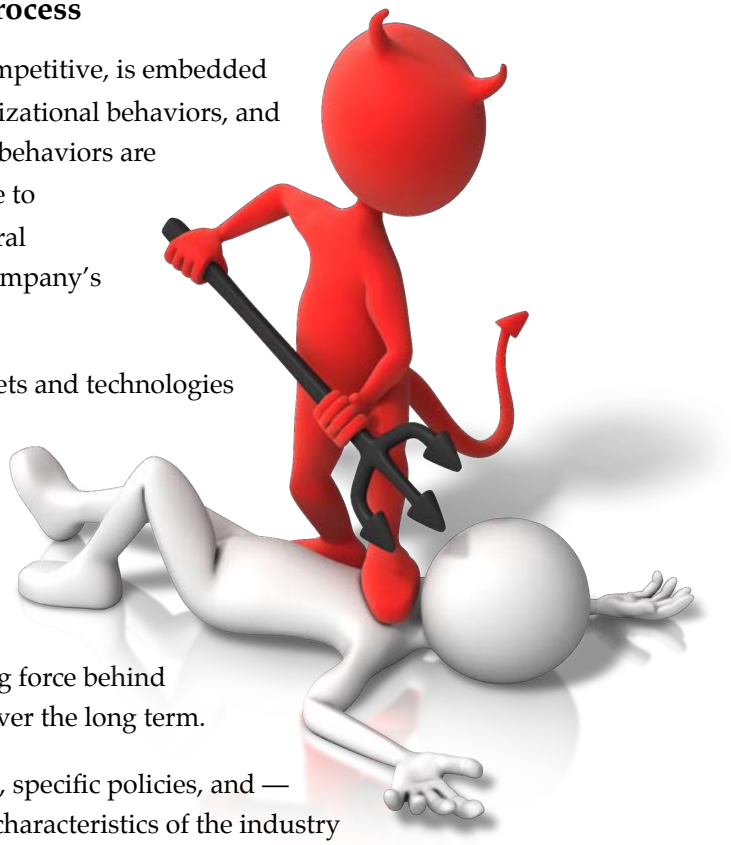
Individuals are not born with specific cultural characteristics or expectations; these attributes are shaped by life experiences. More specifically, in business, cultural values are shaped by the attitudes and actions of other individuals (particularly leadership) employed by an organization. Subcultures may also exist within an organization due to differences in leadership, location, and/or organizational structure.



The *COBRA 3D Business Development Process* stresses the importance of modeling a business in three dimensions: Defining a winning strategy, optimizing operational performance, and creating a competitive culture. Building a competitive culture is a critical, yet often overlooked, dimension of business that can ultimately determine whether, and how effectively, an organization is able to recognize and overcome challenges and opportunities that impact financial performance and wealth creation.

An organization's culture can be viewed as either a powerful intangible asset, or a long-term, and potentially debilitating liability. A focused, motivated, and thereby competitive culture can differentiate a company from competitors through extraordinary customer service, rapid response times, optimized communication, a high level of industry and product/service knowledge, sustained innovation, and other desirable actions. Conversely, a culture that is not focused, nurtured, and aligned with company objectives will often exhibit poor operational performance, resulting in higher costs, corrosion of customer relationships, and poor financial performance.

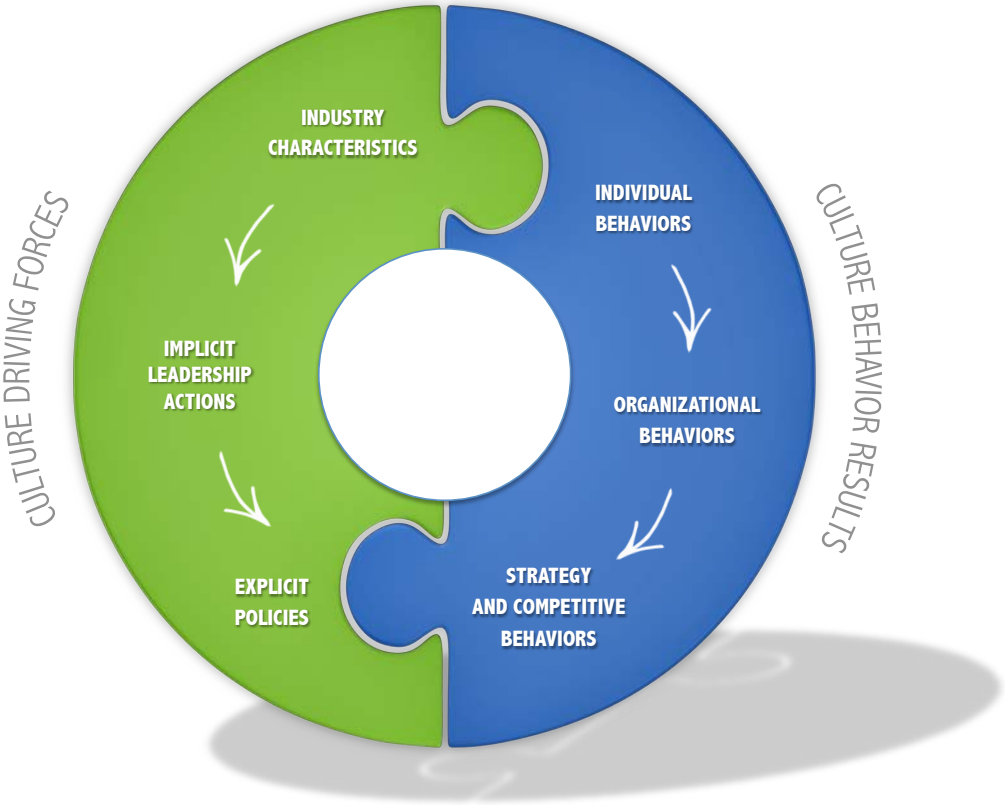
3.2 Culture … A Closed Loop Process



Culture, whether competitive or non-competitive, is embedded in individual behaviors, collective organizational behaviors, and resulting operational capabilities. These behaviors are significant in terms of how they compare to competitive capabilities and to the cultural characteristics required to execute the company's winning strategy.

The dynamic, disruptive nature of markets and technologies has forced leadership teams to approach culture as the cornerstone of strategic sustainability. This fundamental relationship between individual behaviors, business team characteristics, and their relationships to competition and strategy is the driving force behind operational and financial performance over the long term.

Culture is the result of long-term actions, specific policies, and — barring actions taken to differentiate — characteristics of the industry and/or business sector itself. In this context, culture should be viewed in the same way as any other intangible asset; its value to an organization is the result of investments or lack of investments.



Business sector or industry characteristics, which include rate of change, adoption of new technologies, level of innovation, skill level requirements, and overall financial stability tend to determine the prevailing or predominant culture of businesses within an industry. This is easy to understand when you consider the nature of the manufacturing sector vs. the healthcare sector, or the beverage industry vs. the information technology industry vs. the entertainment industry, and so on! Each sector and industry evolves at a different speed, with different levels of maturity, and all are affected differently by cyclical variations in the economy and other global/regional/local influences.

For example, a company in a highly innovative, technology-driven industry must promote creativity, collaboration, and continuous learning to survive. This would also be true of its major competitors. As a result, the baseline cultural characteristics of the industry will be similar, at least as a starting point.

Conversely, if a company is in a mature, slow growth industry with little substantive innovation (real product innovation vs. marketing hype), the culture of that business will typically be more hierarchical, functionally structured, formal, and less likely to require frequent adaptation to new technologies or processes … at least until a competitor surprises the industry with a *disruptive* strategy!

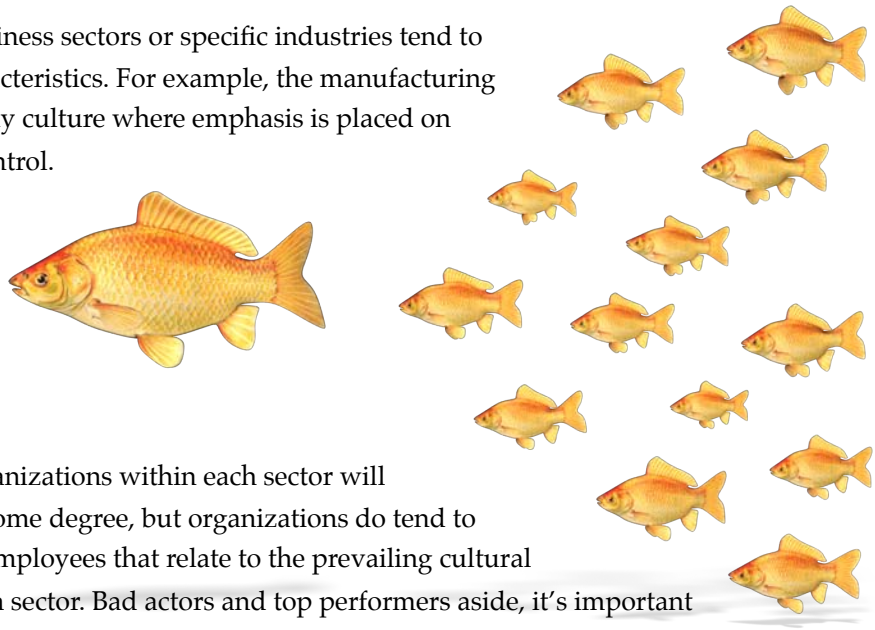
The actions of owners and managers have a disproportionate and decisive impact on the cultural characteristics of an organization. Policy statements rarely make a difference alone and are only relevant to the extent they coincide with the observable actions taken by leadership. When they differ, an organization will *always* abide by the actions *observed* over the *wishful* words communicated.

In fact, when explicit, written policies are reinforced by implicit, observable actions, management gains credibility and desired behaviors are positively reinforced. Policies that validate intelligent, adult, motivated people will tend to result in intelligent, adult, motivated behaviors. Policies that assume or imply that staff members are less intelligent than management, do not behave as adults, and must be coerced to perform … will yield these exact behaviors.

As with any process in need of improvement, when appropriate, well-conceived policies, expectations, and actions are used as inputs, a net positive impact on cultural characteristics can be achieved as the output. The key question that remains is how well the current culture fits the competitive and strategic needs of the business!

Business Sector Norms

As mentioned previously, business sectors or specific industries tend to exhibit defining cultural characteristics. For example, the manufacturing sector tends toward a hierarchy culture where emphasis is placed on efficiency, consistency, and control. Conversely, workers in the technology sector are more likely to encounter an adhocracy culture that emphasizes innovation, transformation, and agility.

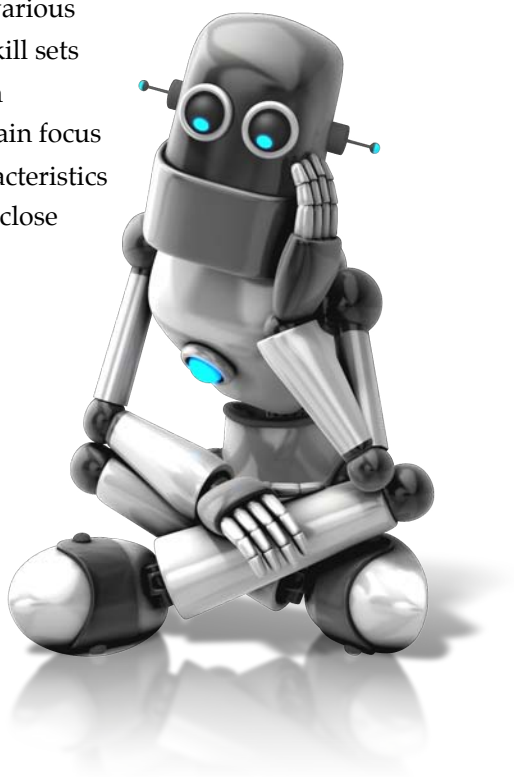


Industries and individual organizations within each sector will deviate from these *norms*, to some degree, but organizations do tend to inherently attract and retain employees that relate to the prevailing cultural characteristics that define each sector. Bad actors and top performers aside, it's important to recognize this prevalence toward a given culture and to use this information as a *baseline* to evaluate an organization's culture.

Let's look at some of the business characteristics that shape the cultural framework of a business sector or industry:

- Rules/history of competition, structure, and channels
- Geography (local, regional, national, global)
- Economics (of investments, capital structure)
- Technology/rate of change
- Skill sets required
- Rate of change of competitive basis
- Competitive basis (technology, functions, price, quality, support)
- Regulations (local, national, international)
- Company structure (small, midsize, large, global)
- Investment thesis (expected return on capital)
- Mobility (of supply, manufacturing location, people)
- Globalization (of supply chain, products, customers)

Obviously, these characteristics will apply differently for various industries. Take skill sets for example. There are specific skill sets needed to work in an organization focused on information technology that simply wouldn't apply to a firm whose main focus is beverage marketing. The key is to look at all of the characteristics that are relevant to the business. Benchmark them against close competitors, define changes that will help align the organization's culture with its winning strategy, and then prioritize and invest in projects that will help move the organization toward the stated objectives.



Leadership Actions

As explained earlier, management is ultimately responsible for shaping the culture in any organization. Those in management roles must lead by example, communicating their expectations both implicitly and explicitly. The old saying "actions speak louder than words" is absolutely true and compelling when it comes to shaping an organization's culture! Positive actions, reinforced by written and oral communications, will build trust, which in turn creates a foundation for competitiveness.

Once the dust settles, the most significant and definitive truth that a new leader of a business realizes is that he or she must face and address the legacy culture of their predecessor. The existing culture is the result of prior actions or lack of actions, reward systems, communications, and other inputs that have been demonstrated to the organization by leadership/management behavior over the past years.

Changing an existing culture is a significant challenge, but it also provides an opportunity for executing new strategies, turn around actions, acquisitions, divestures, or whatever other improvement initiatives the new leadership has defined. Unaddressed, the misguided elements of a legacy culture can become a roadblock to improvement initiatives and future success.

To enhance, or even slightly modify an existing culture, takes a significant amount of time, actions, consistency, and communication. Incoming leaders often impose their vision of what an organization's culture *should be* without a clear understanding of how that vision differs from reality. This often results in confusion, resentment, resistance, or retaliatory actions that are counterproductive.

Following is a list of leadership actions that are likely to have a material effect on an organization's culture over time:

- **Hiring decisions —** Hiring, promoting from within, or going outside to recruit resources will send a clear and definitive message to the organization.
- **Firing decisions and compassion —** Business situations that require terminations or furloughs can be devastating to morale unless handled with professionalism and compassion.
- **Compensation systems —** The fairness of compensation between functions, departments, genders, and grade levels, based purely on business criteria will have a significant impact on employee attitudes and actions.
- **Symbolic gestures —** Simple, symbolic gestures or *perks* — like favored parking spots, desirable offices, face time with the boss, and other perceived status symbols — can have a dramatic (positive or negative) effect on morale.
- **Communication of key business situations —** Open communication to the organization, or lack thereof, regarding strategy, vision, mission, performance criteria, and other key business situations will have a clear impact on trust, independent actions, and commitment to the business.
- **Reward systems —** Above and beyond basic compensations systems, the design and consequences, intended or unintended, of bonus and incentive systems are powerful drivers of culture. These results can be good or bad, intended or accidental, but will always have a significant effect on behavior.
- **Communications style —** The style of leadership communications, whether appropriately positive or perpetually pessimistic, will certainly be reflected in perceptions and attitudes within the organization.
- **Performance metrics —** The specifics of the *scoreboard* that an organization uses to measure and communicate results are critical.
- **Diversity programs / reality —** A recognizable acceptance of diverse peoples, personalities, and lifestyles vs. policy lip service will be a major contributor to the perceived ethics of an organization.
- **Customer interactions —** The way management communicates and reacts to customers will be reflected similarly throughout an organization.
- **Supply chain interactions —** The perceived importance and respect (or lack of) given by management to members of the supply chain will be recognized and emulated throughout the organization.
- **Demonstrations of trust / ethics (or lack of) —** Leadership/management decisions regarding real world situations that require a tradeoff between business performance and ethics will determine how trust and ethics are valued throughout the business.

Virtually every action taken by leadership will have an impact, either immediate, cumulative, or both. Open lines of communication — delivered with respect — along with consistency between actions and words will demonstrate the commitment of leadership to nurturing a positive and productive culture.

HR Policies

Explicit HR policies that invest in the skills and capabilities of employees demonstrate concrete proof of a cultural commitment. These hard dollar investments showcase the behaviors and capabilities that a business is willing to invest in and demonstrate that the organization is serious about the performance of individuals within the context of the business's mission, vision, and strategy.

The following examples demonstrate policies and programs for developing skills, capabilities, confidence, and commitments to support the business's objectives. All of these require investments of money, time, and planning targeted directly at improving professional capabilities:

- **Compensation/benefit plans —** Fair and equal compensation is based on position requirements, with clearly defined criteria for performance and promotion. Benefit plans must be consistent throughout all levels of the organization.
- **Performance reviews —** Quarterly or regularly scheduled reviews of job performance.
- **Discipline procedures —** The method for identifying, discussing, and acting on business related discipline issues must be clear, fair, and discrete. There should be adequate flexibility for unique circumstances and a reasonable opportunity for discussions prior to any actions. Childish or arbitrary discipline in any level of the organization will be destructive to the culture.
- **Hiring procedures —** There must be clearly defined job descriptions, with clear paths for qualified internal candidates and independent selection procedures. These hiring characteristics are essential to demonstrate mobility potential within the organization. Without a sense of internal promotion opportunities, the best performers will seek opportunities elsewhere.
- **Firing procedures —** These policies and procedures must be clear, fair, consistent, professional, and compassionate. Everyone in the organization must be made aware of how the company handles this process.
- **Specific skills training —** Training opportunities must be clearly defined and provided for specific skills, tasks, functions, and processes to support performance expectations for existing positions.
- **General skills training —** General purpose business or functional training programs that develop a deeper understanding of a company's finances, markets, competition, industry, or strategies will strengthen each individual's commitment to the objectives of the business.
- **Diversity programs —** People within the organization must feel comfortable and equal regardless of gender, race, sexual orientation, religion, ethnicity, or any other criteria. Leadership is responsible for proactively ensuring that this situation exists in the organization!

Individual Behaviors

Industry norms, leadership actions, and investments made in people are all reflected in the values, attitudes, and behaviors of the individuals working for a business. Collectively, these behaviors represent the culture of the organization, which is both driven and supported by the collective attitudes and behaviors of all the individuals in the business.

Certainly, every person in an organization has a unique set of skills, experiences, personal history, and relationships with a company. Individuals bring a multitude of values, beliefs, and ideas to the company, many of which vary tremendously from person to person. What some find motivating and effective, others may not. What some value in terms of compensation and rewards, may be disincentives for others. With that background, it is clear that the individual characteristics that define culture can range from agony or indifference to engagement or commitment.

BEHAVIOR CHARACTERISTICS	INDIVIDUAL ATTITUDES			
	AGONY	INDIFFERENCE	ENGAGEMENT	COMMITMENT
Resistance to change				
Distrust				
Politics				
Sabotage				
Retention				
Adaptability				
Independent actions				
Teamwork				
Collaboration				
Innovation				
Loyalty				

Figure 3.1: Performance result of an organization's culture

An organization's culture establishes a framework for how people are expected to behave. This cultural environment has a direct impact on the personal, behavioral characteristics of everyone in the organization, how they act, and more specifically how the team of people acts:

- **Resistance to change —** A bureaucratic culture with a great degree of politics, preferences, or *pets*, will not be flexible, adaptive, or able to change as needed to meet competitive threats.
- **Distrust —** The amount of doubt or insecurity that people have in relation to the organization will significantly inhibit performance.
- **Politics —** When it is clear that there are personal and social reasons for rewards, rather than professional performance, politics will invade and strangle the business.
- **Sabotage —** Above and beyond distrust and politics, an individual's attitude can escalate to outright sabotage of new programs, ideas, and objectives.
- **Retention —** The ability (or inability) to keep top performers is critical to the performance of the business.
- **Adaptability —** The culture of an organization will directly affect an individual's ability to be flexible and adjust accordingly to certain situations for the good of the organization. Business is constantly changing, so being able to adapt is critical to success.
- **Independent actions —** Independent, motivated people will make intelligent, high-impact decisions and take actions that will benefit the business above and beyond expectations.
- **Teamwork —** The ability to work together to solve a common problem or reach a common goal can only occur when individuals are fully engaged with the objectives of the business.
- **Collaboration —** When individuals are committed to the mission and vision of the business, they will collaborate to solve problems and exploit opportunities.
- **Innovation —** Beyond collaboration, committed individuals will find new and better ways of getting things done to make the organization more profitable, and products/services more competitive.
- **Loyalty —** The depth of an individual's commitment to the business will be demonstrated by their loyalty to the performance and sustainability of the organization.

All of these individual characteristics play a key role in how a business performs and how the collective culture competes. Each one of the described behavioral characteristics will ultimately determine whether the individual is in agony, indifferent, engaged, or committed to the organization. In order to cultivate a true competitive culture within a company, all individuals associated with the business should be engaged and committed to the overall organization and its growth, success, and sustainability.

Organizational Behaviors = Culture

Individual attitudes, beliefs, feelings, and behaviors cumulatively represent the culture of a business. Certainly, there is always a complete spectrum of individual characteristics, but culture is essentially a statistical, normal distribution of these characteristics. So while there are groups at each end of the normal distribution that represent extreme negatives and extreme positives, the business is driven by the *core culture*.

The fundamental or core culture of a business is a predictable set of behavioral characteristics that can be categorized in numerous ways. There are several excellent methods available for analyzing and categorizing culture.

For the *COBRA 3D Business Development Process*, we are interested in the cultural characteristics as they relate to implementing the winning strategy and key objectives of the business.

Creating and maintaining a competitive culture is an essential part of modeling and developing a business in three dimensions. Fostering a company culture that enables the organization to compete more effectively is a key ingredient in the business development process. Culture is essentially the *legacy* of the business, and that legacy should be strong enough to seamlessly transition through generations of management.

In this context, one of the best and easiest methods to use was developed by Kim Cameron and Robert Quinn, and is referred to as the OCAI[1] (Organizational Culture Assessment Instrument) analysis. This method of cultural classification was developed based on extensive research and focuses on the key elements of culture that relate to the execution of strategy and effective competition.

1 OCAI information available at www.ocai-online.com.

3.3 Cultural Benchmarking

The OCAI technique of cultural benchmarking is practiced globally. This technique is easy to understand and can be applied to any organization using the company's online tools at www.ocai-online.com. These tools can be used to help a small or midsize business define and understand the *As Is* characteristics of its current culture, and to define the *To Be* characteristics needed to align its culture with the requirements of its winning strategy.

Certainly, there are other cultural benchmarking techniques that are effective in defining the characteristics of an existing culture and the cultural requirements of the winning strategy. The OCAI method is described here to illustrate the key principles of the cultural benchmarking process, and the characteristics of culture that should be considered during the development of a winning strategy.

The OCAI method uses an online questionnaire that is completed by whatever number of individuals the management team has selected to benchmark the culture. The benchmarking group answers a series of questions broken down into the following six dimensions of organizational culture:

- Dominant characteristics
- Organizational leadership
- Management of employees
- Organizational culture
- Strategic emphasis
- Criteria of success

The benchmarking group individually answers and assigns weights to these questions in order to describe their perception of the *As Is* culture. Later in the process, the same group will answer the same questions based on their understanding of the cultural characteristics required to execute the defined winning strategy. This preferred culture will become the *To Be* objective of the organization.

Collectively, the answers and weights are then analyzed by the OCAI software program and plotted into four quadrants to illustrate the organization's behavior tendencies. These cultural tendencies are scored relative to the following behavior characteristics associated with each quadrant:

- Flexibility and freedom to act
- External focus and differentiation
- Stability and control
- Internal focus and integration

When the questions/answers are mapped within the quadrants represented by the competing values framework, the organization's culture can be defined. The collective weighted scores define the cultural characteristics of the organization in each of these dimensions to establish its unique profile.

The four quadrants of the OCAI cultural framework are illustrated in Figure 3.2. The left side of the graphic represents organizations that are internally focused, and the right side of the graphic represents organizations that are externally focused. At the top of the graphic, the organization stresses flexibility and discretion; while at the bottom, the organization is driven in the opposite direction — stability and control.

The basic theory is that most organizations develop a dominant culture/style. However, an organization rarely has only one, pure cultural type. Usually, there is a mix of the four types in varying degrees causing conflicts within the competing values framework. This concept is the basis for characterizing the culture within the four quadrants.

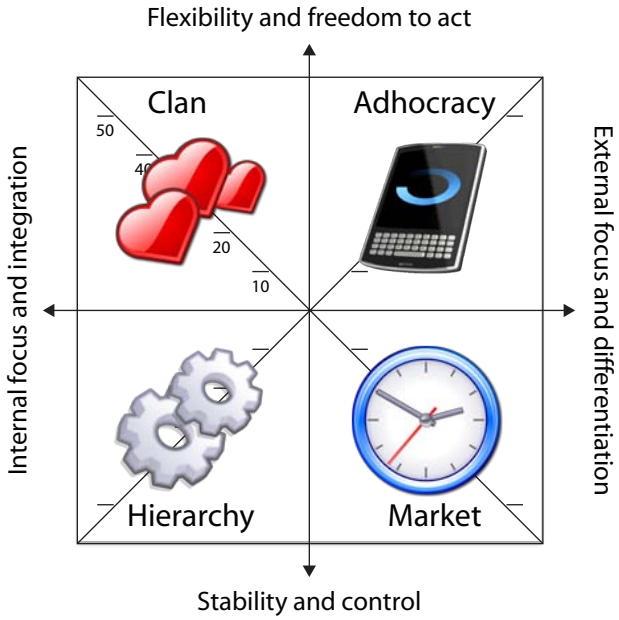


Figure 3.2: Cultural Framework www.ocai-online.com

There is no right or wrong here. Each culture works best within a specific business model that corresponds to its winning strategy. Typically though, organizations that are flexible in their structure are the most effective in handling intense, dynamic, competitive situations. The optimum culture for a given organization is based on the specific strategy and competitive situation the business faces.

The individual attitudes, values, and behaviors that result from a company's characteristics, leadership actions, and human resource policies are magnified at the organizational level. The collective experiences of how people are treated, *how things are done here*, and what's really important, are embedded in the cultural behavior of the organization. Benchmarking of an organization's current culture, compared to its winning strategy culture, is critical. It highlights ways in which your organization can effectively compete, and remain committed and aligned to the strategy and operational performance goals of the business. Research has consistently shown that cultural issues are the main reason why 70% of mergers and acquisitions fail, and by extension, why many strategic initiatives fail.

Following is an overview of the four OCAI cultural types — collaboration, innovation, competition, and control — with descriptions of the leadership styles, value drivers, and other key characteristics that correspond with each culture. Each organization will have some mix of all four cultural types but will almost always have one dominant tendency.

Collaboration Driven

Clan culture is collaboration driven. Clan cultures are run with a leadership style in which the management team places a high value on people, making this leadership type predominantly similar to a mentor or facilitator. An organization with a clan culture tends to be highly people oriented, with a strong emphasis on coaching, training, and up-to-date education for employees to further develop their skill sets. In return, employees in the organization are invested in the success of the business and show high commitment and engagement to sustainability and growth.

The value drivers in this type of culture are commitment, communication, development (both personal and professional), and group participation. Employees in a clan culture often identify themselves with the organization. They view the success or failure of the business as a direct reflection of their contribution to the company. Teams consisting of members who find each other's knowledge base mutually beneficial often create their own *teams* or *groups* that add more value collectively, rather than independently, to organizational goals.

The quality strategies used are empowerment, team building, employee engagement, and open communication. Employees in a clan culture are not micromanaged and are empowered to make their own decisions regarding the day-to-day operation of a business. Clan cultures exhibit a high level of employee engagement due to the fact that team building is revered as a positive attribute to the ultimate success of the organization. This also fosters an open communication atmosphere in which employees of the company feel comfortable and confident with one another.

Innovation Driven

Adhocracy culture is innovation driven. Adhocracy cultures are extremely dynamic, entrepreneurial, and visionary. The leaders of this culture type exhibit a *broker* role; they are typically innovative and tend to foster creativity (think early Apple). Essentially this culture type thrives on finding and/or creating new ways to solve problems or fill a current need, in a more productive, effective, and innovative manner.

The dominant value drivers in this culture are innovation, agility, transformation, and taking advantage of new resources to produce results. This culture type is entrepreneurial, visionary, and thrives on change. Much of the work done in this environment is achieved via brainstorming teams, projects, and, of course, free time/space to experiment. This is the foundation for what is known as a *learning organization* in today's business world.

Mistakes are not the end of the world in an adhocracy culture; they are viewed as important stepping-stones for learning how to do things better, and for becoming more productive and effective. Many times in an adhocracy culture, there is a lack of traditional detailed job descriptions. Instead, a rough guideline of responsibilities is utilized, with much-needed *free space* to innovate and create.

The quality strategies used in an adhocracy culture are to anticipate needs, create new challenges, and find creative solutions. Adhocracy is not always about creating the next, great innovative product/service. It is also about exploring alternative and creative solutions to shortcomings in existing products and services. Many startup companies successfully utilize this type of dominant culture style.

Competition Driven

Market culture is competition driven. Leadership found in this type of culture is results oriented; owners and managers put extreme emphasis on producing results and remaining highly competitive. They are considered hard drivers, and see most if not all business situations as black and white … there is no grey! By putting such a strong focus on *getting things done,* the foundation of this culture type is performance, performance, performance!

The value drivers are market share, profitability, and goal achievement (short and long term). In this culture, aggressive competitiveness and high customer focus are considered effective measures of success. High performance teams are often created to help find new and unique solutions to problems. Dominant market share is the *pot of gold at the end of the rainbow* for a market-driven culture.

Profitability and sustainability are the driving forces that keep the momentum in place for short-term goals such as quarterly targets, as well as long-term goals such as gaining market share or introducing new products and services. Current competition in the marketplace, as well as unknown competitive threats, keep market cultures motivated to continue to compete aggressively and *win*!

Quality strategies used in a market culture consist of measuring customer preferences, improving productivity, and creating external partnerships involving customers and suppliers. Since market cultures are so fixated on performance, they often develop customer care teams or customer satisfaction teams as a means of measuring customer preferences and needs. Improving productivity is also extremely important in a market culture because there is a strong need for continuous improvement on every level in order to remain fiercely competitive in the marketplace. These types of quality strategies are considered integral to the continued development and improvement of the organization.

Control Driven

Hierarchal culture is control driven. The leadership style of this predominant culture consists of coordinating, monitoring, and organizing. A hierarchy culture is extremely formalized and structured. Members of the organization take a very systematic approach to doing things.

Hierarchy culture is what most people think about when they think of a top-down approach to corporate culture. There is a right and a wrong way to do things, as well as a system of management tiers within the company. Everyone in the organization is aware of what *their* responsibilities are and what the chain of command is when it comes to running the day-to-day operations of the business.

The value drivers of hierarchy culture are efficiency, punctuality, consistency, uniformity, and reliability. The main thesis underlying a hierarchy culture is that control and efficiency — along with appropriate processes — produce effectiveness. Think lean manufacturing and Six Sigma.

This ultimately leads to quick error detection and excellent quality control. Due to the business being run under a hierarchical *control* regime, any time there is a discrepancy in the organization, it is recognized immediately and corrected. Running a tight ship allows for many manufacturing firms to remain consistent and uniform in their products, and punctual in their shipping methods.

The quality strategies present in this culture are error detection, measurement, process control, systematic problem solving, and use of quality measurement tools. Being able to identify any inconsistency or variance in the manufacturing and operations of the business, by using innovative error detection and process controls, allows the business to solve problems before they reach the customer.

Targeted Culture

The competing values framework provides a view of any discrepancies that exist between an organization's current ***As Is*** culture and its ***To Be*** targeted culture. This provides a starting point for facilitating change. An organization's culture type must align with the characteristics necessary to execute its winning strategy.

The desired culture type for any organization is ideally some mix of all four cultural characteristics identified in the OCAI matrix, with an emphasis on one dominant type.

Figure 3.3 is a graphical representation of a typical OCAI cultural benchmarking exercise:

The current culture is in red, and the preferred culture is blue. In this example, there is a clear desire to shift to more of a collaboration and innovation culture, with less emphasis on a control and competition culture. This graphic indicates a strong disconnect between the current and preferred culture of the organization. Eventually, the difference will negatively impact the performance of the business.

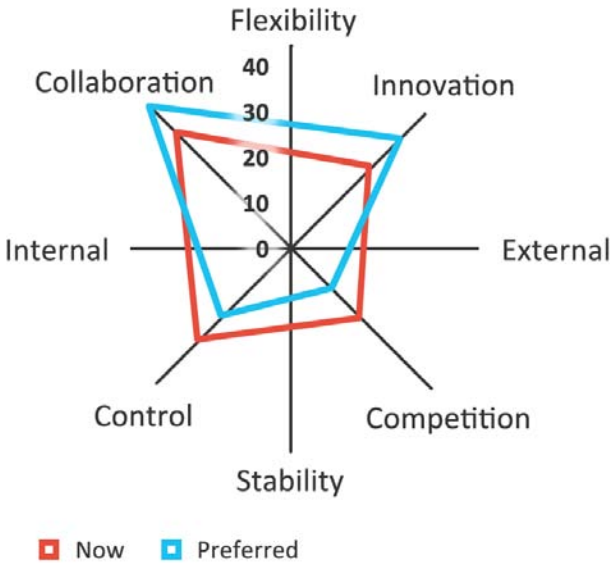


Figure 3.3 OCAI cultural benchmarking www.ocai-online.com

Figure 3.3 is just an example, of course. It is important to remember that every business and industry is different and complex. Each business has its own strategy, operational processes, and competitive culture requirements. The point here is that many times the culture of an organization is not well aligned with its overall strategy. Completing the culture profile will highlight where the culture of the organization is today, and where it needs to be in the future to match the winning strategy and operational requirements defined by management.

Once the culture profile has been completed and the target culture defined, immediate action should be taken to demonstrate management's commitment to change in the organization. This responsibility falls on the shoulders of the leadership team. It is imperative that members of management act swiftly and lead by example in taking ownership of the change process. If change is treated as a priority from the top down, it will be taken seriously by employees, and will give them positive motivation to become involved in taking ownership of the change plan.

3.4 Asset or Liability?

At a business performance level, the momentum and direction created by an organization's culture is compelling. This direction and momentum can be a powerful engine helping to execute the strategies of the business, or it can be a significant braking force in the implementation of key business development projects. The difference financially is the equivalent of an intangible asset compared to a long-term liability.

The OCAI benchmarking process (or equivalent) will provide a current benchmark of what the organization considers important from a cultural perspective. This knowledge can be used as a baseline reference point for strategic planning decisions, and as a guide for the degree of difficulty the organization will face in making cultural transitions. The results of a cultural benchmarking process can also be used as a communications tool, a basis for initiating departmental or interdepartmental decisions, and a tool for reorganizations, mergers, or relocations.

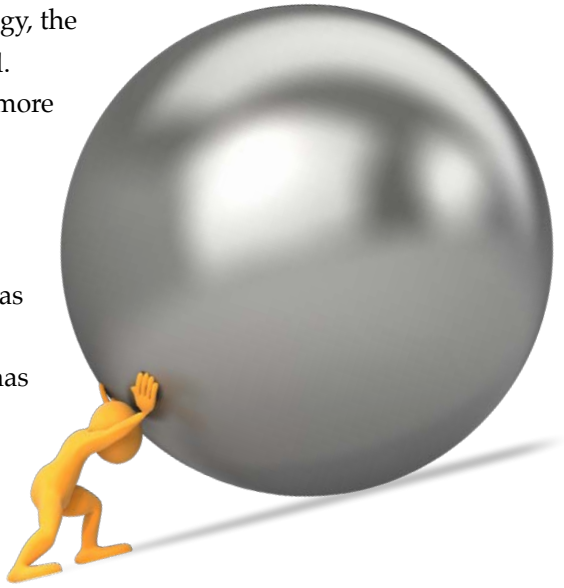
The starting point for using the results from a cultural benchmarking process should be to compare the *As Is* characteristics of the culture to the business's development plans and requirements. There are many areas of the business that affect the culture dramatically, and vice versa. Looking at each one of these areas in detail will allow a clearer picture of the type of culture that is present in the organization as compared to the attributes required to optimize its business performance.

There are numerous ways to evaluate the competitiveness of a culture once it has been benchmarked. The *COBRA 3D Business Development Process* has identified eight general categories for consideration:

- **Culture vs. strategy/objectives —** Does the culture of the organization align with and support the strategy of the overall business?
- **Culture vs. operational objectives —** Does the culture align with the operational objectives and characteristics of the business?
- **Culture vs. best competitors —** Does the culture of the organization influence the success of the business in a positive manner? What cultural attributes give the organization a competitive advantage? In terms of company culture, in what areas do your closest competitors excel?
- **Demographics/business and technology attitudes —** Does the culture align with the workforce demographics relative to business and technology knowledge/attitudes?
- **Ability to adapt and change —** Does the culture enable the organization to adapt and change with technology, new processes, innovation, globalization, and other emerging trends?
- **Innovation/track record —** Does the culture support innovation in a business environment that is changing exponentially?
- **Teamwork —** How well does the organization work together? Do people feel motivated and empowered? Does teamwork occur or not? And to what degree is it present? Is there teamwork within departments? Between departments?
- **Leadership pipeline —** Does the culture develop a constant flow of talented employees moving up the ranks in the organization? A successful competitive culture promotes growth from within, and motivates employees for continued achievement within the organization. If the business is not creating a leadership pipeline, and must recruit outside the organization to place people in leadership roles, it will ultimately destroy the morale of the current workforce, leading to underperformance. Creating the next generation of management should be one of the goals of any successful business.

Sustainable Business Performance

With the existing culture defined and benchmarked against key competitors and the winning strategy, the reality of how to create change must be defined. Unfortunately, this often results in a whole lot more *being said than done*!



Certainly there are many useful methods that have been developed to plan a cultural change. Many of these approaches use communication as the centerpiece of the process. While communication is absolutely essential, it only has value when used to explain actions that have *already* been taken!

That's because an organization's culture is the direct result of *prior* actions and policies. It is not the result of wishful communications, and will not be changed by communications alone. Culture can only be changed by new actions and policies that have been implemented consistently over a significant length of time and adhere to the following:

- Leadership commitment to change and a clear destination (targeted new culture)
- Clarity of the *To Be* situation of the business, including the winning strategy, and the required operational/cultural competitiveness
- Continuous actions and communications with feedback and active listening
- Did we mention *continuous actions*?
- Focused HR policies that reinforce the individual and team behaviors defined in the targeted culture

The key point is that cultural competitiveness is an important factor — equivalent to a winning strategy and operational competitiveness — in defining the sustainable performance of any business!

CASE IN POINT

Leadership actions determine culture, which becomes either a long term asset or liability of the business, very much like the value of a brand.

In 1986 I was promoted and given my first job as general manager of a business with Westinghouse Electric Corporation. The assignment was to turn around Unimation Corporation, once the global leader in robotics; but after four years of culture shock, it was now a financial disaster.

Westinghouse acquired Unimation in 1982 for $107 million, with a clear understanding that robotics technology was rapidly shifting from hydraulics to electronics. At that point, Unimation was the world leader in the number of robots installed, had a highly experienced, entrepreneurial management team and culture, solid technology, and deep pockets. Unimation had developed the key customer relationships needed to achieve global domination in the robotics industry for the next 30 years. Unfortunately, that was not how the story played out!

Rather than exploiting the known strengths of Unimation, Westinghouse — demonstrating its highly controlled, "good old boy" culture — quickly staffed Unimation with its best and brightest bureaucrats, from management to engineering, marketing, operations, and sales. The best innovators, sales personnel, and engineers that Unimation had developed over the past 30 years were driven out of the company or pushed aside from key decision making responsibilities. The die was cast almost instantly, as a rigid and controlling culture overwhelmed a highly innovative, entrepreneurial culture.

When I started to analyze the business in the fall of 1986, four years after the acquisition, Unimation revenue had dropped by 60% to $40 million. The company had $45 million in ongoing operating costs, a negative direct product margin, over 30 people in marketing but only seven direct sales personnel, 11 vice presidents, and well, you get the picture. The total loss in 1986 was more than $60 million and my job was to get it to break even within 18 months, which was achieved by mid 1988.

However, by that time, Westinghouse had lost interest in robotics and decided to sell the business. A once great company passed into the history books along with the $100 million goodwill written off by Westinghouse. I had learned the power of culture!

Developing a Winning Strategy

TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. A winning strategy is best described as the *location, location, location* of a business.
2. The starting point for defining a winning strategy is the *As Is* operations and culture of the business.
3. The core business definition frames the long-term investment thesis for the company.
4. The industry and product structure defines the product space that the business occupies.
5. Competitor's value propositions define the basis for competition in the product space.
6. Served markets/food chains define the growth potential of the business.
7. Forward planning metrics identify significant, potential changes to the basis for competition and profitability.
8. Linear strengths, weaknesses, opportunities, and threats (SWOT) are direct extensions of the current situation the business is facing.
9. Layering disruptive, non-linear technologies, competitive actions, and external forces on top of the SWOT situation defines the probable environment the business will encounter.
10. The intersection of these internal and external forces is the basis for a clear, compelling, sustainable, winning strategy.

4.1 Location, Location, Location!

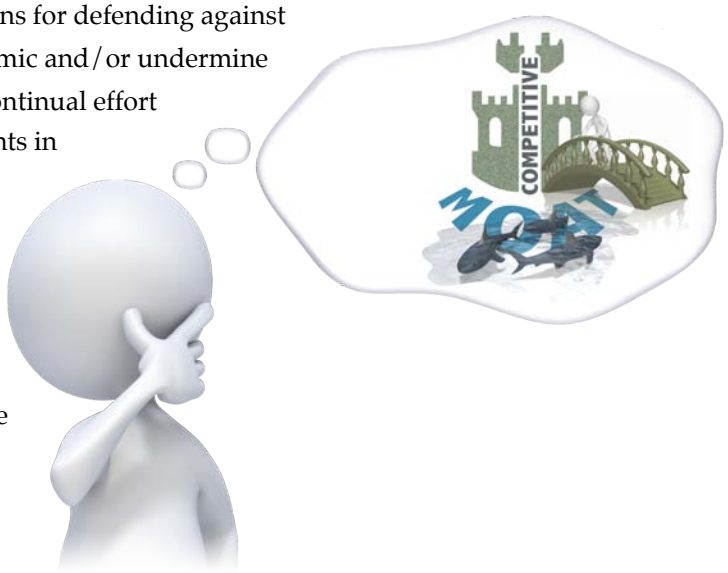
Long-term success in business can only be achieved through implementation of a well conceived, winning strategy. This is true regardless of industry, business size, years in business, or total investment. Without a solid foundation (strategy for success), a business is destined to underperform and will eventually self-destruct or fall prey to more savvy competitors.

So what is a winning strategy? A winning strategy is a plan to acquire, develop, and preserve a compelling competitive advantage in one or more profitable and/or growing served markets, with a clearly defined value proposition. This strategy must be supported by operational capabilities that can sustain and defend the desired market position.

An *advantage* (superior or favorable position) that is *compelling* (evokes interest and admiration), *competitive* (capable of holding its own against others), and *sustainable* (able to be maintained without depletion) is a valuable position worth striving to attain.

To be compelling, competitive, *and* sustainable, it's important to look beyond the borders that define your industry for potential *indirect* competitors that are capable of threatening your position in the market. Customers want solutions to their problems; they're not going to limit their prospects for finding them, and neither should you.

A winning strategy must include provisions for defending against the inevitable efforts of competitors to mimic and/or undermine existing advantages. This will require a continual effort to increase efficiencies, through investments in innovations that allow you to stay one step ahead of the advancements made by others.



These strategic efforts are best described as building a *competitive moat* around the business. Each layer of defense makes it more difficult for competitors to mimic, duplicate, or supersede your successes.

Positioning the business in a profitable and/or growing market is another integral element of a winning strategy. Investing the time, money, and passion it takes to provide a great product or service is fruitless, in the long run, if you're serving a shrinking demand. It is essential to use independent, verifiable research to identify markets that are capable of sustaining growth and profitability over time.

Delivering Customer Value

A clearly defined value proposition is a prerequisite to the implementation of a winning strategy. In the most general sense, a value proposition is a promise of benefit made by an organization to its customers and prospective customers: You must — at a minimum — convince potential customers that the hard earned money they spend on a product or service will return a benefit of equal or greater value. If this promise is weak or not well defined and clearly articulated to prospective buyers, shallow or of lesser value than the promise offered by competitors, or empty (never actually delivered), long-term success is unlikely.

A value proposition supported by unique, proprietary intellectual property (IP), or *virtual intellectual property* (VIP) is stronger and more easily sustained than one that is based on an idea, concept, or technology that can easily be copied or obtained by competitors.

Intellectual property is any creation of the mind that can be legally protected by patent, trademark, or copyright. This can include inventions, designs, or processes developed by an individual or organization that are sufficiently unique in the eyes of governing authorities to warrant a grant of legal protection. This protection is limited by time frame and legal jurisdiction.

Virtual intellectual property is an asset that may not be legally protected, but is nonetheless unique to the market in some way. This can include intellectual property that is marketed beyond the limits of previously granted legal protections (an expired patent, for example, or a process that is trademarked in one country but unprotected in others), exclusive distribution rights granted by a third party, or unique pairings of components and processes (e.g. recipes). It can also include proprietary knowledge embedded in superior designs, higher-speed processes, higher throughput, higher yields, and other equivalent capabilities.

Beyond intellectual property and virtual intellectual property, other competitive differentiators can also be used to create or sustain a defensible value proposition. Structural capabilities that are the current day result of historic IP/VIP, for example, may provide efficiencies, through experience or scale, that are difficult for competitors to match. Market share, when sufficiently dominant, can also deter competitors from entering or expanding their presence in the market.

A low cost producer can more easily defend its place in a market as well. This status may be achieved through volume, but it can also be achieved through superior design, development of unique and more productive processes and subprocesses, reductions in labor costs, improvements to the organization's culture that reduce return rates, and so forth.

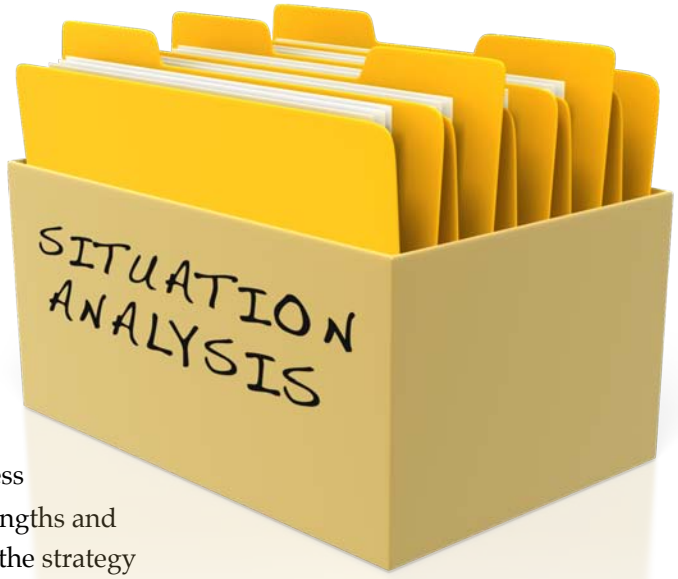
Products and services that entail higher switching costs also provide competitive protection. Consider products that have embedded proprietary software such as cell phones, computers, industrial equipment, etc. These products have steep learning curves that make users think twice before switching to competing solutions. Products tied to training or support plan investments that would be lost if suppliers were switched also achieve *stickiness*, as do products coupled to a data plan, or investments in high-value accessories.

Stickiness can also be achieved through a *network effect* that multiplies the value of a customer's purchasing commitment through user interactions. As the network of users grows, each user contributes additional value (e.g. LinkedIn, Morningstar, Facebook). This makes it much more difficult for newcomers to gain a foothold in the market.

As you can see, a clearly defined value proposition creates the basis for *customer demand*, while sustainable competitive advantages are needed to maintain the market position created by this demand. Value, or a promise of value, is a requirement imposed by your customers and potential customers; while competitive advantages are self-imposed requirements. A smart investor, which hopefully includes the owners of your company, will want to see both! These investors need to see a plausible scenario in which a customer will choose your product or service over competing alternatives, *and* they also need to see how you intend to preserve this scenario over time.

4.2 First, Get Organized

At this point, there should be no doubt about the importance of a winning strategy … or the benefits conveyed to a business seeking long-term sustainable growth and profitability. There should also be little doubt that something this valuable will require a significant commitment by leadership — both in time and resources — to develop.



Before you begin, it will be necessary to organize the tools and resources needed. The *COBRA 3D Business Development Process* uses *As Is* benchmarking results from Chapter 2 as a cornerstone of the winning strategy knowledge library. The detailed competitive information, management team debates, and resulting consensus of opinion needed to complete this benchmarking effort, provides a good starting point for strategic analysis.

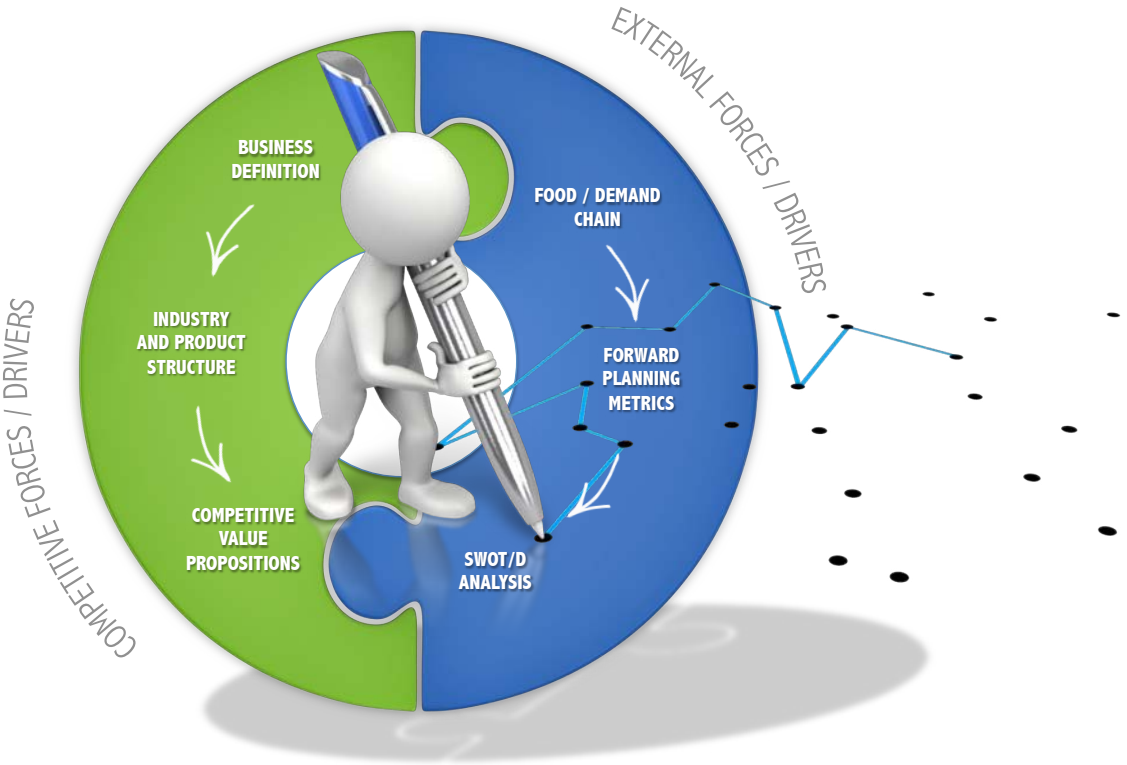
Results of the cultural benchmarking process undertaken in Chapter 3 will highlight strengths and weaknesses in the current culture, helping the strategy development team to gauge the degree of difficulty likely to be encountered when implementing alternate strategies.

Participants in the aforementioned benchmarking efforts will also play a key role in the development of a winning strategy … at a minimum serving as critical *expert* resources in the strategy development process. Guidance from external experts — experienced in either general business development planning or optimization of specific business functions — should be included in the process to help keep the team focused and objective.

Independent research, in the form of market studies, technology analyses, white papers, academic publications, industry/trade reports, etc., should also be used to ensure that all applicable perspectives are considered. This information should be available to all members of the strategy development team.

4.3 Then, do the Analysis

Once all essential data is collected and organized, you can begin to *connect the dots*. Six independent, functional analyses must be performed, with each analysis addressing a specific, strategic business factor. These six analyses are illustrated below. Eventually, the research and debate that takes place within each of these analyses will come together to create a single, strategic formula for success.



The six strategic analyses that make up the strategy development process can be separated into two logical groups. The first grouping analyzes the competitive forces that define the markets in which the company chooses to conduct its business. This analysis starts with a carefully considered, concise definition of the business: Why it exists … what its owners are trying to achieve … why, and as a result, which markets and market participants it will *choose* to attack.

With this core definition as its cornerstone, the strategy development team can now define the key characteristics of the selected market(s), and the products that will be offered to each market based on the chosen business definition. To complete the competitive perspective, the strategy development team must also define, justify, and document the perceived value proposition of its major competitors.

The second group of analyses focuses on the external, macro forces at work in the company's chosen business. These forces include the business's served markets (the *food chains* that structurally define each product's target audience), and the forward planning metrics which include technology trends, regulatory trends, market maturity levels, tax policies, and other economic factors.

The goal is to map the consumption end points in a food chain for each product line, so that a realistic view of future demand can be determined. The macro forces at work in each market are summarized in what we call a SWOT/D analysis (Strength, Weakness, Opportunity, Threat analysis overlayed with an analysis of potential Disruptive forces). This helps the strategy development team evaluate potential risks and rewards in each market.

Brief Summary of Strategic Analyses

In the sections that follow, we'll take an in-depth look at each of the key strategic analyses identified above. Before we begin, however, it might be helpful to view a brief summary of all six analyses to put them in perspective:

- **Core business definition** — Basically an investment thesis for the organization
- **Industry and product structure** — The product space you occupy
- **Competitor's value propositions** — The basis for competition in a product space
- **Food chains / served markets** — Basis for future product line demand and growth
- **Forward planning metrics** — Macro/megatrends that affect the markets served
- **SWOT / D analysis** — A view of linear and non-linear threats and opportunities

Core Business Definition

The foundation for defining a winning strategy is the core business definition. On the surface, this step always seems simple … until specific words and ideas are discussed and debated by owners, the management team, and other vested interests in the business. Having a clear business definition is essential to the rest of the strategic planning process.

The first step in defining a business is to describe, in practical terms, its core mission. In the *COBRA 3D Business Development Process*, this mission statement is a description of the functional purpose of a business — the essential reason or reasons that it exists — and why it should succeed.

The mission statement should clearly communicate, to members of the organization, what the business is trying to achieve, and why it should be possible … without delving into lengthy, detailed descriptions that fail to describe the essential nature of the enterprise. A good example for a niche automobile manufacturer might read something like this:

> *"Our mission is to establish a dominant position in the middle-income commuter automotive market by combining our patented overhead cam technology with new lightweight chassis materials to deliver class-leading levels of reliability, comfort, and fuel efficiency."*

Notice that this mission statement includes a clear description of the targeted market (middle-income commuters), a value proposition (class-leading levels of reliability, comfort, and fuel efficiency) and competitive differentiators (patented technology, new materials).

A lengthy mission statement with lots of detail usually indicates that more work is needed to hone in on the true essence of why the business exists. Too little detail, "Our mission is to make money," will serve no practical purpose.

The next step is to define a long-term vision for the business, from the employees' perspective. In order to elicit support across the organization, a good vision statement will be worded in a motivational manner … framing the organization's objectives and beliefs as a legacy with intrinsic value that will hopefully extend beyond the tenure of any individual.

A vision statement for the auto manufacturer cited above might read as follows:

> *"Our vision is to establish [company name] as a leading innovator in the automotive industry. We believe that the innovations we seek in automotive technology will ultimately improve the lives of our customers by reducing travel costs and improving air quality."*

Once the mission and vision of the business are defined, it is critical to define the products/services and scope of supply of the business. The most effective way of doing this is to define the product lines, served markets (food chains), and served geographies that make up 80% of current revenue. While there may be more products or services, additional served markets, or new geographies the company wants to pursue, the reality of the current core business must be defined first. Moving beyond this 80% core will require serious discussions, analysis, and financial commitments.

Next, we need to document the business owners' expectations. In a small or midsize business, the owner(s) may be an individual, family members, a small group of angel investors, a private equity group, the general public (as stock holders in a publicly traded company represented by a board of directors) or some combination of the above.

In any case, all owners' objectives must be considered to establish a clear consensus on the purpose, time frame, financial return expectations, and risk tolerance of each investment. The proposed investment thesis of the forward plan of the business must describe expected future revenue growth, EBITDA growth, return on invested capital, and the appropriate incremental capital and risk involved in achieving the business's targeted position.

Defining the existing cash position and credit availability will highlight the financial resources available to the management team for the proposed *winning strategy*. Clearly documenting the owners' risk tolerance and threat issues will also set boundaries on the strategy. Defining the existing capital structure and acceptable future changes to the structure will frame the strategic alternatives.

Business Definition Worksheet

This worksheet is a convenient tool for outlining the core business definition elements previously described. Worksheet entries should be discussed, debated, and eventually finalized to document the team's decisions regarding each element of the business definition. The completed worksheet for the new automotive company might look like the following:

Core Business Definition Worksheet

Company: NEWCO AUTOMOTIVE

Mission / Functional Purpose (Describe)

Establish a dominant position in the mid-income commuter automotive market by combining our patented overhead cam technology with new lightweight chassis materials to deliver class leading reliability, comfort and fuel efficiency.

Vision / Leadership Legacy (Describe)

Establish Newco as a leading innovator in the auto industry. We believe that the innovations we seek in automotive technology will ultimately improve the lives of our customers by reducing travel costs and improving air quality.

Products / Scope of Supply (Define 80% of Revenue)

1. Compact SUV
2. Four door compact sedan
3. Two door sports car
4. Compact pickup

Served Markets (Define 80% of Revenue)

1. Urban commuters
2. First time buyers
3. College students
4. Family second car

Served Geographies (Define 80% of Revenue)

1. Northeast USA
2. Pacific Northwest USA
3. Japan urban centers
4. Korea urban centers

Owner Expectations (Summarize):

1. Investment Thesis / Time frame

R&D investments and precise market focus will yield an average 5% growth, 18% EBITDA margin and 12% ROIC over the next 10 years

2. Cash / Credit Availability

The company has a $500M line of credit and $200M annual free cash flow available to fund strategic projects

3. Risk Tolerance

Equity and bond investors currently support our stated strategy up to the limit of existing lines of credit

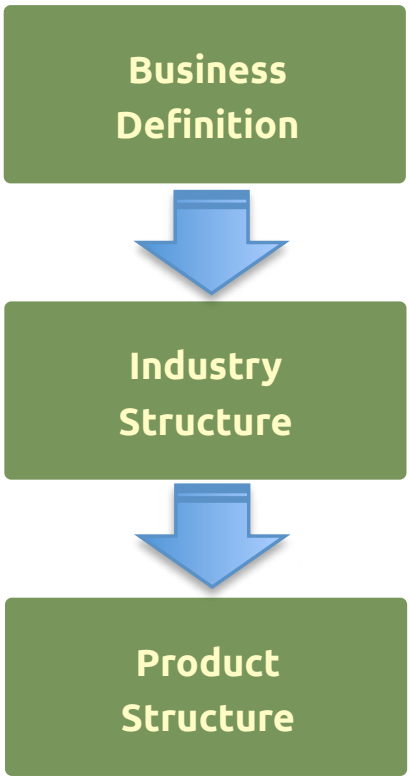
4. Capital Structure

Current structure is $1.5B in debt and $1.0B in equity, 1.5:1 debt to equity ratio

Figure 4.1: Core business definition worksheet

Starting with the mission and vision, the worksheet can be used to summarize all of the decisions and debates necessary to reach consensus on these key issues. Certainly, there is no precise definition of these elements that will fit every business. The concepts, however, are critical and how each element is interpreted only matters as it relates to each individual business. The most important point is to make sure these factors are defined and agreed to by all the members of the strategy development team.

Industry and Product Structure



Once the core business has been defined, research and documentation of the business's industry and product structure can begin. This analysis provides a critical strategic perspective, since it will identify the range of products competing in a chosen product space, along with the channels and end users/consumption industries that represent 80% of purchases.

The starting point in this analysis is to map each product line to document the functional products surrounding it. With these product spaces defined, the various sales channels of the product lines in the targeted space will bracket the competitive forces and value streams confronting the sales and marketing efforts.

Defining the end consumption points/industries of these channels will frame the potential user opportunities and threats to the company's products or channels. This structural view of how the product lines and channels fit within the overall industry framework is a fundamental perspective necessary for defining a winning strategy.

With industry structures, product spaces, and marketing channels defined, it is important to further analyze the relative position of the business's product lines. In some cases, the company's products are directly consumed by the end use industry. However, in many cases, these products represent subsets of other, broader functions (higher level systems) or subsystems, sitting above a set of component suppliers.

Once again, it is critical to have a clear picture of where these products fit within the overall component … subsystem … system structure. This strategic product structure view will outline the potential threats, opportunities, and complementary situations that can have a strategic impact on the business.

Industry Structure Worksheet

The industry structure worksheet is intended to help the strategy development team identify a product space relative to the broader structure surrounding it. Adjacent products are best described as similar, complementary, or alternative to the target product space. The channels define the various ways that a product and adjacent products flow to the point of end consumption. These channels can be direct sales, distributors, OEMs, integrators, value added resellers, or any combination of these options. The end consumption industries are final demand customer groups or end users of each product. The industry structure for a microprocessor manufacturer might look like Figure 4.2:

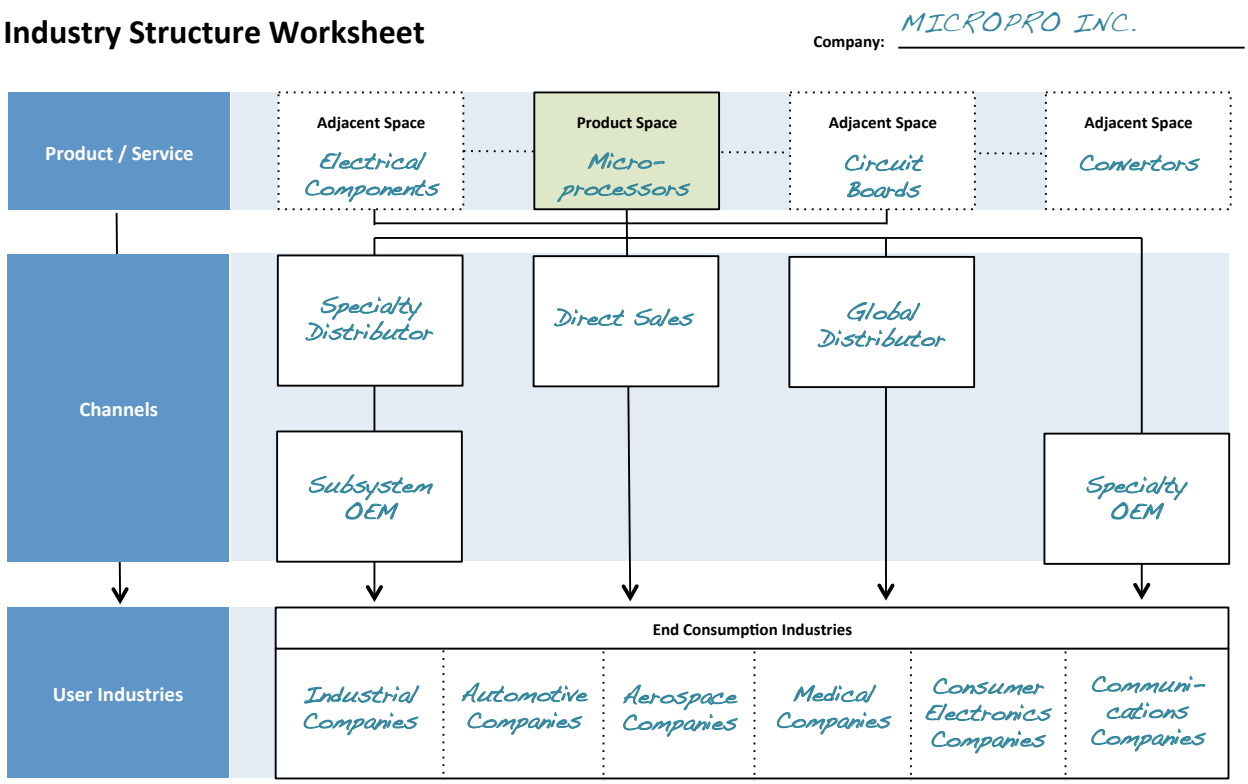


Figure 4.2: Industry structure worksheet

Product Structure Worksheet

The product structure within the product space is used when the target product is a subset of another product or superset of several subordinate products. Essentially, this worksheet is used to identify the flow of the target product to final consumption, if it is consumed as part of a broader scope of supply. If the target product is directly consumed by end users, then this worksheet will help identify the subsets of the target product. Overall, this worksheet should help define where the target product fits in the overall product space, relative to the function that is being consumed by the end user. The product structure for the microprocessor manufacturer might look like Figure 4.3:

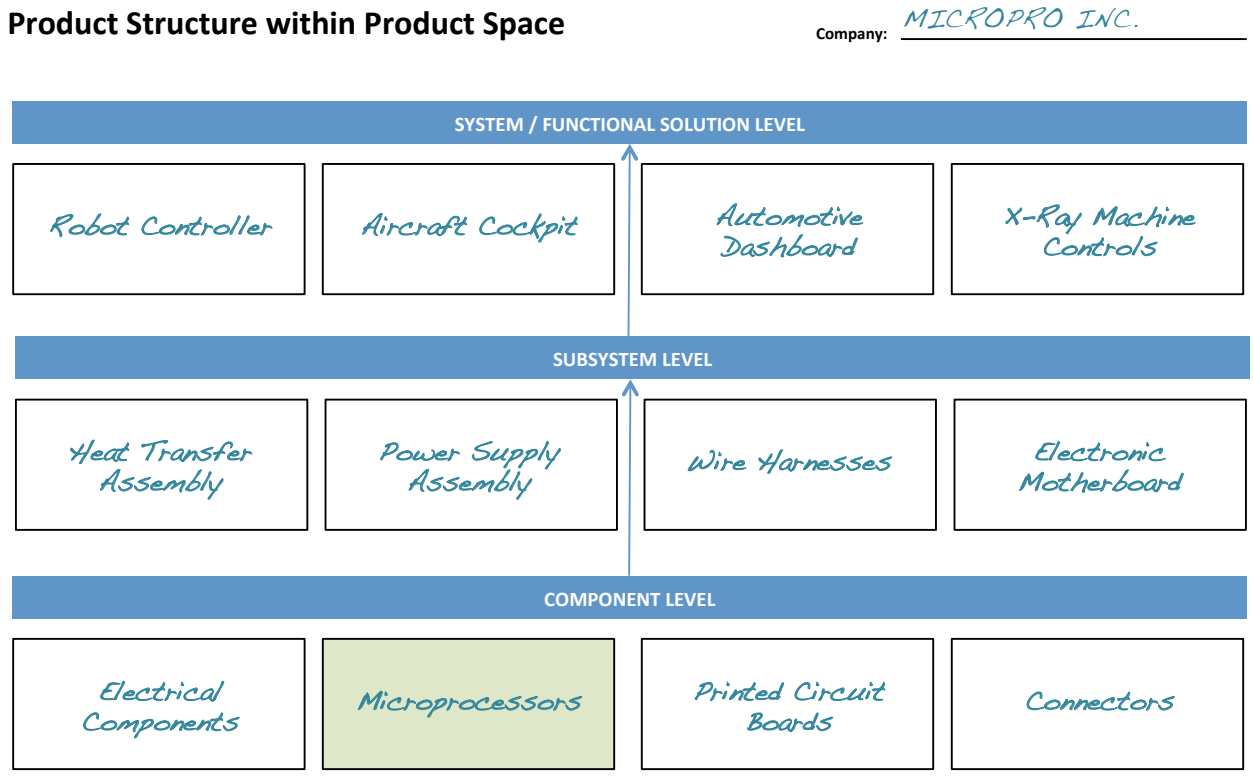


Figure 4.3: Product structure worksheet

Competitor Value Propositions

Information gathered in the *As Is* benchmarking process can now be used as a basis for defining the competitive value propositions of several top competitors. If possible, two or three top competitors should be included. In highly fragmented industries where *top* competitors cannot be determined based on market share, it is nonetheless necessary to choose two or three competitors that represent a direct threat or functional alternative to your products.

Once these competitors are selected, you need to define their product line implied value propositions, and their associated strengths and weaknesses. Similarly, describe their key business and operational processes from your perspective, and their associated strengths and weaknesses. This information will be used as a basis for outlining the targeted served markets of each competitor.

In many cases, the logic of product and process strengths simply leads a business to a served market … or a served market to a business. Regardless of how this connection has evolved, it is essential to describe your perception of your competitors' targeted served markets and the apparent product and process basis for this connection.

The connection between your competitors' products, processes, and served markets will help describe their preferred basis for competition. This preference may be based on price, quick delivery, excellent quality, strong aftermarket support, more functions, easier use, bundling, or some other real or perceived competitive advantage.

Having captured and recorded your perceptions of your key competitors, in terms of their products, processes, served markets, and their preferred basis for competition, you must analyze the sustainability and strength of these positions. The strength of a competitor's intellectual property or virtual intellectual property, as it relates to their targeted value proposition, will frame the strength of their position. It's important to understand the basis for *why* a competitor behaves in the marketplace as they do. Usually, there are logical reasons for a competitor's behavior that may not make sense to you because you do not have the same IP/VIP as they do!

Competitors' Value Proposition Worksheet

The competitor's value proposition worksheet is a practical tool for summarizing the research, analysis, and team inputs for each key competitor. A separate worksheet should be used for each. A worksheet for a refrigerator manufacturer's competitor would look like the following:

Competitors' Value Proposition Worksheet

Company: TRAD APPLIANCE CO.

Competitor 1: Smart Appliance Co.

Implied Value Proposition (describe):

High tech stainless steel appearance, large capacity and state-of-the-art energy savings technologies will justify the higher price point.

Product Strengths / Weaknesses (from Benchmarking Analysis):

1. Strength: High tech styling
2. Strength: Best-in-class energy efficiency
1. Weakness: No low end product offering
2. Weakness: Higher maintenance costs

Process Strengths / Weaknesses (from Benchmarking Analysis):

1. Strength: Global supply chain / components
2. Strength: In-house electronics assembly capability
1. Weakness: Packaging / protection of appearance
2. Weakness: Persistent quality complaints

Targeted Served Markets (top 3):

1. New, high end construction
2. Environmentally driven consumers
3. Upscale contractors

Preferred Competitive Basis (top 3):

1. Appearance
2. Energy efficiency
3. Capacity

Strength of Competitive Position:

Intellectual Property (patents, trademarks, copyrights)

1. Patented high efficiency motor
2. Patented temperature sensors
3. Established trademark

Virtual Intellectual Property (processes, channels, etc.)

1. Distribution network
2. Subcontracted service network
3. Global supply chain

Figure 4.4: Competitors' value proposition worksheet

A competitor's value proposition can usually be derived from their perceived process and product strengths and weaknesses. Similarly, estimating each competitor's top three targeted served markets, preferred competitive basis, and the relative strengths and weaknesses of their IP and VIP will establish the parameters for evaluating their value proposition.

Served Markets / Food Chains

With the business, industry structure, and key competitors clearly defined, the next step is to analyze, justify, and document the end use consumption of the company's product lines. This concept is best described as a *food chain*. These served markets of the business are the most important elements in defining the external / macro forces that impact the business.

The conceptual *food chain* used to represent the flow of products through various intermediate channels to the end user can be very simple in some businesses and very complex in others. However, the basic underlying principle — and the questions it answers regarding who is ultimately consuming your products and why, what factors drive their demand, and how they buy — is *always* the same.

Served Markets / Food Chains

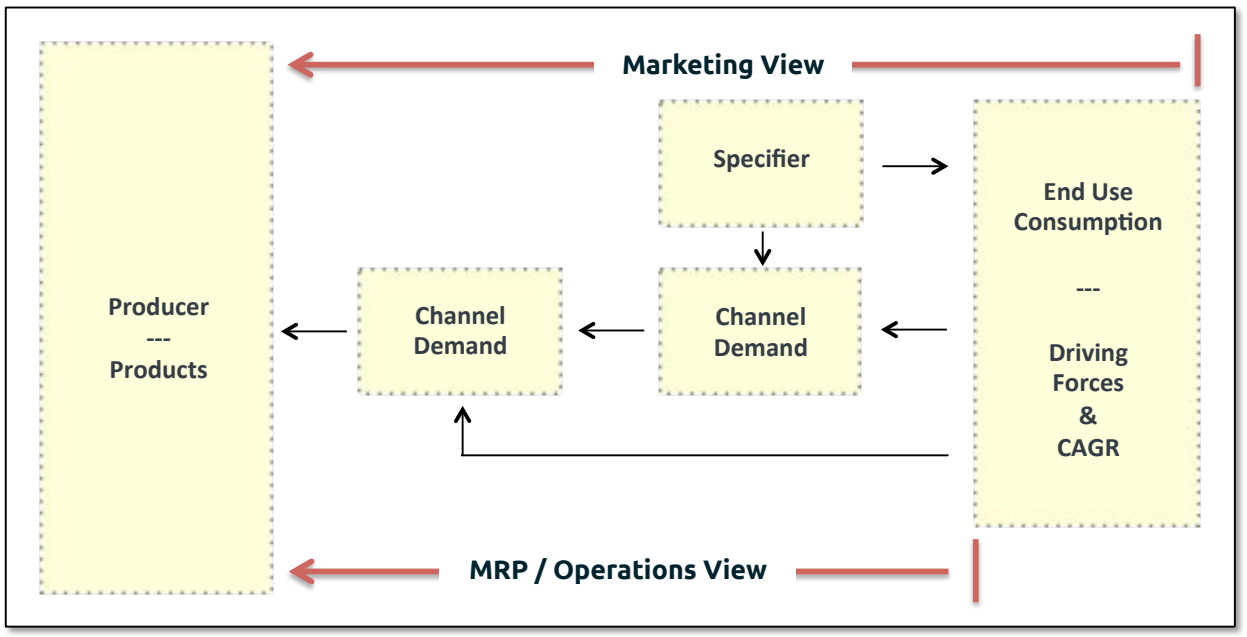
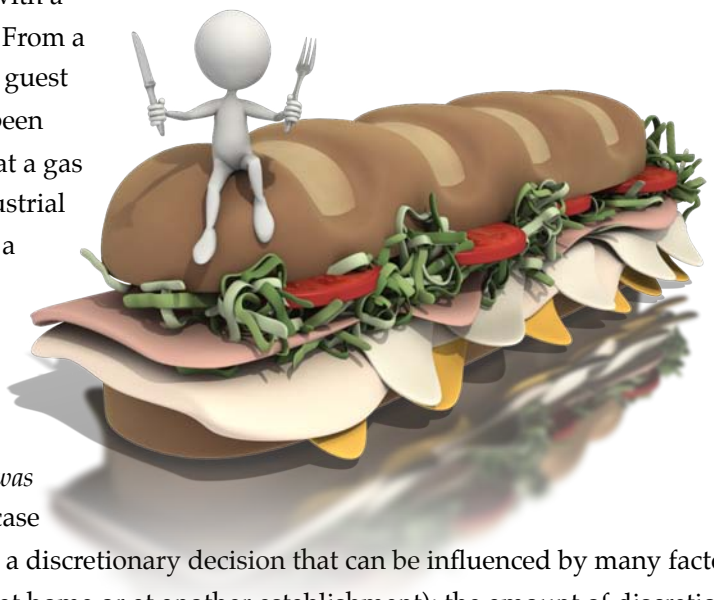


Figure 4.5: Served markets / food chains

To help explain this concept, let's start with a basic example of end use consumption. From a restaurant owner's perspective, when a guest finishes his/her meal, the product has been consumed. Similarly, when a customer at a gas station fills his/her fuel tank, or an industrial distributor delivers an electric motor to a chemical factory to drive a pump, the *end consumer* is very clear.



The concept of *consumption* gets more complex when you start to ask detailed questions: *What drives demand* and *why was supplier X chosen over supplier Y?* In the case of the restaurant, dining out is typically a discretionary decision that can be influenced by many factors: The relative cost of the meal (vs. eating at home or at another establishment); the amount of discretionary income available (sustenance meal or a celebratory event); availability of alternatives (within driving distance and operating during convenient hours), etc. The consumption drivers identified (want vs. need, price sensitivity, available alternatives) will generally explain the growth, or lack of growth, in the primary demand of the company's products.

The *food chain* concept gets even more complex when you think about a restaurant from its suppliers' perspectives. For example, as a grower of vegetables selling to a group of distributors that, in turn supply a group of restaurants, you would be two steps removed from the ultimate consumption of your product. Simply taking the distributors input on the outlook for vegetables in the next six months could be a major mistake. As a vegetable supplier to restaurants, or a vegetable fertilizer supplier to farmers, you really need to understand the end consumption drivers of your products … just like the restaurant owner.

A *food chain* can also be described as the served markets of a business. We prefer the food chain analogy because it's a common mistake for businesses to assume that a *served market* is the first customer who takes delivery of a product. In any event, it is important that the strategy development team and management work together to map and document all channels, to ensure that the end consumers of the product are included in the analyses used to devise a winning strategy.

It is equally important to analyze, rationalize, and define the major factors driving the final use, or consumption, of the products. The process of connecting dots in the food chain will ultimately provide the most accurate view of the future growth potential (or lack of) for a company's products.

Served Markets / Food Chains Worksheet

The served markets / food chains worksheet is often the most important analysis in the strategy development process. The purpose of this worksheet is to clearly define the channels and specifying influences that the target product flows through to reach the ultimate consumer. It is a common, but potentially fatal mistake, to assume that sales channels are good predictors of future growth potential … or that they understand the driving forces of true functional demand: Consumption of the target product. A basic mapping of the food chain will focus the strategy development team on the *why* of end demand, not the *how*.

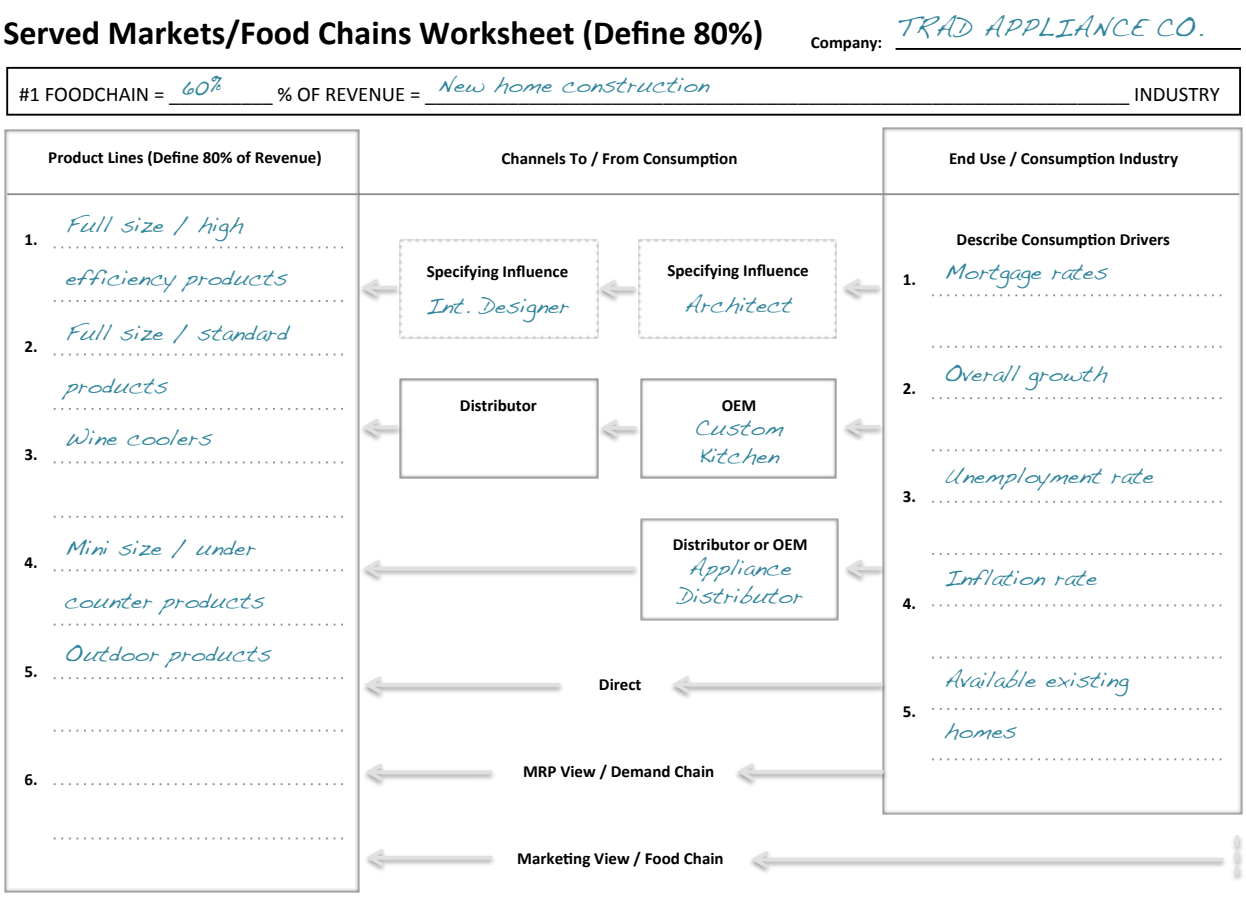


Figure 4.6: Served markets / food chains worksheet

Forward Planning Metrics

In addition to the served markets (food chains) of the business, there are also many other external/macro factors that will impact the environment the business faces in the future. While it certainly is not possible to forecast random events in the future, it is very practical to extend known trends forward.

This forward planning process is based on identifying the key macro economic, technological, political, environmental, and other relevant forces that will have a material effect on the business environment in the next three to five years. While some of these trends are clear, others may require significant research to identify and quantify. In some cases, there will be no definitive trend, simply an approximation or awareness that some external force is likely to affect the business in the near future.

While there is no way to define a comprehensive list of all factors, there is enough information available to categorize *mega trends*, which can be used as a starting point for research and analysis. Listed below are several key factors that, in one way or another, can impact the forward plans of a business:

- **The cost of capital —** This is extremely important for evaluating investment decisions. The cost of borrowing today compared to the outlook for the next several years can have a significant effect on the decision making process.
- **Technology / productivity —** Technology and productivity advancements are a seemingly never-ending (and accelerating) trend that impacts how business is done, where it is done, and who can contribute. Technology has enabled the 24/7 business clock that now drives productivity worldwide. The intersection of these technologies is now beginning to occur with geometric impacts clearly emerging.
- **Process / productivity —** Beyond technology innovations, there are basic developments in processes, materials, automation, mechanics, and other physical sciences that change the basis for competition. The continued developments of these new and existing processes will clearly be game changers in certain industries.
- **Workforce skills / location —** The use of remotely located workers to supplement the internal resources and skills of an organization is now a reality. The use of these powerful capabilities will be a major challenge, and a probable threat, in the next several years.
- **Energy costs —** Almost every business is affected, either directly or indirectly, by energy costs. In addition to fluctuations in the absolute value of energy, there is a relative difference in the costs of different sources such as oil, gas, coal, solar, wind, etc. to consider. These choices can have a significant impact on future business plans.
- **Commodity costs —** Even more dramatic than energy costs are the costs of commodities from copper to aluminum, corn, wheat, sugar, iron ore, soybeans, silver, platinum, rare earth minerals, as well as many others. These can all affect certain types of businesses in a material way.

- **Globalization —** Globalization is a process that has been evolving for over a century, but has seen most of its impact occur in the last 20 years. Globalization can impact these key areas:

  Competition — More and more businesses will face competitors with footprints in more than one continent.

  Customers — Similarly, industry consolidations will drive localized customers into global organizations or global organizations into localized markets.

  Supply chain — The power of global supply chains is being driven by advanced logistics systems, information technology, and, of course, the consolidation of many industries.

- **Regulations —** Whether local, state, federal, or international, the impact of government regulations can be dramatic. These forces regarding healthcare, taxation, safety, work rules, security, and privacy must be considered in the planning process.
- **Environmental factors —** There is no question that concerns for the environment and subsequent efforts to achieve sustainability will continue to be a major factor in business planning.
- **Taxes/structure —** The impact of local, state, and federal taxes, and the structure of how tax policy is implemented, has become a major force in many business decisions. This trend will continue to drive small and midsize (SMB) owners' decisions in the near term.
- **Customer ecosystems —** The evolution of customer ecosystems must be considered in the planning process. Companies with strong market shares in technology or other *connected* functions leverage their ecosystem stickiness.
- **Social networks —** The migration of social networks from our private lives to our business lives has just begun. The power of *purpose built social networks*, with strong leadership, is the next major driver of innovation and productivity. This mega trend will shape organizational structures and dynamics for the next 10 to 20 years, and must absolutely be considered in defining a winning strategy.

The key to defining this phase of a winning strategy is to identify the forward planning metrics that have, or will have, a material effect on the business. These macro forces should be defined, trends identified and analyzed, and clear expectations established for the next three to five years. By identifying these external, material factors and quantifying their expected forward impact, it is possible to forecast the overall external environment the business is likely to face. This forward *model* of the key macro metrics will help shape the winning strategy.

Forward Planning Metrics Worksheet

The forward planning metrics worksheet is designed to be a tool for identifying and quantifying the overall external environment the business will face over the next five years. The intent is that the strategy development team must research and quantify known macro trends that are likely to have a material impact on the business. These factors can sometimes be mitigated with offsetting actions. In other cases, these factors may be warning signs that will help stimulate early responses when they reach a critical level. In either case, the purpose of this worksheet is to have as clear a picture as possible of the external forces that can significantly impact the business. The forward planning worksheet for the traditional refrigerator company would look like Figure 4.7:

Forward Planning Metrics Worksheet

Company: TRAD APPLIANCE CO.

METRIC	MATERIAL EFFECT YES	NO	MEASUREMENT / SITUATION TODAY	PRIOR 5 YEARS	FUTURE 5 YEARS
Cost of Capital	✓		Bond interest rate	5-6%	7-10%
Technology / Productivity	✓		Revenue per employee	1-2%/year	+3%/year
Customer Ecosystem / Networks		✓	Not required	N/A	N/A
Process / Productivity	✓		Mfg. cycle time	12-18 days	6-10 days
Workforce Skills / Location		✓	Cost per hour	N/A	N/A
Energy Costs	✓		Electricity / 8¢ Kwt/hr	1-2% change	5-10% change
Commodities Costs	✓		Copper (per lb.)	$3.81	+7%/year
Global Competitors	✓		No. competitors	3 major	6 major
Customers / Globalization		✓	No. global buyers	N/A	N/A
Supply Chain / Globalization	✓		No. global suppliers	3-4	12+
Regulations	✓		Energy efficiency	Recommendations	Min. requirement
Environmental Factors	✓		Coolant type	Local limits	Global limits
Taxes / Structure	✓		Corp. tax structure	Net 22%	Net 31%
Other (describe)					
Internet connectivity	✓		% of market	Approx. 10%	Approx. 50-60%

Figure 4.7: Forward planning metrics worksheet

SWOT / D Analysis

Using a SWOT/D analysis is a proven way to frame the major issues facing a business. Identifying internal and external factors that are positive or negative allows decision makers to establish the planning framework for making strategic choices. Internal factors consist of strengths and weaknesses within the organization; external factors are driven by the market and industry environment.

By integrating all the competitive and macro factors that impact a business, a SWOT/D analysis that is completely candid can produce a very clear picture of the current situation (the *As Is*), and where the business needs to go in the future (the *To Be*). The SWOT portion of the analysis should be a summary of the most important forces affecting the business from all of the prior strategic summaries.

The "D" in SWOT/D stands for *disruptive*. Disruptive, from a business development standpoint, means anything *non-linear* that disrupts the typical way business has been done. A disruptive strategy can be any game-changing factor that has the potential to transform what is currently thought of as the established basis for competition. This can be as simple as being first in a market to introduce an existing, but still innovative capability, or as complex as a newly developed technology that fundamentally changes supply, demand, or other key market factors.

A disruptive strategy introduced by a competitor, if unforeseen, can lead to rapid losses in market share, technology obsolescence, and in a worst-case scenario, business failure. Staying on top of trends in new technologies, materials and processes, and paying attention to direct and functional competition, is as important as defining the traditional SWOT forces.

Disruptive thinking is now considered a standard strategic technique. The following are some examples of disruptive strategies in the current business environment. Remember, these techniques can be used both against the business and by the business to attack a targeted market:

- Ecosystem
- Extreme frugal design
- Cloud/mobile solutions
- Outscoping
- Substitute technology

Ecosystem

The Ecosystem concept can be disruptive to a business or even an industry as a whole. Take Apple for example; they are well known for creating ecosystems around their brands that have changed the way much of the world communicates and does business. Not only is their PC/server business strong, they have created an entire iWorld around every product that they design and market. It started with the iPod, followed by the iPhone, iPad, iChat and iCloud, not to mention supporting software products. Each product is designed to more or less seamlessly connect to the others, sharing information in a way that had never been done before. The company's iTunes and App Store concepts take it one step further. Creating an ecosystem around products — which may include aftermarket complimentary products, training, technical support, spare parts, or other capabilities — can certainly change the rules in many markets.

Extreme Frugal Design

Extreme Frugal Design is another example of a disruptive technique. The basic idea is to take an existing product that is highly advanced and expensive, and make a simplified version of that product that serves the same need minus all of the *bells and whistles*, making it affordable to the masses. Essentially, a frugal design meets the basic functional need it was produced for, but only that need; there are no *extras* that create added costs and complexity.

A good example of this would be a generic MP3 player that only plays downloaded music, as compared to an iPod touch that has all the extra features that allow it to sync to other products and share information. Many products that were designed based on the developed market's requirements can be redesigned and baselined for the economies of emerging or lower price point markets.

Cloud and Mobile Solutions

Cloud and mobile technologies have also changed the way business is done in many industries. Advances in these technologies have allowed large segments of the world's workforce to conduct business remotely, be connected 24/7, and share information in near real time, regardless of physical location. Not only have these improvements added value for many businesses, by significantly reducing costs, they have also promoted a more productive work environment and opened the available resource pool to a global capability. There is much less time and energy wasted on travel and accommodations, and much more time available to complete the work that needs to be done.

Outscoping

Businesses that have strategically expanded their scope of supply can be game changers to a fixed business structure. If a competitor can increase their scope of supply to a point where it is more valuable to a customer than the traditional product's scope, it may not be feasible for other firms to continue to sell a single product or service at a competitive price. A change in geographic scope can also be considered disruptive. An organization that can effectively market and sell their product on a national, international, or global scale while their competitors are still trying to effectively do so regionally can be very disruptive to others in the industry. Once that strategy is defined and executed by a well-run organization looking to differentiate themselves from the pack, it is much harder for their competitors to keep pace.

Substitute Technology

Substitute technology is a way that functional competitors can dramatically change the products and services in their target market. If a competitor develops a functionally equivalent, substitute technology that allows them to produce, manufacture, sell, or market their product or service more effectively than the prevailing business model, the impact is disruptive.

In fact, a substitute technology may ultimately be the demise of other players in that product space, because another firm can offer virtually the same function-value proposition, at a much lower price, or with more value, or both, than their traditional competitors. The best way to combat the threat of substitute technology is remaining vigilant within your industry and product structure. Proactively searching for substitute technology threats and opportunities is an effective strategy for protecting the business from these disruptive traps.

SWOT / D Analysis Worksheet

With linear (SWOT) and non-linear (Disruptive) factors identified, the strategy development team now has a clear summary of the overall outlook for each *defined product space* of the business. Hopefully, this process has forced new thinking, questioning, and active debates to get to a point where there is a consensus view of the business's strategic situation.

The SWOT/D analysis worksheet is organized in two sections. The traditional SWOT analysis is an excellent method for summarizing the major strengths, weaknesses, opportunities, and threats that a business faces. These factors should include both internal and external situations, offensive and defensive conditions, as well as current and projected forces. The disruptive portion of the analysis is designed to stimulate discussions and debates regarding both defensive (under attack from a disruptive competitor) and offensive (attacking based on a disruptive capability) situations.

SWOT / D Analysis Worksheet

Company: TRAD APPLIANCE CO.

Strengths:

1. Established distribution network
2. Full line of household appliances
3. In house service organization

Weaknesses:

1. Limited smart products/capabilities
2. Weak high efficiency products
3. No 24/7 online service capability

Opportunities:

1. New home construction market growth
2. Build common smart appliance interface
3. Higher energy prices drive high efficiency demand

Threats:

1. Smart Refrigerator Co. expands product line
2. Smart Refrigerator buys or is bought by complementary mfg.
3. Energy regulations force entire industry into our space

Potential Disruptive Strategies:

Ecosystem: Home appliance smart communication network

Extreme Frugal Design: Asian mfg. with bare bones functionality and very low price

Cloud / Mobile Systems: Home appliance smart network with 24/7 performance monitoring

Outscoping: Competitor finds way to bundle smart family of products

Substitute Technology: None identified

Other (specify):

Figure 4.8: SWOT/D analysis worksheet

4.4 Now, Assemble the Puzzle

With all major analyses completed, it's time to begin developing, debating, and defining a winning strategy. The ideal method for this step is to assemble all the key members of the strategy development team in one location, with the specific purpose of beginning the process. First and foremost, the team should review, discuss, and achieve a clear understanding and agreement on the content of the pieces of the strategic puzzle they have developed. The major pieces of the puzzle all have a critical role in the strategic logic:

- **Business definition —** Defines the basis for the financial investment thesis as well as the cultural purpose of the business. The cultural purpose of the business is the mission and vision defined by leadership. The products, markets, and geographies chosen by the strategy development team will outline the financial investment thesis of the business from the owners' perspectives.
- **Industry product structure —** Defines the product space the company has chosen based on the core business definition. The product space establishes the relative proximity to other related products within the industry structure. This proximity generally identifies the amount of capital required, the technical sophistication, and the potential direct and functional competitors a company faces. It also outlines and brackets the value chain relationship of the business.

- **Competitors' value propositions —** These value propositions collectively define the basis for competition that the strategy development team must consider in crafting its winning strategy. A competitor's *perceived* value proposition represents the market's view of the promise of a specific value, or set of values, that competitors are communicating to customers. These customer promises frame the known options available to the company in defining their own specific, unique value proposition.
- **Food chain / served markets —** These end use consumption models define the driving forces and forward estimates for the primary demand of the company's products. This primary demand, and the rationale behind it, is the essential starting point for connecting the other major strategic factors. The food chain is the underlying economic purpose of the business, and the logic of all the winning strategy pieces must be validated against this basic factor.
- **Forward planning metrics —** These are the macro or mega trends driving the general economic, political, social, and technological environment surrounding the winning strategy. These factors frame the rate of change, degree of risk, volatility, cost of doing business, and potential external threats to the business in the near term. While there is no way to predict the absolute value of these trends, the identification of macro factors that are material to the business — and the tracking of these forces — is critical to executing a winning strategy.
- **SWOT / D analysis —** This technique defines the linear (business as usual) and nonlinear (disruptive) forces at work. The purpose of this analysis is to summarize the internal and external trends that have a material effect on the business. These *mega trends* will shape the macro environment the company should expect to operate within for the next three to five years.

Collectively, these strategic analyses will frame the competitive market and macro environments that the strategic team will use to define the company's winning strategy.

Winning Strategy Formulation

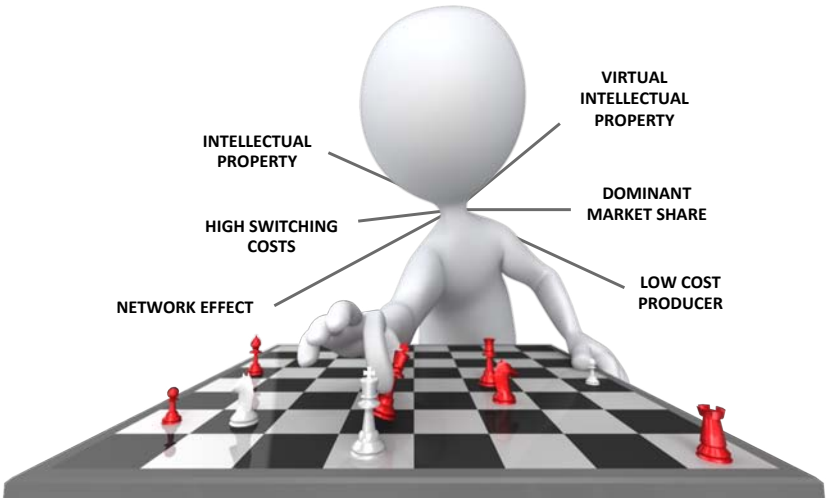
These six strategic analyses, combined with the information developed in the *As Is* business definition phase, provide the strategy development team with the knowledge needed to formulate a winning strategy. Collectively, these various analyses, views of the business, views of the market, competitive benchmarks, and perspectives of the future business environment enable the team to begin to formulate alternative winning strategies.

It is the intersection of all these forces that the strategic team must consider when defining the optimum position for the business. The core business definition used to attract investors and motivate the organization is the cornerstone of the thought process.

Choose Wisely!

From this comprehensive set of information, a winning strategy will emerge. At this point, a few very significant decisions will become a road map for the business; a road map that will ultimately determine the probability of sustainable success (or failure) for the company.

These decisions involve answering the following questions:

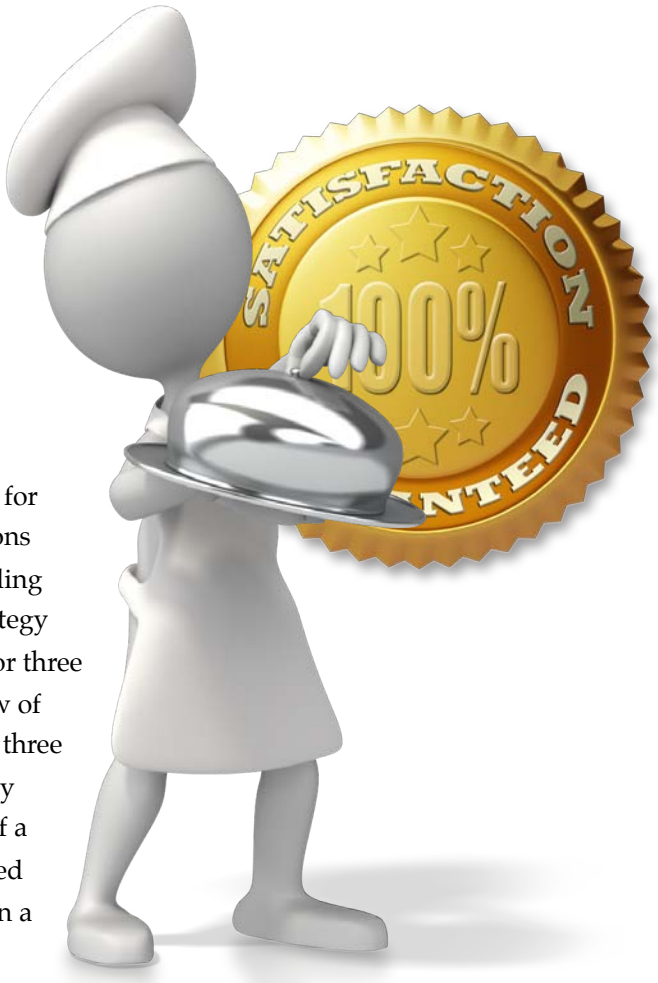


- What are the top three competitive advantages that the business has developed, or can develop, to achieve a strong, sustainable position in the market?
- What are the top three to four served markets chosen to attack (must represent approximately 80% of revenue)?
- What are the three key elements of your value proposition to customers in each of your served markets?
- How do you defend and sustain these competitive advantages, long term, against competitors who will likely try to copy your success?

As answers to these questions are discussed, it is important to remember that a number of potential winning (and losing) strategies may be suggested. This should be encouraged, and all suggested alternatives should be discussed, documented, and debated by the strategy development team. Over time, the team will need to narrow the alternatives until one best choice is identified.

Hopefully, the final choice will be unanimous or very close. The winning strategy will serve as a filter, or litmus test for future investments, business development projects, and other basic choices the organization must make to survive and prosper. Identifying and pursuing a clear and compelling winning strategy is the #1 responsibility of the management team!

Success Baked In (Or Not)!



The most important test of the defined *winning strategy* is to present it to selected key customers and key employees. Their reactions to the clear and compelling competitive advantages will be the first test. If the strategy is easy to understand, makes sense, and articulates the value of the business, it will be obvious to *all!*

Winning Strategy Worksheet

The winning strategy worksheet is a useful tool for organizing and summarizing the critical questions that need to be discussed and debated surrounding alternate proposed strategies. Typically, the strategy development team will be able to develop two or three basic thought patterns regarding the logical flow of the alternate strategies. By starting with the top three compelling competitive advantages, and actively discussing these fundamental building blocks of a winning strategy until a clear consensus is agreed upon, the process can move through each step in a logical progression.

One approach that seems to work well is to use this same technique for each building block in the strategy development process: Compelling competitive advantages, targeted served markets, and compelling value propositions. By focusing on validating each of these winning strategy building blocks, and documenting each in a logical sequence, the strategy development team can then use these factual blocks for articulating the definitive winning strategy.

Winning Strategy Defined

Company: TRAD APPLIANCE CO.

Compelling Competitive Advantages (top 3):

1. Complete family of home appliances – refrigerators/washers/dryers/ovens/cooktops
2. Develop or acquire leading controls/network technology capability, and then:
3. Integrate 24/7 intelligent monitoring capability with 10 year warranty

In Targeted Served Markets (top 3):

1. High end (above $350K) new home construction
2. Northeast USA / highest consumer energy cost markets
3. Customers seeking a sustainable, energy efficient alternative

With Clear / Compelling Value Proposition:

1. Common user interface for full line of appliances
2. Industry leading energy efficiency ratings in each appliance category and across all categories combined
3. 24/7 performance monitoring with a 10 year warranty

Supported / Defended By:

Intellectual Property

1. New controls technology
2. New network/monitoring technology
3. Assembly technology

Virtual Intellectual Property

1. Dominant distribution network
2. Global supply chain/key suppliers
3. Fully automated assembly

Figure 4.9: Winning strategy worksheet

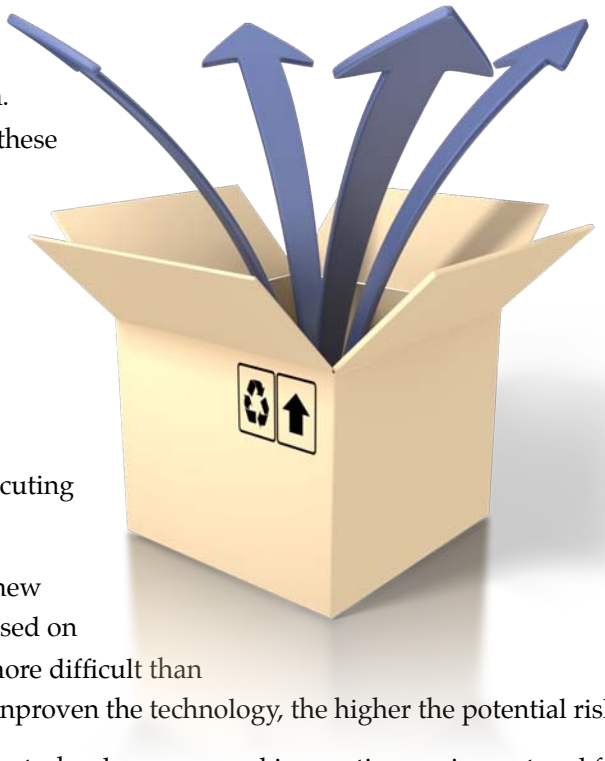
When all is said and done, the adopted strategy should be written in clear, compelling, and precise wording that fits on one page. A one- to three-sentence *elevator pitch* should be developed as a basis for communicating the essence of your winning strategy to the entire organization.

4.5 Identify Risks

The major reason to define risks is to quantify their potential impact and to develop contingency or mitigation plans. For example, a winning strategy based on one or two key technology resources puts the entire business at risk. It is more cost-effective and manageable to have a mitigation plan in place before a crisis event occurs, and the organization has very limited options and time to respond. These contingency plans should be developed as risks are identified. Hoping that possible risks will never materialize is a dangerous practice, and will odds-on have a major negative effect on the business over time.

Internal Risks

It is essential to identify major risks that may arise as the winning strategy plan is executed. This should include internal and external threats … both direct and indirect (e.g. threats posed by the expected macro environment). Internal threats may include the following:



- **Key people and skills —** In almost all winning strategies, there is a fundamental connection to key people/skills within the organization. If there are only a limited number of these scarce resources, the entire strategy could be at risk.
- **Financial resources/timing —** The availability and timing of financial resources related to the execution of strategic projects, whether for capital expenditures, operating expenses, or working capital, is a key factor in executing the winning strategy.
- **Technology —** Developing targeted new technologies, or product functions based on new technologies, is almost always more difficult than expected. The more innovative and unproven the technology, the higher the potential risk.
- **Equipment and facilities —** Similar to technology, new and innovative equipment and facilities almost always take longer than expected to implement. The planning, acquisition, construction/manufacturing, installation, commissioning, and training processes must be well-defined and executed to meet strategic timing requirements.
- **Others/never-ending —** There can be many other internal threats to the execution of the strategy from cultural factors, random events, macro forces, and other circumstances.

External Risks

External risks can be much more difficult to define. However, categorizing the types of external threats that can materially affect the strategy execution will enable the organization to monitor and identify these threats as clearly as possible. Following are some examples of potential external risks:

- **Changes in market conditions —** An unforeseen change in the basic economic metrics, demand drivers, or other structured market situations such as a natural disaster, cost of financing, shortage of complimentary components, etc., can materially affect the business.
- **Direct competitors' actions —** Certain competitive actions are very predictable. However, unforeseen or unpredictable events such as acquisitions, mergers, licensing agreements, marketing agreements, divestures, and other non-linear competitive actions can change the strategic situation very quickly and decisively. These actions are obviously unpredictable, but in many cases, the overall industry and market situation will signal a higher or lower probability for such events so that some general form of these threats can be identified.
- **Disruptive competitors' actions —** When a new competitor enters your product space without warning, the effects can be confusion, panic, irrational pricing responses, or other potentially damaging actions.
- **Regulatory actions / standards —** New government regulations, industry defined standards, and third-party standards (such as ASME, UL, CE) can change the competitive and consumption basis of an industry dramatically. Typically, these situations have a fairly long development process before their impact is felt.
- **Others / never-ending —** Similar to internal threats, there will be a never-ending evolution of external threats to the winning strategy. The management team must maintain an open mind to these events in order to evaluate the situation quickly. When a new threat emerges, management must be prepared to assess the situation quickly, and develop an appropriate response or countermeasure tailored to the specifics of the actual threat as it unfolds.

The Business's North Star

The North Star is closely aligned with the earth's axis of rotation. While other stars appear to change position in the sky throughout the night, the North Star's apparent position remains virtually fixed, making it an excellent reference point for navigators seeking to identify their current position, direction of travel, and velocity.

The winning strategy defined by the management team and accepted by the owners, should now become the North Star of the business. This virtually fixed navigational aid should be used to guide the business toward its *To Be* objectives. The winning strategy enables the management team to quantify and prioritize challenges, threats, and opportunities in the midst of never-ending, day-to-day events. Regardless of the many real, and sometimes imagined, situations that a business encounters, the winning strategy is the powerful, navigational tool that will always guide you north!

The winning strategy serves as the strategic filter and the roadmap for identifying and prioritizing investment opportunities, operational alternatives, cultural development projects, branding and marketing strategies, and all other key, directional decisions of the business. This North Star use of the winning strategy should also be used to reject proposals that may take the business in a direction other than true north.

In later chapters, you will see how to apply the winning strategy as the primary filter in considering all proposed business development projects. This strategic filter will eliminate projects or initiatives that would eventually undermine the operational and financial performance of the business.

CASE IN POINT

A winning strategy is analogous to the real estate adage of location, location, location. The importance of a winning strategy vs. a losing strategy is like the difference between building your dream house on waterfront property or on a lot next to the interstate.

You want to rent a movie, where do you go? One option is to get in your car and drive over to the local video rental store. Another option is to go to your mailbox. A third option is to download a video from your computer, tablet, or cell phone. So, this is truly a case of location, location, location.

Blockbuster, founded in 1985, was at one time the dominant U.S. video retail chain. At its peak, Blockbuster had 9,000 stores. The company had grown rapidly, both organically and through acquisitions, and was bought by Viacom for $8.4 billion in 1994. By 1999, Viacom spun Blockbuster off as a public company to exploit its cash flow; however, its fate was already sealed!

Reed Hastings founded Netflix in 1997, partly out of frustration from having to pay more than $40 in late fees to Blockbuster for a single movie rental. For reference, Blockbuster collected over $800 million in late fees — roughly 16% of its revenue — in 2000 alone. Imagine the number of frustrated and angry customers this policy created!

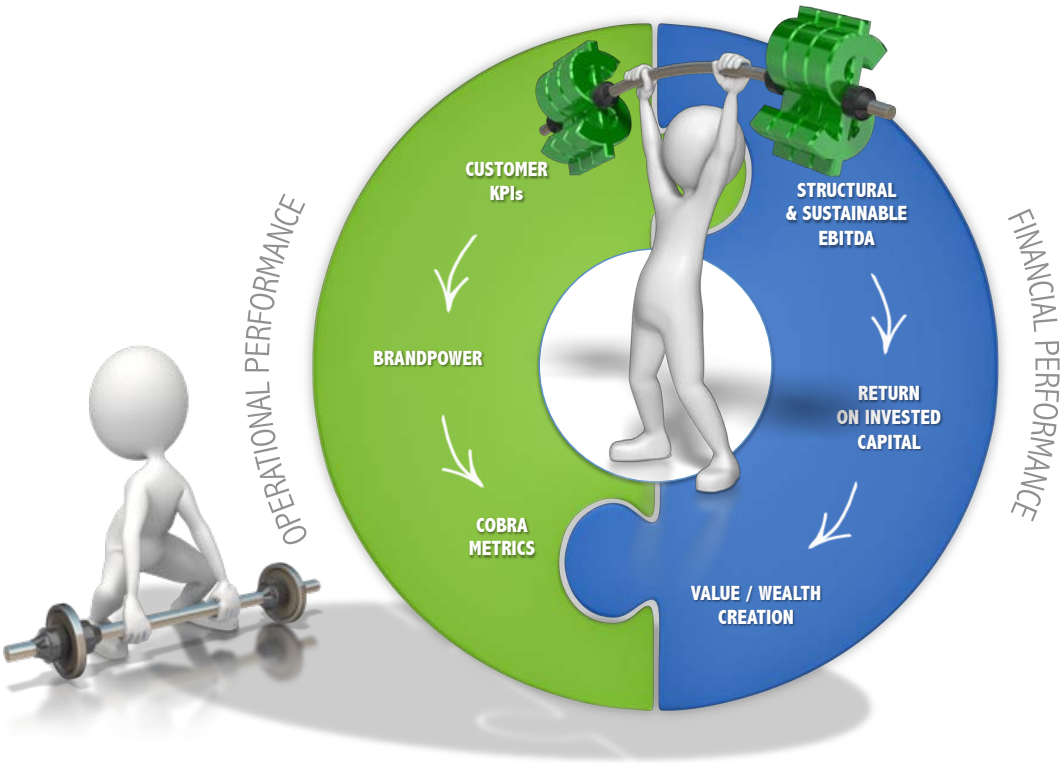
In 1999, Netflix launched its unlimited, mail-based subscription service for one relatively low monthly fee. This was a disruptive, functional competitive alternative to Blockbuster's brick and mortar business. In 2000, Netflix launched its personalized recommendations system. By 2002, Netflix had 857,000 members, up 88% from 2001. By 2007, when Netflix introduced its streaming video service, their customer base had reached 7.5 million members. Since that time, they have launched a constant stream (pardon the pun) of innovations — growing their members to over 44 million in 2014.

So, what did Blockbuster do to counter the major disruptive strategies of Netflix? Basically nothing! Blockbuster reached its peak in 2004 with 9,000 stores, but filed for bankruptcy in 2010, and completely shut down all stores by the end of 2013. This is clearly one of the best examples of a disruptive strategy putting a dominant leader out of business. With the estimated rate of technology change in the next five years, this situation will become typical of many industries.

Measuring Performance

TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. Strategy, operations, and culture drive business performance.
2. Operational performance drives financial results.
3. Customer satisfaction performance metrics are the leading indicators of business performance.
4. BrandPower measures the tangible business value of a brand's strength.
5. COBRA metrics define the overall operational effectiveness of the management team.
6. The capital structure of a business is the ratio of bondholders (debt) to shareholders (equity) — all the invested capital of a business.
7. EBITDA (earnings before interest, taxes, depreciation, and amortization) is a key measure of the annual financial performance of a business.
8. ROIC (return on invested capital) is a key long-term financial performance measure of a business.
9. A balance sheet is a summary of everything a business owns (assets) and owes (liabilities).
10. Sustained growth in operational and financial performance is necessary to grow the value of a business (wealth creation).



5.1 Thereof, Business Results!

The results of a business's strategy, operations, and culture are measured by operational and financial performance. The *COBRA 3D Business Development Process* measures annual performance and calculates long-term performance across both operational and financial metrics.

Operational performance measurements and projections are based on customer key performance indicators (KPIs); sustainable competitive advantage and customer satisfaction (BrandPower); and Cost of goods as a percentage of revenue, Operating expense as a percentage of revenue, Brand strength, Revenue growth year-over-year, and Asset utilization as a percentage of revenue (COBRA).

Financial performance measurements and projections are based on earnings before interest, taxes, depreciation and amortization (EBITDA); return on invested capital (ROIC); and valuation/wealth creation.

Together, operational and financial performance results represent business performance. These powerful metrics help connect the leadership and management teams of a business with the objectives of its owners and investors.

5.2 Operational Performance

Operational performance is measured first and foremost by how well a business serves its targeted customers. The specific data or *metrics* used to define customer satisfaction will vary for every business; but no strategy, technology, or price point, however favorable, will offset poor customer satisfaction.

The next measure of operational performance is *BrandPower*. This is a breakdown of the measures used to define a business's brand strength, as determined by its willingness or ability to deliver and sustain value propositions made to customers in a chosen market. COBRA 3D's BrandPower concept views brand strength quantitatively … as either an intangible asset or a long-term liability.

The final measures of operational performance (COBRA metrics) help a business identify structural strengths or weaknesses that will ultimately impact financial performance, thereby enhancing or reducing the business's ability to create value for investors.

Customer Satisfaction Metrics

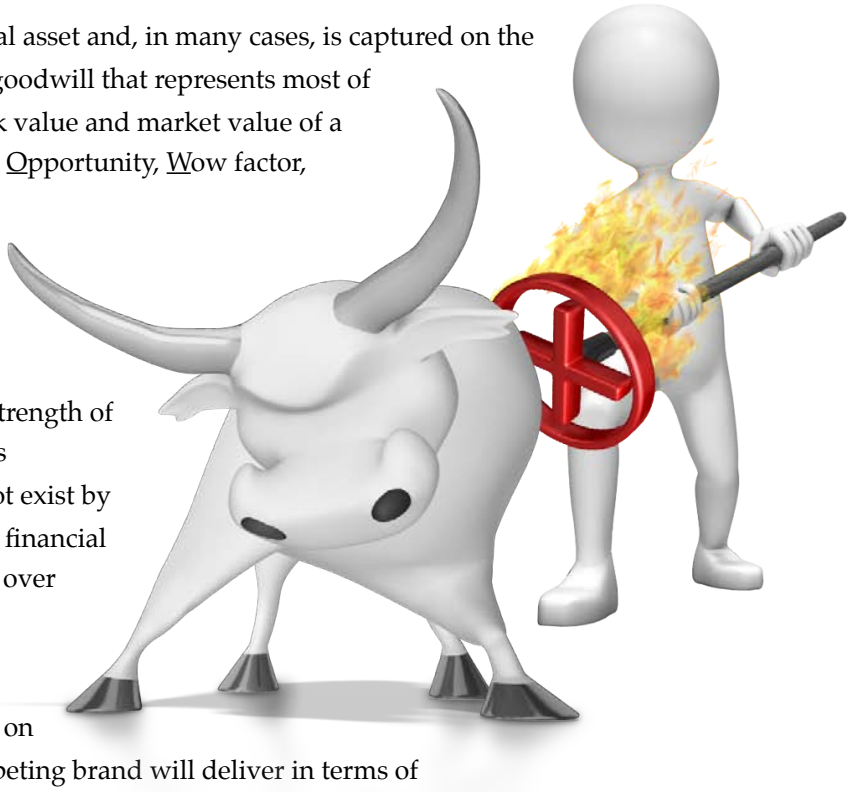
From a customer's perspective, the operational performance of a business is not defined in process or financial terms. The business's operational performance is measured by the critical metrics that customers use to make initial purchase decisions; and more importantly, the metrics they use to engage in and evaluate long-term supplier relationships. These decision factors will vary from industry to industry, competitor to competitor, and in many cases, customer to customer. The net result, however, is that every customer has a set of key performance indicators (KPIs) that it uses to qualify suppliers … and these metrics drive repeat purchase decisions.

Members of management should use customer KPIs as a scoreboard for measuring their organization's day-to-day operational performance. The metrics included in this scoreboard should be limited. Three to five metrics are sufficient to capture the essence of the customer relationship. These metrics must be customer specific, measurable, and objective. Once established, these KPIs should be clearly communicated at every level of the organization, and should be used as a basis for salary reviews and employee incentive plans.

The customer satisfaction metrics chosen should cover all key aspects of the customer/supplier relationship, from initial inquiry through order entry, fulfillment, delivery, payment, and after-market support. Examples of useful customer KPIs might include these:

- Proposal response time
- Stock to order fulfillment rate
- Order entry accuracy
- Order entry/acknowledgement cycle time
- Change order response time
- Total order cycle time
- First pass yield percentage
- Percentage of orders delivered to request date
- Percentage of orders delivered to acknowledge date
- Field complaints — number of cases outstanding
- Field complaints — number of cases/percentage shipped
- Technical support response time
- Field failure rate
- Mean time to repair
- Spare parts fill rate
- Accuracy of technical documentation
- Percentage of shipping errors
- Percentage of billing errors
- Percentage of receivables past due
- Percentage of receivables in dispute
- Warranty cases as a percentage of units
- Warranty cases as a percentage of sales ($)
- Warranty costs as a percentage of revenue
- Customer retention rate
- Pricing power (percentage of inflation pass through)
- Average year-over-year revenue growth per customer

BrandPower



A company's brand is a financial asset and, in many cases, is captured on the balance sheet as some form of goodwill that represents most of the difference between the book value and market value of a business. BrandPower (Pricing, Opportunity, Wow factor, Ecosystem, Retention) is a measure of the individual metrics that reflect the brand's contribution to operational performance. BrandPower is essentially the strength of the brand's relationship with its customers. Strong brands do not exist by accident. Their operational and financial value is developed and shaped over time.

In most cases, a customer's purchasing decisions are based on a perception of what each competing brand will deliver in terms of their value expectations and requirements. From a marketing perspective, the brand represents a conceptual vote of confidence (or lack thereof) in a business's value proposition. It's not simply a logo or slogan, it is a summation of customer impressions and experiences (promises made vs. promises kept). The following factors are included:

- Customer service (or lack of)
- Promise of value (explicitly stated or implied)
- Pricing (vs. competition and value proposition, stated or implied)
- Reputation (earned from personal and third-party experiences)
- Execution (delivery performance, product performance, documentation)
- Confidence in future availability (long-term support)
- Sales/service interactions

BrandPower Metrics

BrandPower metrics translate the intangible, emotional attributes of a brand, from the customer's perspective, to operational performance metrics from the business's perspective:

Business Impact	Description	Metric
PRICING	Ability to pass materials & labor cost increases through to customers	Favorable / unfavorable change in COGS % of revenue prior 3 years
OPPORTUNITY	Ability to successfully expand scope of supply / new product lines	% revenue in current year of new scope from prior 3 years
WOW FACTOR	Ability to successfully introduce new products with improved COGS % vs. prior version	Favorable / unfavorable change in COGS % revenue new vs. old product version
ECOSYSTEM	Ability to successfully add related services, upgrades, products, paid training, aftermarket revenue	% revenue in current year of new ecosystem products from prior 3 years
RETENTION	Ability to retain targeted A & B Class customers	Favorable / unfavorable change in number of A & B Class customers prior 3 years

Figure 5.1: BrandPower metrics

Pricing Power

The first measure of BrandPower is pricing power. Pricing power is the ability to pass material and labor cost increases through to customers in the form of higher prices. The higher this ability, the more favorable year-over-year changes will be in cost of goods as a percentage of revenue. If a company is able to pass cost increases through to customers — without sacrificing market share — then their brand is making a net contribution to performance. The best way to measure this is to analyze the three-to-five year trend in cost of goods vs. revenue. If cost of goods as a percent of revenue has improved or remained constant, the Brand Power is strong and financially favorable.

Opportunity Power

The next BrandPower metric is opportunity. This represents a business's ability to leverage existing goodwill to help expand the scope of supply. When goodwill exists, a company is often able to extend its offering of products and services with relatively small incremental increases in marketing and sales costs. Apple's reputation for innovation and quality is one great example. McDonald's ability to expand offerings beyond the *traditional* scope of fast food fare is another. In both cases, brand strength provides an opportunity for each company to attract existing customers to new lines of business.

The opportunity metric can be measured by calculating the percentage of new product sales in the current year as a result of products introduced in the prior three years.

WOW Factor

WOW factor leverages brand strength by introducing changes in the value proposition of a product or service, thereby reducing cost of goods sold as a percentage of revenue. Examples include a price increase to an existing product or service that is not driven by corresponding cost increases, re-release of an existing product or service in smaller portions (or with lesser functionality) with no change in price, or the release of a new product or service at a price point that improves profitability without negatively impacting existing product/service sales.

Ecosystem Power

An ecosystem approach leverages brand loyalty by introducing peripherals, technical service contracts, and other related add-on or *after-market* extensions to an existing product or service. Connectivity to other *intelligent* products and services is another example of brand strength leverage. In some cases, a lesser known product or service introduces connectivity to a larger, more established brand. Ecosystem leverage can be measured by the percentage of revenue earned in the current fiscal year from related products, relative to similarly leveraged sales over the prior three years.

Retention Power

Customer retention is, over time, the highest value element in the BrandPower equation. Retention metrics should be based on A and B class customers (the top 20% of customers, which typically represent 80% of profitability) and should, by definition, exclude customers that are not profitable or core to future growth (based on the company's winning strategy). Measuring retention of customers in the current year vs. the prior three years will reveal favorable or unfavorable trends that impact the sustainability of current profits.

COBRA Metrics

The day-to-day reality of any business is a real time mix of customer demands, supplier dynamics, competitive forces, employee issues, and never-ending time constraints. It is a continuous challenge for any organization to stay focused on delivering quality products and services while maintaining the operational discipline needed to deliver sustainable profitability, and implement strategic investments that drive long-term success. These pressures are captured in a few key performance metrics that impact the profitability and sustainability of a business. Collectively, the operational performance metrics captured by COBRA provide valuable information about areas of a business that are performing up to par, areas that may be ripe for optimization, and the impact made by prior strategic investments. These metrics are also leading indicators of future financial performance and wealth creation. The acronym COBRA summarizes these crucial metrics. Figure 5.2 details the business factors that are included in each COBRA metric.

COBRA Metrics

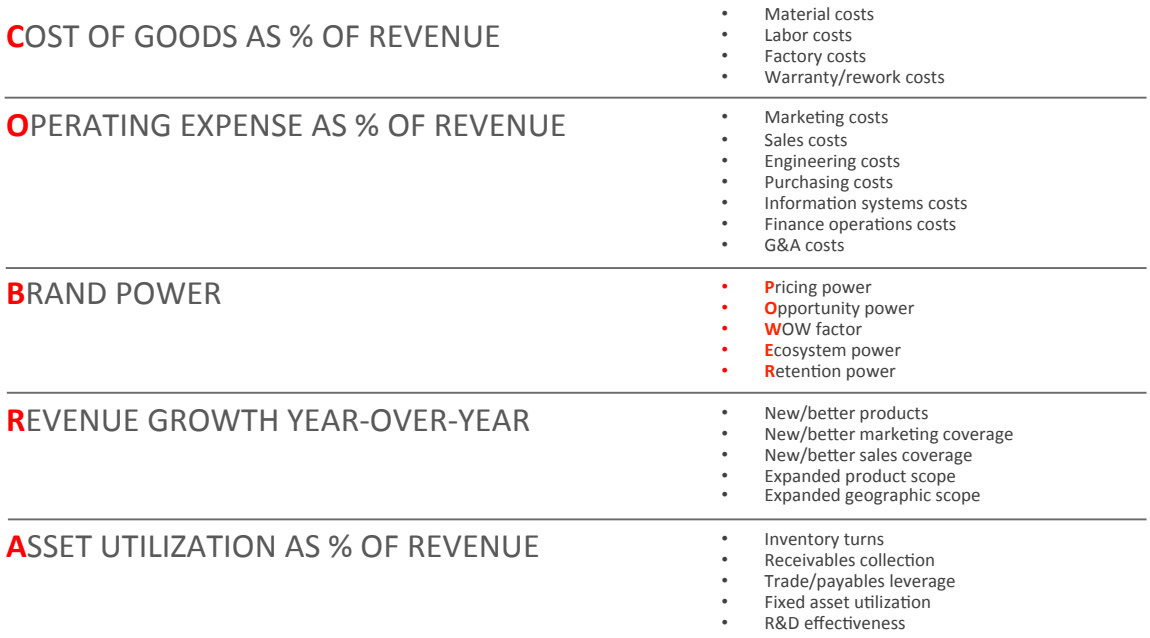


Figure 5.2: COBRA metrics

Cost of Goods

The most direct financial measure of operational performance is the cost of goods and services as a percentage of revenue; in other words, the direct material, labor, and variable costs embedded in every product or service delivered. For example, the manufacture and sale of a pair of shoes would incur costs for leather, rubber, and other materials; as well as labor costs to cut, mold, assemble, stitch, inspect, and package the shoes. Rework costs might also be included if inspectors or customers reject a product.

Comparing the costs of goods every year to previous years, as a percentage of revenue, will establish a benchmark for operational performance that reflects management's commitment to process optimization — how effectively they manage product design, purchasing, production, and distribution processes — and the business's ability to pass through costs of inflation.

Operating Expense

Operating expenses (OPEX) are costs that do not directly vary with production volume. These costs are incurred regardless of whether — or how many — products or services are produced and delivered to customers. These costs, often referred to as overhead, may include rent, labor costs for support staff, costs not directly tied to producing products or delivering services (accounting, clerical, and customer service teams, etc.), and costs associated with marketing, sales, or maintenance.

Operating expenses are measured as a percentage of revenue each year. Comparing year-to-year operating expenses over time will reveal trends relative to an organization's overall efficiency: An organization bloated with high overhead costs as a percentage of revenue will struggle to achieve or maintain profitability … particularly during industry or economic down cycles. By contrast, an efficiently managed business is continuously looking for ways to increase productivity and reduce operating costs as a percentage of revenue.

Brand Strength

As discussed in the prior section, brand strength is the sum of individual BrandPower metrics. Brand strength should be calculated so that year-to-year comparisons can be performed. This intangible, but very real asset, creates value for an organization beyond the market value of its tangible assets.

Revenue Growth

Revenue growth is a fundamental indicator of business success. However, it must be viewed in the overall context of sustainable, growing profitability. When used in context — along side other key business performance measures — revenue trends (revenue growth year-over-year) identify a vitality, or lack of vitality in a business.

A business in decline (indicated by decreasing revenues over time) is either misinterpreting customer requirements (losing share by failing to deliver on the promise embedded in its value proposition), misinterpreting competitor value propositions, or serving a market that's in decline. In any case, corrective action is needed to reverse the trend and avert disaster.

Asset Utilization

Asset utilization measures the effectiveness of an organization's investments, and the effectiveness of its efforts to manage short- and long-term assets over time. Consider an equipment investment of $100,000 and debt service payments of $1,750 per month: Running at full capacity (say 80% utilization) this machine generates enough net revenue (gross revenue minus operating costs) to cover monthly purchase payments plus $500 per month. Not bad. But what if that same business had invested $50,000 in a slower, older machine, or $150,000 in a newer, faster machine?

The devil is in the details, of course. Both the newer, faster machine (by virtue of reducing operating costs) and the older, slower machine (by reducing investment outlays) may end up generating higher returns for the money invested. Thus the effectiveness of an organization's investment decision can only be determined through an analysis of available options.

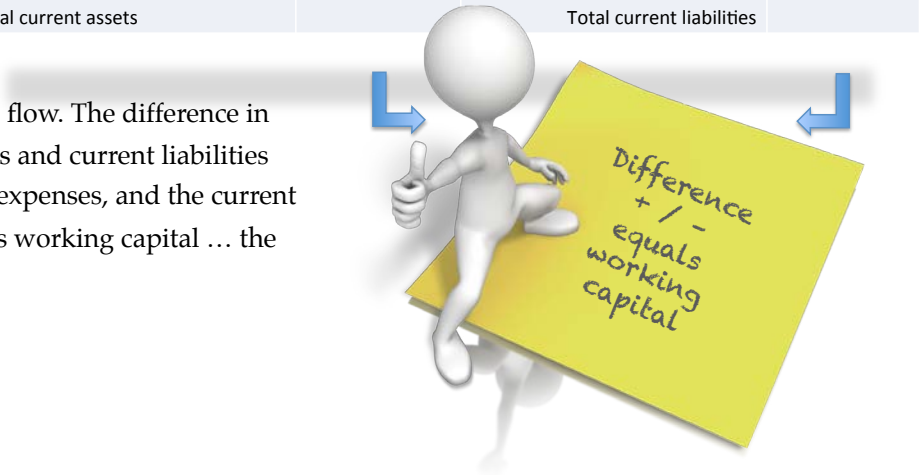
Now let's consider what might happen if gross revenue declines. The slower, older $50,000 machine in our example may continue to run at or near 80% utilization to keep up with declining demand, thus its return on investment is more or less unchanged. The newer, faster machine, on the other hand, drops to 50% utilization. Budgeted hourly rates to operate this $150,000 machine, and service the debt incurred, are fixed, thereby creating a net negative impact on investment returns *and* cash flow.

The business may weather the impact of low (or no) returns on its investment, but this underutilized asset is now a drain on working capital. It's draining cash from the business at a time when additional investments may be needed to address the structural cause(s) of its declining revenue.

Lots to consider, but the important point is this: Long-term assets (facilities, machinery, information systems, etc.) are capital intensive, and investment capital is always limited. A well researched, properly financed, fully or near fully utilized asset that generates revenue above and beyond costs, is a net contributor to working capital … while an underutilized asset becomes a drain on working capital. A business that understands the short- and long-term implications of asset utilization will recognize its value as a key operational performance metric.

Short-term assets, including cash on hand, receivables, and inventory must also be managed very carefully to maintain a net positive cash flow. The difference in value between current assets and current liabilities (accounts payable, accrued expenses, and the current portion of long-term debt) is working capital … the lifeblood of a business.

ASSSETS	$	LIABILITIES	$
Cash		Accounts payable	
Accounts receivable		Accrued Expenses	
Inventories		Current portion long-term debt	
Total current assets		Total current liabilities	



The Importance of Asset Optimization

A positive working capital position implies strong operating effectiveness and financial liquidity. On the other hand, a negative working capital position will eventually require a company to borrow cash to support its current level of inventory, receivables, and accounts payable.

Measuring working capital as a percent of revenue is, therefore, an effective metric that can be used to monitor the management team's operational effectiveness. For example, one of the most significant uses of working capital is inventory. The longer inventory sits on a shelf, the longer the company's working capital is sitting idle (think negative return on capital). When not managed properly, a business can easily outgrow its cash position, requiring more borrowing to sustain operations, or in the worst case, creating a cash crisis. For this reason, working capital optimization is essential to performance.

In a similar context, the fixed assets of a business, as a percent of revenue, are a critical metric from an investor's point of view. Fixed assets are typically funded with longer-term obligations compared to working capital funding, but both types of borrowing add to the capital required by the business. These longer-term assets are referred to as capital expenditures (CAPEX) since their useful and tax life is greater than one year, and they are charged to the income statement annually on a depreciation-time basis that is dictated by the appropriate tax code.

It should be clear that management must continually optimize the use of existing assets, such as buildings, machinery, equipment, computer systems, furniture, and fixtures as a percent of revenue. Comparing the business's annual depreciation expense to its annual CAPEX investments (plus or minus) will provide an excellent metric for the fixed asset utilization performance of an organization from an investor's point of view.

COBRA Trends Define Performance

It is important to understand how these performance metrics behave individually and interactively. There are many situations where specific, targeted actions can have an important effect on each of these metrics individually. A good example would be a major redesign of a product that reduced the cost of goods as a percentage of revenue. Or, an investment in a new customer resource management (CRM) system that reduced sales costs (OPEX) as a percentage of revenue. These are examples where an individual COBRA metric can be improved, as a percentage of revenue, independently of any other change.

Conversely, a change in one metric that doesn't affect the others can have an unfavorable outcome. For example, if a company's product line becomes more costly to build, as a percentage of revenue, for any reason — price pressures, older technology, higher labor costs, higher cost of materials, etc. — these factors could have a negative effect on only one COBRA metric without impacting any others.

However, in many cases, these basic operational performance metrics are related to some degree and behave interactively. In Figure 5.3, Example 1, the company has achieved organic growth year-over-year for five years. This organic growth (not associated with a merger or acquisition) is the most significant responsibility of the management team. Certainly, it is possible to improve profitability in one or two years with cost reduction actions alone. However, it is almost impossible to deliver sustainable, profitable growth longer term, without organic revenue growth.

Growing Revenue

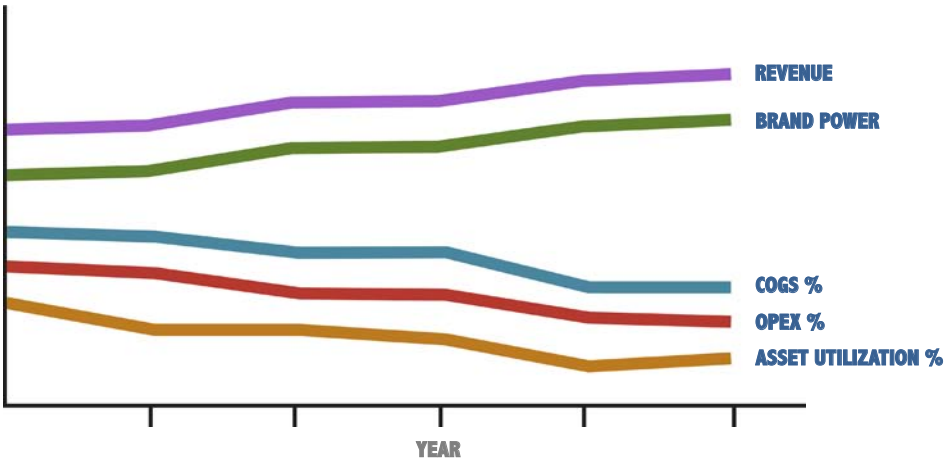


Figure 5.3 Example 1 — COBRA metrics with growing revenue

In this example, the five year change in organic revenue is significant year-over-year, with consistent growth. In this situation, the following is highly likely:

- Cost of goods as a percentage of revenue has decreased due to the purchasing leverage, higher per unit absorption, and probable learning curve effects.
- Operating expenses as a percentage of revenue have decreased, based on operating leverage and productivity gains, more than offsetting inflation pressures.
- BrandPower has increased based on more resources being available for product enhancements, customer support, and other opportunities.
- The asset utilization rate has improved (assets as % of revenue reduced) due to operational leverage, higher use of fixed assets, and more flexibility in inventory use.

An investor would review these prior trends, assume they would most likely continue in the future, and calculate the value of the business accordingly.

An Underperforming Business

Another example of the interaction between COBRA metrics is illustrated in Figure 5.4 below.

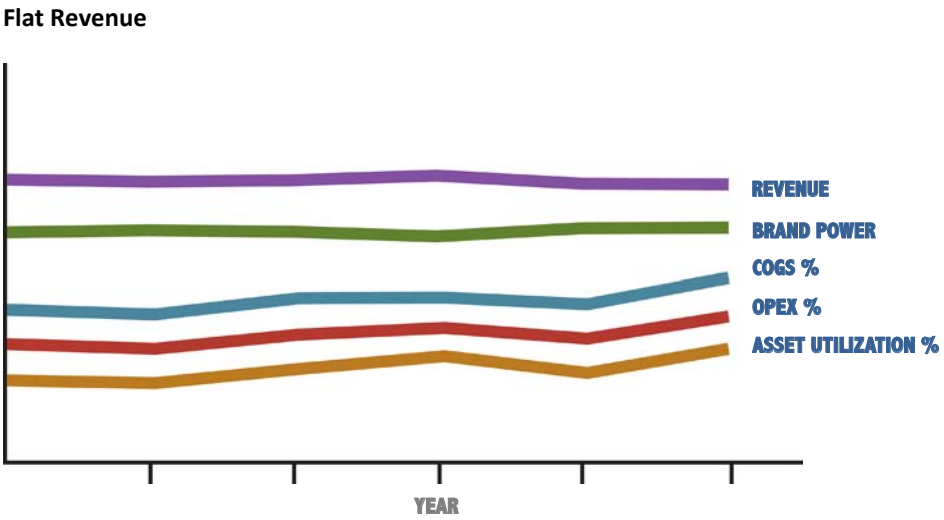


Figure 5.4: Example 2 — COBRA metrics with flat revenue growth

In this example, the five-year change in revenue is minimal, or essentially no growth. In this situation, the following is highly likely:

- Cost of goods as a percentage of revenue has increased due to inflation pressures and lack of any incremental purchasing leverage.
- Operating expenses as a percentage of revenue have increased, or at best remained steady, based on the lack of productivity improvements that offset inflation pressures.
- BrandPower is stagnant or declining.
- The asset utilization rate has remained flat to slightly negative, depending on the operational effectiveness of the management team.

An investor reviewing these trends would likely assume that the next five years will be more or less equal to the last five years, and calculate value accordingly.

A Business in Trouble

The opposite of Example 1 is shown in Figure 5.5, Example 3. In this case, the management team has been unable to maintain sales over the last five years.

Declining Revenue

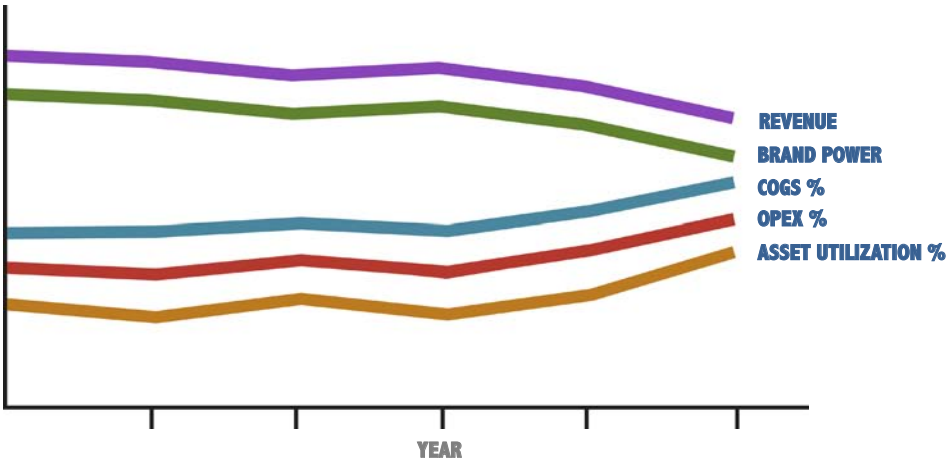


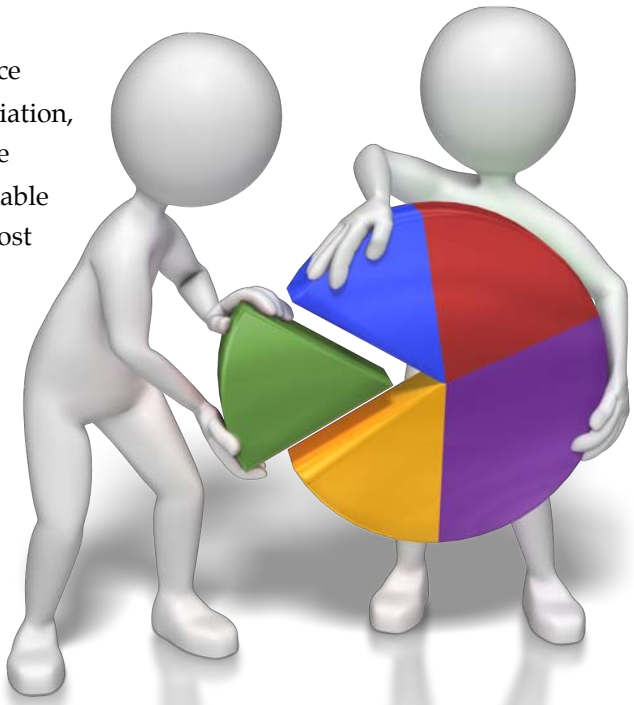
Figure 5.5: Example 3 — COBRA metrics with declining revenue

The five-year change in revenue is negative. In this situation, the following is highly likely:

- Cost of goods as a percentage of revenue has increased due to inflation pressures, less purchasing leverage, and less per-unit absorption of factory costs.
- Operating expenses as a percentage of revenue have increased based on inflation pressures that have not been able to be offset by productivity gains.
- BrandPower has declined significantly as there is less money available for new products, marketing, and customer support.
- The asset utilization rate has deteriorated as fixed costs are spread over a smaller revenue base and inventory turns have slowed.

An investor reviewing these trends would typically assume that the declining trends would continue or accelerate downward. A valuation of the business forward would be based on declining revenue/EBITDA streams and ROIC results.

5.3 Financial Performance



On the financial side of the business performance equation, earnings before interest, taxes, depreciation, and amortization (EBITDA) are used to measure annual performance. The structural and sustainable EBITDA of the business is the foundation for most methods of calculating the long-term value or wealth creation power of the business.

Along with a business's operating structure and EBITDA performance, its return on invested capital (ROIC) is used by investors to gauge how well the business utilizes the capital provided by both equity and debt investors. This includes all forms of net capital used by the business, including the amount of working capital necessary to support operations.

Finally, all of the operational and financial performance metrics roll up to determine the forward value of the business. This market capitalization, or enterprise value, is essentially the value of the business as an asset, similar to the value of a building as an asset that can be sold in the open market. The annual change in this dollar value is the wealth creation power of the business.

EBITDA Performance

EBITDA is the first of three key financial metrics that define the overall financial performance of a business. EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) is a measure of the direct product and operating costs of a business as a percent of revenue. It it useful for defining the percent of revenue available to pay for the depreciation, amortization, interest, and tax costs incurred by a business. It also reflects the effectiveness of the company's strategy, operational performance, and culture.

The relative change in EBITDA, as a percent of revenue over several years, is an excellent metric for determining the overall financial performance of the business from an operating perspective. However, by itself, EBITDA does not tell you anything about the financial performance of the business from an investor's point of view. This is because EBITDA does not include the essential costs of the *necessary* assets … depreciation and amortization, the costs of interest on *necessary* debt or borrowing of the business, and of course, the appropriate taxes of the business.

EBITDA/Income Statement

The use of EBITDA as a financial metric will be discussed again later in this chapter, but first, let's define and explain what it is. As shown below, EBITDA is derived from the income statement of the business. The revenue of the business is all the invoices for goods and services issued by the company, to customers, over a specific time period (typically a year).

FINANCIAL METRIC	EXAMPLE	% REVENUE
Revenue	$500,000	100%
Minus Cost of Goods	($250,000)	50%
Equals gross profit	$250,000	50%
Minus operating expenses	($100,000)	20%
Equals EBITDA	**$150,000**	**30%**
Minus depreciation	$30,000	6%
Minus amortization	$20,000	4%
Equals EBIT/OP profit	$100,000	20%
Net operating profit after tax*		
Minus interest expense	$20,000	4%
Minus tax expense	$25,000	5%
Equals net income	$55,000	11%

Figure 5.6: EBITDA

Cost of goods sold is the direct material, labor, and factory overhead costs that go into the manufacture and delivery of a product or service. Operating expenses are all the indirect costs the business incurs during the specified time period. These costs support all activities needed to market, sell, service, purchase, invoice, insure, and otherwise continue the operations of a business. In other words, operating expenses are all costs of doing business beyond the direct product or service costs included in cost of goods sold during the specified time frame.

As you can see in Figure 5.6, revenue minus cost of goods sold, minus operating expenses for a given time period equals EBITDA. In this structure, it should be clear that you have included all of the direct, variable costs (costs that vary based on the quantity of products/services sold), and that you have accounted for all of the indirect costs needed to sustain operations throughout this time period. By reviewing the income statement, it should now be clear that if the cost of goods is reduced as a percent of revenue by either increasing the price or by finding a way to lower costs, it would increase the percent of revenue available to pay for the other costs of the business.

Similarly, if you were to reduce the direct costs incurred for a given volume of revenue during the specified time frame, or the indirect costs of keeping the doors open, you would also increase the dollar amount, as a percent of revenue available, for the other costs of the business.

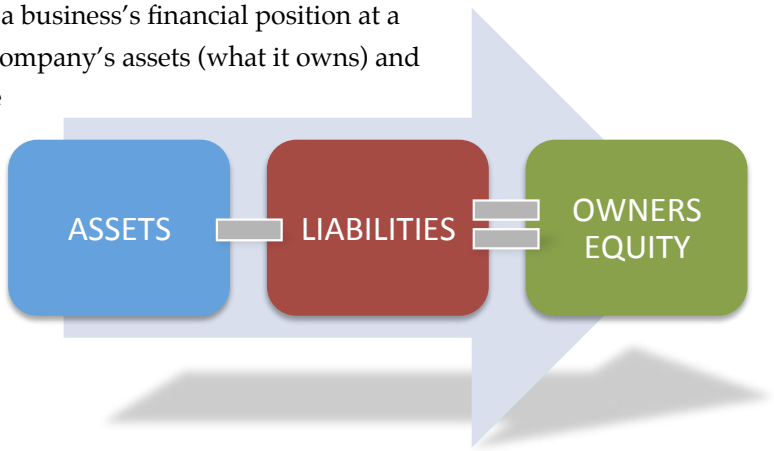
EBITDA can help you to see these relationships by defining the percentage of revenue required to directly produce and support the products and services of the business. EBITDA also helps to define the dollar amount and percentage of revenue available to pay for fixed assets (depreciation and amortization), working capital (inventory, accounts receivable), interest on debt, and of course, taxes on the profit (if any) of the business.

Balance Sheet Overview

To fully understand how EBITDA should be used as a financial metric, let's complete our definition of the income statement by reviewing the company's balance sheet. Understanding the relationship between an income statement and a balance sheet is key to understanding how EBITDA should be used for performance optimization purposes. However, it only represents a portion of the overall financial scoreboard.

An income statement measures the annual flow of transactions from customers into the business, and then on to the business's suppliers. It captures the volume of dollars flowing through the business. A balance sheet, on the other hand, is a financial summary of the assets, liabilities, and equity of the business. It represents what is *owned* by the business and what is *owed* by the business. The difference in these two dollar amounts is the equity value of the business.

A balance sheet provides a snapshot of a business's financial position at a specific point in time, listing all of the company's assets (what it owns) and liabilities (what it owes to lenders). The bottom line, or two sides of the balance sheet, must always be in *balance* … assets minus liabilities equals owners' equity.



Balance Sheet Details

Now, let's review a balance sheet in more detail to understand how the elements of a balance sheet change based on the operations of a business, and how the balance sheet is reflected in the income statement. In Figure 5.7, the major elements of the assets, liabilities, and owners' equity are broken down.

Assets represent anything of value owned by the business. These assets are recorded on the balance sheet at net book value or net realizable value. They are further broken down into current assets (those that mature in less than one year), and fixed assets (those with a maturity that exceeds one year). Fixed assets are further broken down as tangible and intangible assets. Tangible assets are essentially physical resources. Intangible assets are typically non-physical, such as brands, patents, trademarks, etc. These assets are generally described as goodwill, which represents the cost of acquiring brands, technology, product lines, and companies above their book value.

Current assets are the lifeblood of operations and must be managed intensely to optimize business performance:

- **Cash** — All forms of liquidity, including checking accounts, money market, and short-term savings accounts.
- **Accounts receivable (AR)** — Cash due from customers based on the invoices issued for delivery of goods or services. Accounts receivable represents the time between when an invoice is issued and when the cash is received.
- **Inventory** — Inventory includes all raw materials a company purchases for resale (whether directly or after post-processing to add value) and all finished goods produced in advance of, or in excess of, current demand. When (and if) this inventory is ultimately sold, it is accompanied by an invoice and added to the balance sheet as a receivable (for credit sales) or cash asset (payment on receipt).

The liabilities and owners equity sections of the balance sheet represent a company's source of funds (creditors and investors). Both funding sources are necessary for the continuing operations of a business. The company uses these funds to acquire assets … all the things of value that are owned by the business.

In this regard, liabilities represent a company's obligations to creditors, and owners' equity represents the investments of owners in the business. In essence, creditors and owners are both investors in a business. The only differences are their respective degrees of anxiety, and the ways in which they expect to receive a return on their investments.

Liabilities are broken down into current liabilities and long-term debt. Long-term liabilities are typically bonds or notes that mature beyond 12 months related to the acquisition costs of items such as buildings, land, and equipment. Current liabilities are obligations that mature and must be paid within 12 months:

- **Accounts payable** — These are obligations that must be paid to suppliers of products or services invoiced to the company. Suppliers typically offer terms of payment from 30 to 60 days from receipt, and these obligations are categorized as accounts payable.
- **Accrued liabilities** — These are obligations owed but not yet paid, such as wages and payroll taxes that have not yet come due. Accrued liabilities also include interest payable and employee benefits accrued, such as pensions.
- **Current portion of long-term debt** — This is the portion of long-term debt to be paid in the current fiscal year.

Owner's equity is the final section of the balance sheet and represents the net value of all assets minus all liabilities. This amount plus the current earnings retained in the business, represents the net book value of the business to the owners.

	For the period of _____
Assets	
Current assets	$000.00
Cash	$000.00
Receivables	$000.00
Inventories	$000.00
Total current assets	$000.00
Fixed assets	$000.00
Tangible assets	$000.00
Land	$000.00
Buildings	$000.00
Machinery & equipment	$000.00
Furniture & fixtures	$000.00
Less accumulated depreciation	($000.00)
Intangible assets	$000.00
Goodwill	$000.00
Less accumulated amortization	($000.00)
Total fixed assets	$000.00
Liabilities	
Current liabilities	$000.00
Accounts payable	$000.00
Accrued liabilities	$000.00
Current portion of long-term debt	$000.00
Total current liabilities	$000.00
Long term debt	$000.00
Owner's equity	
Current earnings	$000.00
Total equity	$000.00

Figure 5.7: Simplified balance sheet

Income Statement to Balance Sheet Connections

To understand the strengths (operating effectiveness) and weaknesses (ignores investment costs) of EBITDA, you can connect the income statement to the balance sheet. In the example (Figure 5.8), it should be clear that EBITDA does not include certain annual costs from the balance sheet. These costs are the annual portions of depreciation, amortization, and interest paid to bondholders.

In accounting parlance, depreciation refers to expensing a certain portion of the value of *tangible* fixed assets to the income statement each year. Typically, the annual amount of depreciation permitted is defined by Internal Revenue Service (IRS) rules based on the estimated useful life of each asset.

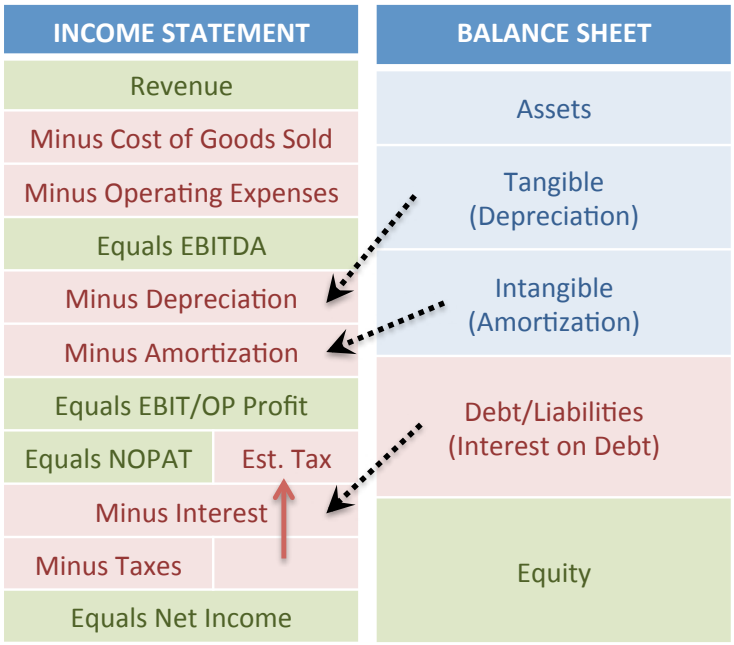


Figure 5.8

Similarly, amortization refers to the expensing of acquisition costs minus the residual value of *intangible* assets. These intangible assets are typically intellectual property such as patents, trademarks, and copyrights. Amortization of intangible assets is done in a systematic way over the useful life of the asset, typically based on IRS rules. The intent is to reflect the consumption or decline in the intangible asset's value as a result of the passage of time.

Another major balance sheet cost expensed to the income statement annually is interest paid to bondholders. These interest payments are ongoing costs to the business. Bondholders monitor the EBITDA generated by a business each year to calculate the *interest coverage* ratio the business produces. In other words, if the business generates $100,000 of EBITDA and has $50,000 of interest payments, it has a 2:1 coverage ratio. Typically, the higher the coverage ratio a business produces, the lower the interest rate it will pay.

The final clarification of the income statement is federal and state income taxes. When all income taxes are accounted for, the bottom line on the income statement is *net income*.

Investor Perspective

The second key financial metric for measuring the performance of a business is return on invested capital (ROIC). As discussed in the last section, EBITDA is a useful metric for measuring the relative operational performance of a business, over time, as a reflection of its strategic and competitive position, efficiencies, quality, and the effectiveness of its culture. However, since EBITDA specifically eliminates depreciation, amortization, and interest on debt, it does not measure performance compared to the investments needed to produce and/or sustain the product, and operational cost profile of a business. As a result, it does not capture the essential purpose of making an investment in the business in the first place — getting a sustained, positive return on the dollars committed.

This basic concept is intuitive and essential to the long-term viability of an enterprise. However, there are cases where ROIC is not well understood by the management team of a business. So, before beginning to discuss future cash flows and the market value of the business, you must first understand the factors that define a firm's return on invested capital.

Investor Expectations

To start with, there should be a clear understanding of the sources of capital and the underlying investment concepts associated with each. Figure 5.9 summarizes the capital structure of a typical investor-owned business, starting with common and preferred stock, and ending with subordinated and senior debt.

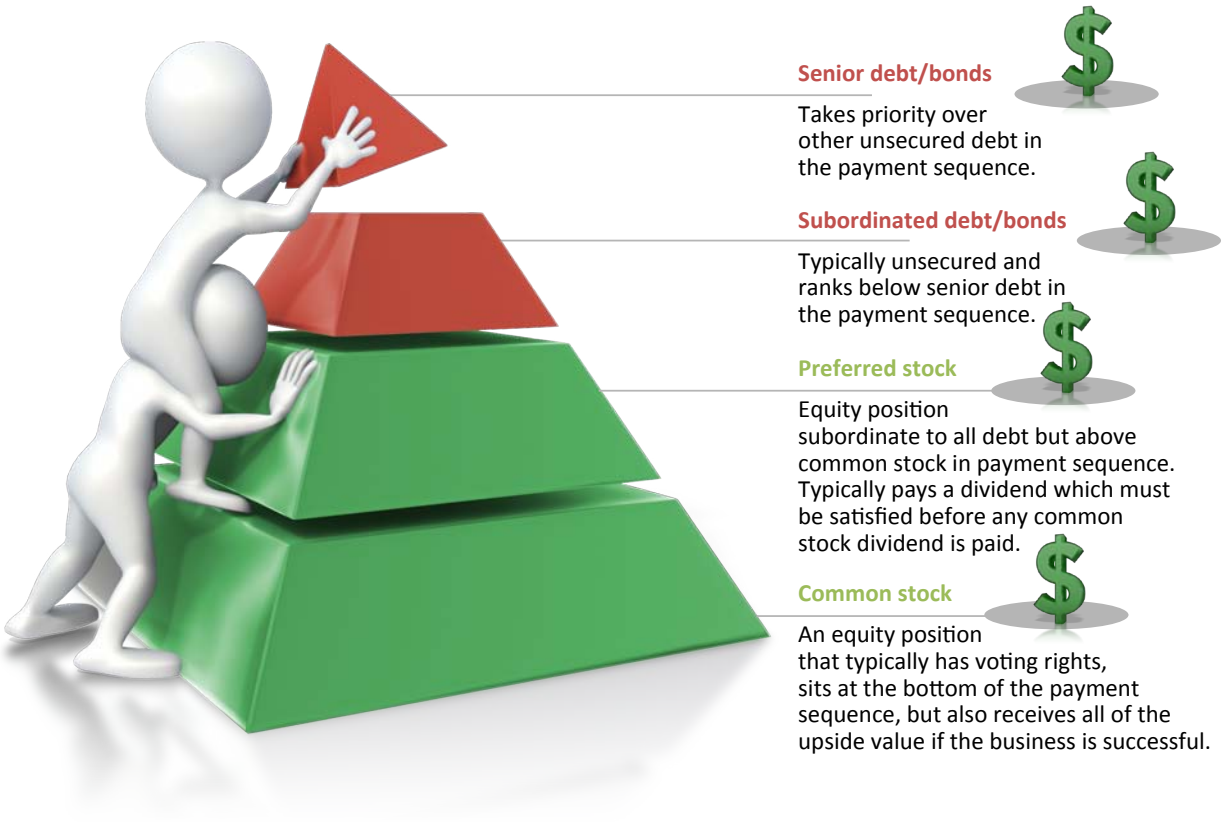


Figure 5.9: Typical capital structure of an investor owned business

Most businesses initially start with equity investors. These investors are shareholders, investing in a business with no guarantee or promise that they will be repaid. An equity investor's investment thesis is that the mission, strategy, business model, products, and operations of a business they've invested in will be successful. Therefore, it will generate adequate profits, over time, to either repay the investment or increase the value of the company's share price.

Equity investments are risky because all equity monies invested in an organization are wiped out if that organization happens to fail. Conversely, if the organization is successful, all of its *upside* opportunity goes to the equity investors after the debt (bond) holders are paid. Equity investments have unlimited upside opportunity (in theory), but also a 100% downside risk. The expected rate of return must be high enough to account for this.

Preferred stockholders are positioned above common stock in the capital structure of a business. Typically, the preferred stock is paid as a dividend, but the value of the preferred stock is essentially fixed with some variation for changes in interest rates and risk.

Once equity investors have committed funds to an organization and a reasonable chance of success has been demonstrated, debt investors (bondholders) may be willing to commit monies to the company. Unlike equity investors, debt investors expect a guarantee that they will be paid back … with interest ... in return for use of their capital. They also look carefully at a business's ability to repay principal (the original investment amount) within the agreed upon time period (the bond's maturity date).

Bondholders look at the historical, current, and projected EBITDA of a business to make sure there is a sufficient buffer between EBITDA income and the interest payments they expect to earn from a bond investment. In many cases, an organization will have multiple levels of bond holders: Senior (secured) debt holders take precedence over subordinated (unsecured) debt holders in terms of who gets paid first if sufficient funds are not available to cover all of an organization's debt obligations. In this scenario, equity shareholders won't be paid anything until debt payments to senior and subordinated bond holders are satisfied!

Capital Structure

The *capital structure* of a business is essentially the ratio of debt vs. equity investors. If an equal amount of debt and equity is invested in a business, this ratio is 1:1. If debt is twice the equity of a business, its capital structure ratio is 2:1, and so forth. The higher the ratio of debt to equity, the higher the leverage of the equity investors.

In any case, equity investors and debt investors both expect to get a *risk-adjusted* rate of return on the capital they commit to a company. The fixed interest rates of bond investors and expected total rate of return of equity investors multiplied by the relative weight of each, will define the weighted average cost of capital (WACC) for the business. This is the return on invested capital threshold that a business must exceed to sustain itself and create value for its shareholders. Simply put, a business must produce a higher rate of return on its capital than its *cost* of capital.

Return on Invested Capital

With an understanding of capital structures and the weighted average cost of capital (WACC), you can begin to calculate the return on invested capital (ROIC) of a business. ROIC attempts to measure the returns earned on capital invested by all investor groups, and is defined by the following equation:

$$\frac{\text{Net Operating Profit "After Tax" (NOPAT)}}{\text{Book Value of Invested Capital t-1}} = \text{Return on Invested Capital}$$

There are four key elements of this equation. The first is the use of net operating profit rather than net income. The second is the hypothetical tax adjustment to operating profit. The third is the use of book values for invested capital rather than market values. The fourth is using the capital from the end of the prior year, and the operating profit from the current year.

FINANCIAL METRIC	EXAMPLE	% REVENUE
Revenue	$500,000	100%
Minus Cost of Goods	($250,000)	50%
Equals gross profit	$250,000	50%
Minus operating expenses	($100,000)	20%
Equals EBITDA	$150,000	30%
Minus depreciation	$30,000	6%
Minus amortization	$20,000	4%
Equals EBIT/OP profit	$100,000	20%
Net operating profit after tax		
Minus interest expense	$20,000	4%
Minus tax expense	$25,000	5%
Equals net income	$55,000	11%

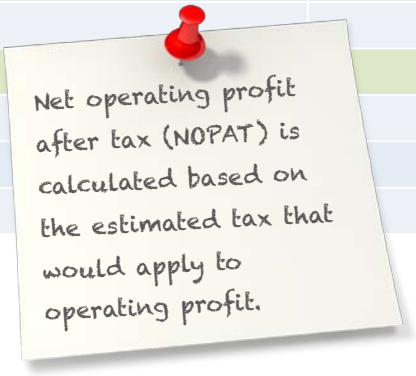


Figure 5.10: Net operating profit after tax (NOPAT)

A return on invested capital calculation has to consider returns to all investors — debt as well as equity. Therefore, we should consider the earnings of a business before paying the bondholders' interest. This measure — operating profit — is a pre-debt measure of earnings. To get an accurate measure for the *after tax* capital invested by shareholders and bondholders, however, we need to adjust the operating income to an appropriate *after tax* number. In practice, the actual after tax adjustment can be done a number of ways depending on the tax structure of the business, and the magnitude of the interest payments. In most cases, it would be accurate to use net income and add back interest expense, **minus the corresponding tax-adjusted impact**, to yield net operating profit after tax (NOPAT).

Connecting Profit to Invested Capital

The overall relationship between the income statement, the balance sheet, and the return on invested capital, is illustrated in Figure 5.11 below. Once we have defined the net operating profit after tax (NOPAT) from the income statement, we can then calculate the return on invested capital using the *book value* of the total debt plus equity from the balance sheet. This return on invested capital (ROIC) is the second key financial metric used in the COBRA method to define the performance of a business from an investor's point of view.

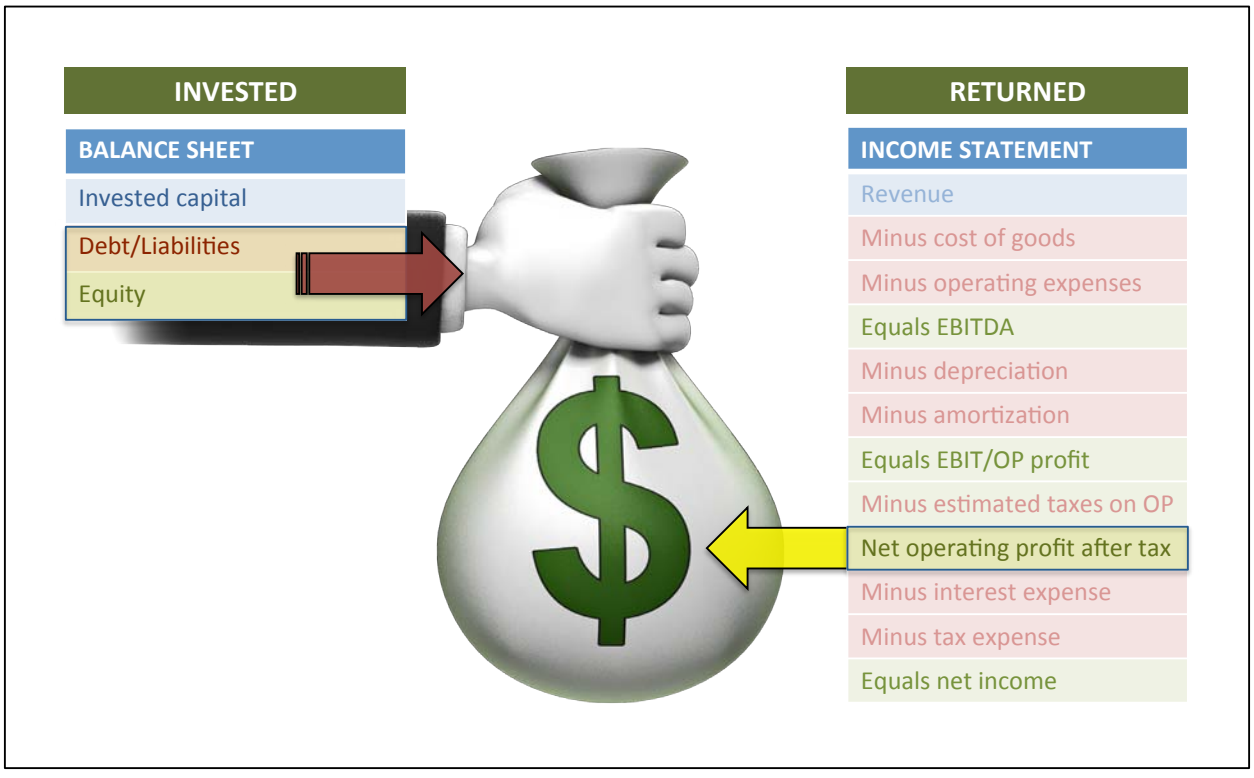


Figure 5.11: Return on invested capital (ROIC)

Obviously, the greater the net operating profit after tax, compared to the invested capital amount, the higher the return on invested capital. This key investment performance metric is critical to the long-term performance of the business. The difference between the ROIC and the WACC is the true economic value or wealth created by the management team.

The *COBRA 3D Business Development Process* is focused on privately held small and midsize businesses (SMBs). As such, it focuses on return on invested capital as the most significant investment metric, rather than return on equity, or return on assets. The reason for this distinction is that most SMBs must carefully manage both their equity and bondholder relationships, and do not have an ongoing, externally defined market value for the business as is the case with publicly traded companies.

A clearly specified market value can provide more flexibility for capital financing alternatives, and is one of the advantages of publicly traded companies. So for SMBs to sustain long term investors — both equity and debt — management teams must provide a reasonable, consistent rate of return greater than their weighted average cost of capital for all investors. Therefore, return on invested capital is the most useful metric.

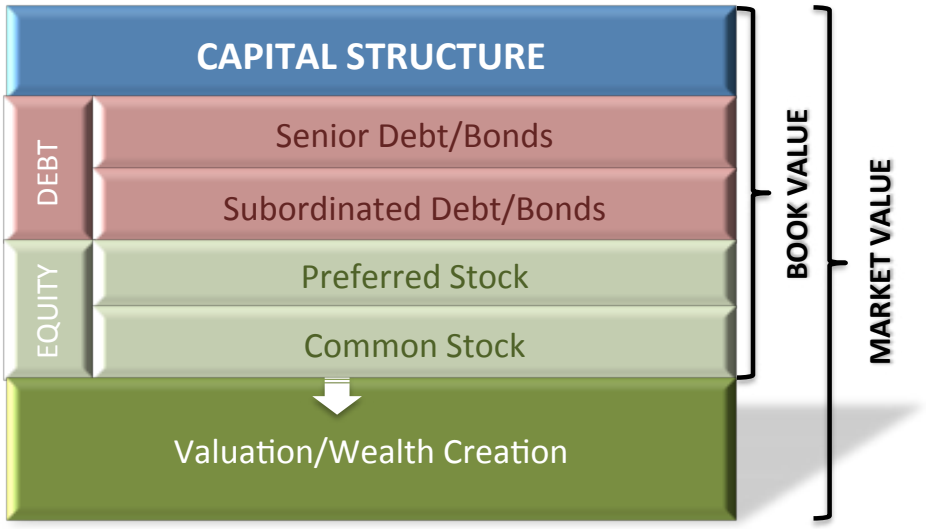
This key principle, delivering a consistent return on invested capital that is greater than the weighted average cost of capital, is referred to as *economic profit*. Economic profit is the difference between the actual return on invested capital (for example, 10%) and the weighted average cost of capital (for example, 8%). The economic profit generated, in this example, would be 2%. Surprisingly, there are many companies that don't generate a positive economic profit. Unfortunately, this is an unsustainable situation, because no reasonable investor will lend money at a lower rate than his/her expected rate of return over an extended period of time.

Business Valuation as an Asset

As discussed previously, EBITDA and ROIC are two key metrics used to measure the performance of a privately held business from an operations and investor's perspective. These performance metrics are viewed as fundamental to the value of a business, by its current investors, and to potential buyers or new investors seeking to place a value on the business. In this section, we will try to outline the key parameters of a business that new owners might use to establish the *market* or *enterprise* value of a business.

In this context, we are discussing business valuation for purposes of selling a business to a financial buyer (individual investor or private equity group), or a strategic buyer (a business that can leverage some capability of the acquired business). We do not include valuation methods that might be used for estate planning, tax calculations, or any other purpose.

In the discussions regarding ROIC, capital structure, and book value, you saw that all debt obligations of a business (senior and subordinated bonds), and all dividends paid to preferred stock holders, must be paid before common stock holders can realize a financial gain. However, once these fixed obligations are paid, the incremental value of net income generated by the business goes directly to the value of its common stock.



From a market value perspective, the *wealth creation value* of a business is based on its ability to generate ROIC above the expected, weighted average cost of capital going forward. In a privately held business, market value isn't easy to quantify because you simply don't have a broad-based set of investors analyzing the company's operational and financial performance for valuation purposes on a day-to-day basis.

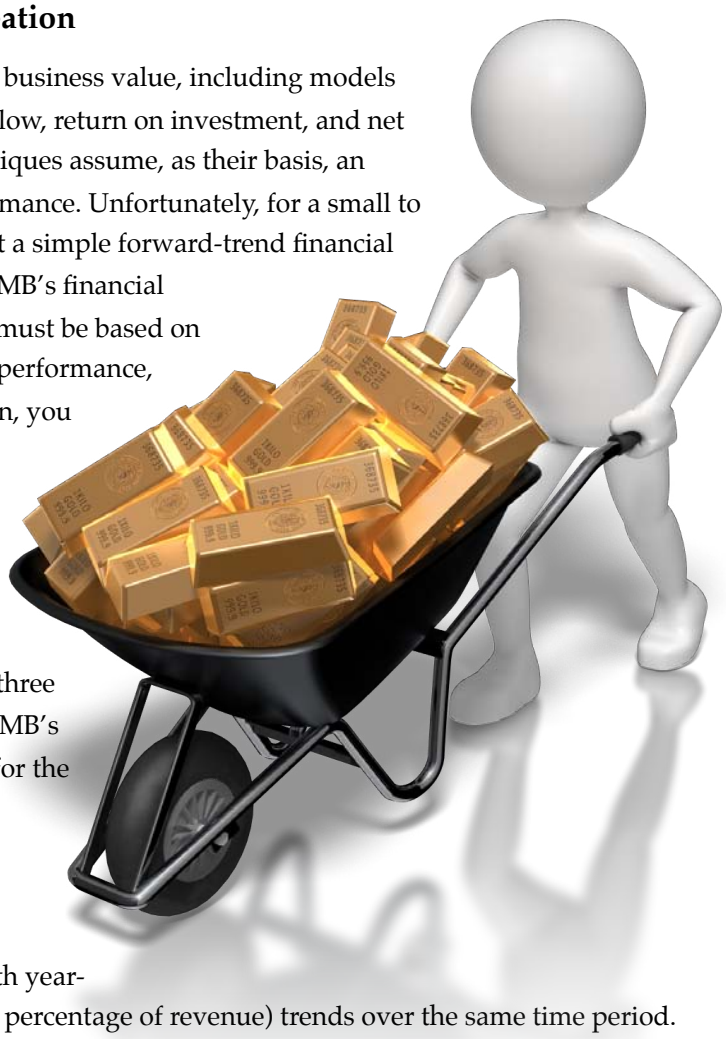
For this reason, the market value of privately held companies is typically estimated using a multiple of EBITDA. This can be a good starting point for valuation; however, there are several critical factors that must also be taken into consideration because multiple values of EBITDA can vary widely across firms of similar size, even in the same industry. These factors include the following:

- How capital intensive the organization is (as future CAPEX requirements increase, a lower multiple should be used for valuation)
- The historic COBRA/EBITDA performance over the past five years, and therefore the reliability of future projections as the basis for calculating future cash flows
- The cost of capital based on the reliability of prior performance data used for future performance projections … the higher the cost of capital/perceived risk of the business projection, the lower the multiple

So, assuming that potential investors are rational, the foundation for their valuation of a privately held company will be their perceived reliability of the future COBRA/EBITDA performance and the CAPEX requirements of the business.

The concept that the value of a business is a function of its expected cash flows is deeply embedded in finance. Fundamental to this principle is the fact that a company has to raise and invest capital in the assets and operating costs of the business. Furthermore, the cost of this capital, whether from equity investors or debt investors, is a basic obligation of the business. In fact, a business is not truly creating value until it covers the costs of providing adequate returns to both its equity and debt investors. The net result from a business valuation perspective is that the value of a business as a resaleable asset is based on the credibility of its future cash flows. The future cash flows can only be reasonably estimated based on their historic COBRA performance or in other words … *what you see is what you get!*

5.4 Driving Forces of Wealth Creation



There are many methods used to estimate business value, including models based on calculations of discounted cash flow, return on investment, and net present value. All of these valuation techniques assume, as their basis, an accurate forecast of future business performance. Unfortunately, for a small to midsize privately held business, this is not a simple forward-trend financial calculation. For forward projections of a SMB's financial performance to have any credibility, they must be based on assessments of the business's operational performance, culture, and strategy. With this information, you have a reasonable chance of predicting a business's future revenue/EBITDA streams and ROIC results.

As you may have guessed, the *COBRA 3D Business Development Process* uses COBRA, EBITDA and ROIC metrics over three to five years as a basis for determining a SMB's valuation. EBITDA and ROIC trend lines for the selected period are adjusted forward by analyzing and validating COBRA (cost of goods and operating expenses as a percentage of revenue, strengthening or weakening of BrandPower, revenue growth year-over-year, and relative value of assets as a percentage of revenue) trends over the same time period.

An investor would typically review these trends and assume that the trends would continue forward and then evaluate all other factors to make adjustments in their perceived value of the business. The valuation would be based on a net assessment of the revenue/EBITDA streams going forward, and the resulting ROIC of the purchase price of the business. COBRA metrics add reliability to estimates of the probable future behavior of the EBITDA stream. In preparation to sell, buy, or optimize a business, owners and managers are well advised to do the same analysis as a wise investor.

COBRA Validation: Step by Step

The best way to think about the fundamental value of an SMB is to understand the analysis that an impartial investor would require before committing long-term funds. First and foremost, a rational SMB investor would calculate *organic* revenue growth (or lack thereof) for the subject investment over the past three to five years. Using this information as a basis for analysis, the next key factors an investor would consider are the trends related to cost of goods as a percent of revenue, operating expenses as a percent of revenue, and asset utilization as a percent of revenue over that time period. By benchmarking COGS, OPEX, and asset utilization against changes in revenue, the investor can develop a much clearer picture of future financial performance expectations.

With the future revenue, cost of goods, operating expense, and asset utilization rates defined based on clear, past performance metrics, investors can calculate the value of the business. This value will be based on achieving a risk-adjusted rate of return greater than their cost of capital. The value of the business is the price they are willing to pay that achieves this risk-adjusted rate of return. So, fundamentally the price is driven by the past performance of the business.

The end point (objective) of the business valuation process may be the sale of the business to a qualified, interested buyer, or it may be to benchmark current value against a target value set by the current owner(s), thus serving as a basis for ongoing business development activities. In either case, the *market price* or *enterprise value* of the business, less the payoff amount owed to preferred stockholders and bondholders, less the payoff (or add back) of working capital adjustments, will equal the dollar value of all stock owned by common shareholders.

This dollar difference between the current value of the business's common stock and the common shareholders' original investment is wealth created by the business!

CASE IN POINT

Excellent financial performance is the result of excellent strategy, operations, and culture. Poor financial performance is the result of poor strategy, poor operations, or poor culture.

There is no doubt that the intense strategic, operational, and cultural focus of Apple set performance benchmarks for global business from 2009 – 2014. Apple's clear, compelling strategy (one most financial analysts still don't comprehend) has blurred the lines between hardware, software, and services, creating a more-or-less seamless platform from cloud to servers, desktop, and mobile devices. Apple pursued this strategy relentlessly, embedding technologies and hooks that built upon the synergies of their business model over the following 2 to 3 years. Add in an obsessive commitment to customer satisfaction, brand value, and precision operations, and the results speak for themselves:

Customer Satisfaction Metrics — Apple has consistently ranked #1 in customer satisfaction in the technology industry based on the "net promoter score" (NPS) index studies.

Brand Power — Through innovation and customer satisfaction, Apple has also consistently ranked #1 in brand value studies, with estimates in the $90 – $100 billion range.

COBRA Metrics — Apple consistently outperforms their competitors by 15% – 20% in all of these metrics and has built a dominant balance sheet as a result, including $150 billion in cash as of the first quarter of 2014.

The following comparison illustrates the direct correlation between operational performance and financial results, although stock valuations are sometimes confusing in the short term.

Financial Performance Summary [1]

Five Years (2009 – 2013)	Apple	HP	Amazon	Samsung	Google
Operating Income as % of Revenue	28%	7%	.01%	14%	24%
ROIC %	25%	8%	2%	22%	14%
CAGR Revenue Growth	+35%	-1%	+32%	+15%	+24%
Valuation Change	+500%	-10%	+500%	+200%	+250%

1 Per Morningstar database

Investing for Success

TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. Implementing strategic business development projects is the most effective way to create value in a small to midsize business.
2. Strategic business development projects are temporary, collaborative, labor-intensive investments.
3. Embedded knowledge is a collection of facts, skills and information that can be packaged and transferred for the use and benefit of others.
4. Best practices are generally accepted methods, procedures, and processes that are proven to be superior to other alternatives.
5. A learning or experience curve measures the performance gains achieved when a specific activity is repeated again and again over time.
6. Projects provide an opportunity to benefit from learning curves through the transfer of embedded knowledge and best practices.
7. Best practices based projects are the highest return/lowest risk approach to business development.
8. Organic growth based projects typically focus on one or more big ideas that are unique to a specific business.
9. Exiting or divesting a poor performing product line or portion of a business may be the highest value project a company can choose.
10. Merging or acquiring a business must have a greater return on the capital invested than the cost of that capital.

6.1 Strategic Business Development Projects

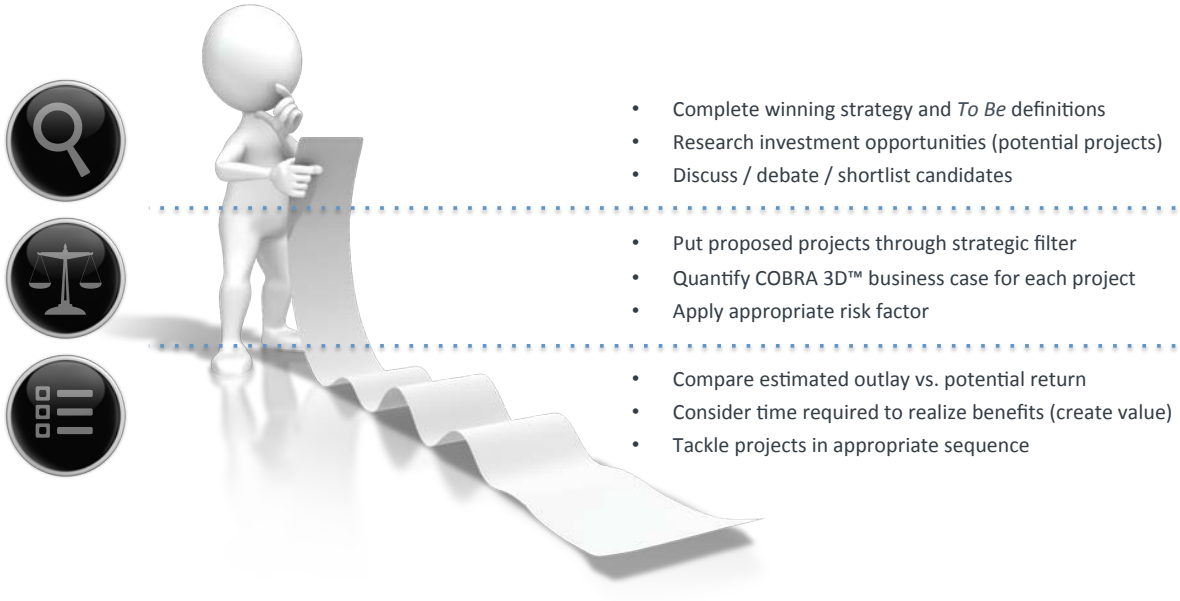
With a clearly defined winning strategy, it is now possible to begin identifying investment opportunities that will make the strategy a reality. These investments are best described as strategic business development projects, which have the following characteristics:

- **Temporary** — Projects have a beginning, an execution cycle, and an ending.
- **Collaborative** — By nature a project requires a team effort to achieve the defined result.
- **An investment** — The purpose of *strategic business development* is to create value and to generate a greater overall financial return, over time, than what is spent (invested) to accomplish the specified result.
- **Labor intensive** — Extra resources required to execute a project are not permanent headcount on the company's payroll. However, since the project is an important activity that requires internal and external knowledge, strategic business development projects are usually staffed with a combination of internal and external contributors.

The goal is to help move the company from its *As Is* situation to its *To Be* objective. Therefore, strategic business development projects should also include these goals:

- **Improved competitiveness** — First and foremost, all strategic business investments should have some level of impact on the operational or cultural competitiveness of the business.
- **Improved business performance** — Strategic business development projects must improve the operational and financial performance of the business in some way.
- **Clearly defined objectives** — There is no basis for investing resources without a precisely defined set of objectives.
- **Leverage of existing assets or capabilities**
    - Operations
    - Products/technologies
    - Marketing capabilities
    - Sales team and channels
    - Balance sheet resources

Collectively, these factors will incrementally create value for the business. This value will result in improved operational and financial results for the company.



6.2 Creating Value

To ensure that the highest impact projects are selected, it is important to apply a logical, structured, prioritization process. The overall project selection process should identify potential value-adding projects, justify the best candidates, and prioritize the execution of selected projects to create the maximum value for the least cost in the shortest time frame.

Identifying high impact projects begins with a clear definition of the *As Is* situation, a clearly defined winning strategy, and a clear understanding of the *To Be* objectives of the business's owners. The process of researching potential project opportunities is the responsibility of the management team. In most cases, using experienced external resources to identify opportunities is an excellent starting point. The research, discussions, brainstorming, debates, and follow-up scrutiny applied to proposed project candidates, will eventually lead the team to a short list of potential projects. These investment opportunities are the starting point for prioritization.

In most cases, more project opportunities will be identified than a company can afford to execute. This forces the management team to apply a logical, consistent justification process to quantify potential benefits from each project.

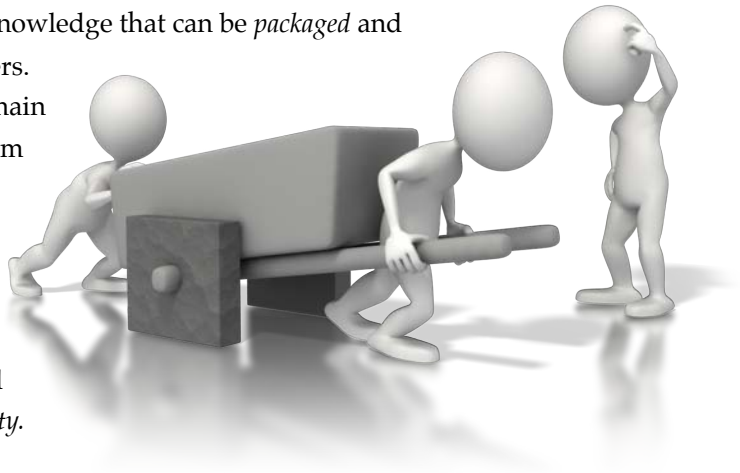
The justification process makes the *business case* for each prospective project by applying predefined operational and financial metrics to estimate potential investment returns, along with a thorough analysis of potential risks, to gauge the likelihood of success.

If all other factors were equal, projects with the highest potential returns would become top priorities for implementation. However, all other factors are rarely equal! Therefore, the potential returns estimated for each project must be weighed against a risk factor, and an estimate of the time frame required to achieve the estimated returns. A strategic business development project that offers lower overall returns, but is able to do so in a shorter time frame, may be prioritized ahead of higher return projects in some competitive situations. Likewise, a project with high potential returns but also a higher risk factor may be prioritized behind a project with less financial impact but a higher probability for success.

Embedded Knowledge Leverage

Every business is unique in some way, and the projects used to optimize its performance should reflect this fact. However, significant commonalities also exist between businesses, and these commonalities provide valuable opportunities for businesses seeking to improve their operational and financial performance. The basis for these opportunities is embedded knowledge leverage.

The concept of embedded knowledge is an extension of the traditional meaning of explicit knowledge. Explicit knowledge has been recorded, articulated, documented, or otherwise codified in some form. Embedded knowledge is knowledge that can be *packaged* and transferred for the use and benefit of others. This knowledge may be in the public domain (freely available to those willing to perform the necessary research), or it may be proprietary (embedded within a commercial product or service, such as software).



The opportunity and power of embedded knowledge lies in its inherent *transferability*.

Best Practices

Best practices are generally accepted, formally and/or informally standardized methods, procedures, and processes for performing a specified function or process. By definition, best practices are proven to be superior to previous, less successful alternatives. And by virtue of the public vetting process that makes a practice *best*, these practices are ideal representations of the concept of embedded knowledge.

The *packaging* of best practices into transferrable, embedded knowledge opportunities may be performed by public or private research organizations (e.g. trade groups or standards-issuing bodies) or for-profit businesses in the form of consulting services, white papers, market studies, software products, intelligent machines or systems, training programs, and other tools that a business can use to improve a function or process.

A business *leverages* embedded knowledge by acquiring its benefits without having to underwrite the considerable investments of time and money otherwise required to achieve a similar result. A qualified consultant, for example, may convey years and years of cumulative research and experience in a few short days, for a tiny fraction of the total cost needed to acquire that knowledge independently. Similarly, a software product that performs a function or series of functions based on best practices, may save countless hours and dollars when compared to the expenditures that would be needed to reach a similar level of process optimization through trial and error.

Furthermore, best practices in many realms are constantly evolving through innovation. Organizations that specialize in the processes, subprocesses, or operational functions addressed by a best practice are typically in a better position to identify, prove, and document these practices than organizations that utilize them to produce an entirely different product or service. For example, a company devoted to developing state-of-the-art marketing automation software will have more expertise in these technologies than a business that manufactures industrial products, or one that performs appliance repair services.

Learning Curve Theory

A learning curve, or experience curve, is a graphical representation of the rate of change in the time it takes to perform a given activity, the more times it is performed. As an example of learning curve theory, consider the time it takes to perform virtually any daily activity the 10th time vs. the first time. This progression of less time, each time you do this activity, is a learning curve.

In business, a learning curve reduces the time needed to perform a function or process after each subsequent cycle (until proficiency is achieved). But, in many cases, the learning curve also reduces other operating costs … by avoiding costly mistakes, for example. Each process and subprocess becomes less difficult, less time consuming, and less prone to error over time.

This progressive advancement in proficiency creates operational leverage, as depicted in Figure 6.1 below.

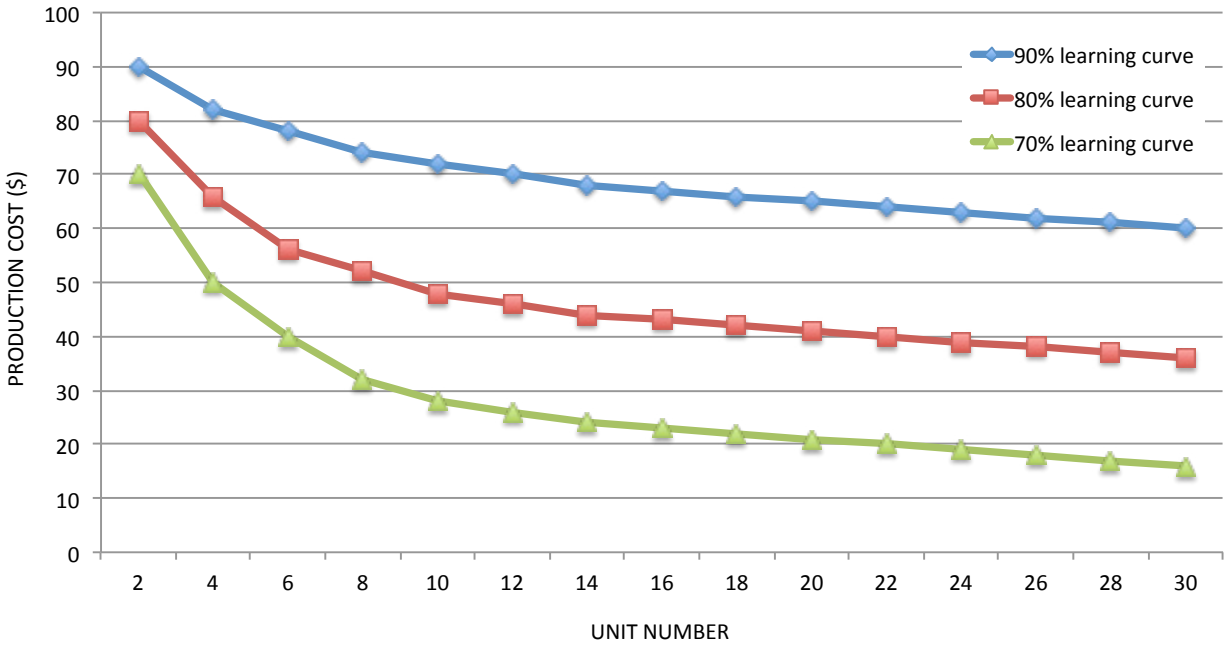
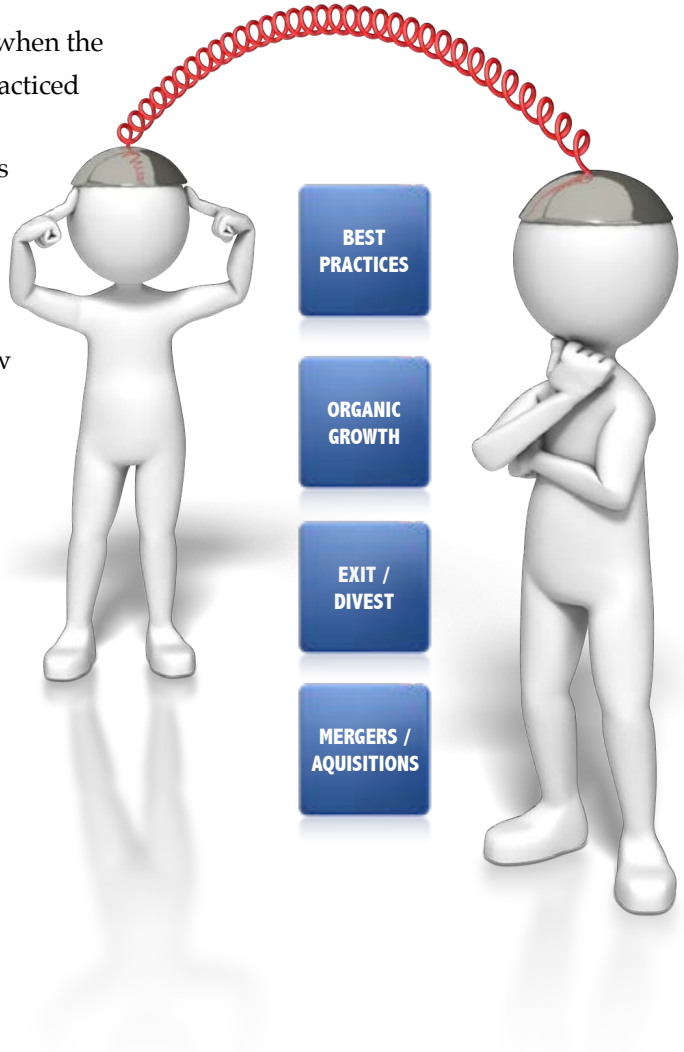


Figure 6.1: In this example, with a 90% learning curve, the difference from unit 2 to 30 is $90 to $60. With an 80% learning curve, the difference is $80 to approximately $37. With a 70% learning curve, the difference is $70 to approximately $15. An excellent example of this principle is the cost of cell phones, televisions, and computers as production volumes increased.

Learning curves will vary by function, process, or subprocess depending on complexity and the availability of suitable trainers and training materials, documentation, etc. The important point is that processes that exhibit longer learning curves can be leveraged more easily than simple processes to gain a competitive advantage in the market. Complex processes are also prime opportunities for optimization because of embedded knowledge in best practices.

Project Based Knowledge Transfer

Opportunities for knowledge transfer arise when the implications of optimization for a widely practiced process achieve critical mass: Someone, somewhere, recognizes the potential benefits of standardization and optimization to both *transferer* and *transferee*.



This win-win situation creates value for all parties involved. The transferer has a new product, service, or benefit to offer; the transferee benefits from a significant improvement in the return on investment realized through low-risk, proven-process optimization techniques.

Projects are the vehicle most often chosen to transfer embedded knowledge.

6.3 Identifying Investment Opportunities

Knowledge transfer projects offer some of the highest returns, lowest risks, and quickest opportunities for impacting business performance. However, in some cases a totally unique *big idea* concept, technology, process, or product will be identified by management as a top priority for improving performance. In most business situations, embedded knowledge, or some combination of knowledge transfer and *big ideas*, offers the best overall opportunities because risks are minimized and time frames are shortened.

It is not simple to identify high impact projects that create significant, sustainable growth, and profitability for a business. To guide the management team in starting this process, it is helpful to outline the four general types of projects that are available for business development:

- **Best practices** — These projects leverage investments in time and money made by others. Most will combine acquired embedded knowledge with proprietary processes and procedures, thereby adapting a best practice to the company's specific functions or processes.
- **Organic growth** — These projects typically focus on one or more *big ideas* that are unique to a specific business or industry, but may be combined with, or comprised of, best practice components to reduce risk exposure and development time frames.
- **Exit / divest** — In some cases, the most direct way to improve the performance of a business is to unload a poor performing product line, service, unit, or other *severable* piece of the company.
- **Mergers / acquisitions** — A company with a strong balance sheet (or an aggressive investment strategy) may seek opportunities that combine two related businesses to produce superior operational and financial performance.

Knowledge Transfer Opportunities

Knowledge transfer opportunities are usually the highest return, lowest risk, and quickest methods for impacting business performance. However, in some cases, a unique new technology, process, product, or service will offer the best opportunity for a business to improve performance. These innovation options incur considerable risk, returns can be difficult to predict, and they generally take longer to implement. For these reasons, many businesses will consider an investing strategy that includes some combination of knowledge transfer investments and new *big ideas* for the highest overall return.

Of the four basic business development project types, best practice projects are most easily identified with the concept of knowledge transfer. Best practices are generally defined, as such, by performance metrics that can be applied to a business during the business case development process ... making these projects among the safest a business can undertake.

Organic growth projects, by contrast, tend to be very company specific and are undertaken to address industry or competitive position situations. Embedded knowledge opportunities will be hard to come by, but external consultants with subject matter expertise may be available and should be used where possible. Since organic growth projects tend to incorporate one or more *big ideas* that help differentiate a business from competitors, the project management methodology employed for these projects will need to accommodate an *agile* element.

In situations where a graceful exit from an underperforming market, product, or service is determined to be necessary, best practices and external experts are available to help guide a business through the divestiture process.

Similarly, if a decision is made to merge with or acquire another business or product line, expertise is available to help a business avoid potential pitfalls during the process. This expertise may come from merger/acquisition specialists, private equity investment firms, or investment banking professionals. These resources will likely specialize in a specific industry, business size, or geographic market, so care should be taken to evaluate available options.

Best Practices Opportunities

There are five general categories of best practices that can typically be used to optimize a business's performance. In all of these cases, the prior experience, knowledge, and development costs that have been captured as embedded knowledge will help create value!

These general best practice categories are as follows:

- Commercial, configurable software, which applies to many business situations
- Intelligent machinery and systems that use programmable controls for both industry and process specific applications, in addition to general purpose business equipment that can be used by most businesses
- Best practices for business processes such as marketing, sales, financial management, human resource management, and other functions
- Best practices for operational processes, which tend to be industry and subprocess specific but are usually highly leverageable across industries, typically offer enormous performance improvement potential
- Internal and external training programs, particularly when used in combination with advanced training techniques and technologies to improve internal operating processes or to educate external customers and suppliers

Commercial/Configurable Software

Rapid advancements in cloud computing technologies have changed the time, cost, complexity, and return on investment metrics for commercial, configurable software. These changes allow small and midsize businesses to take advantage of applications that previously only large corporations could afford, yet many businesses are still unaware of the opportunities available to them.

To illustrate the vast array of capabilities available — and the opportunities they present for optimizing business performance — commercially available software applications have been structured under the general categories below. Certainly there are other ways to partition these capabilities; what's important is that a structured method be used to categorize, define and track the booming, high impact, cloud-based software that is available from a business development perspective. Preferred categories, and general descriptions of each, are listed below:

Marketing and Marketing Management

- Advertising
- Brand management
- Campaign development and monitoring
- Content management
- Email marketing
- Marketing automation
- Mobile/online marketing
- Public relations
- Product management
- Product documentation
- Product support
- Search engine optimization
- Social media

Sales and Sales Management

- Contact management
- Customer relationship management
- Lead management
- Proposal development
- Quote management
- Sales management

Business Intelligence

- Analytics
- Real time decision management
- Data mining
- Information discovery

Operations Management

- Asset management
- Business process management
- Facilities management
- Inventory/MRP management
- Logistics management
- Manufacturing execution systems
- Maintenance management
- Procurement management
- Quality management
- Supply chain management
- Warehouse management

Customer Service Management and Support

- Case management
- Customer surveys/feedback management
- Documentation management
- Field service management
- Help desk and social support
- Mobile resource management
- Parts identification

IT Applications

- Application life cycle management
- Backup and archival
- Electronic data interchange
- Email management
- Enterprise resource planning (ERP)
- Enterprise social networking
- Help desk and ticket management
- Issue tracking
- Mobile workforce management
- Network management
- Presentation/graphics
- Security management
- Telephone/VOIP
- Video conferencing
- Web conferencing
- Web training

Finance and Accounting

- Accounting
- Accounts payable management
- Accounts receivable management
- Asset management
- Budgeting
- Compliance
- Contract management
- Debt collection
- Expense management
- Financial reporting
- Tax management

Human Resources and Employee Management

- Benefits administration
- Benefits communications
- Compliance
- Employee assessment
- Employee scheduling
- Onboarding/orientation
- Payroll
- Performance appraisal
- Recruitment management
- Time and expense management
- Training management

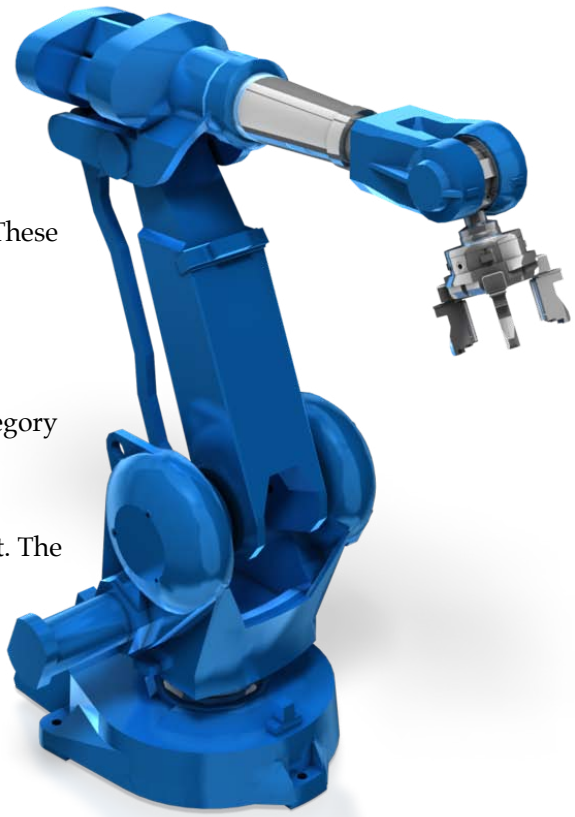
Training and E-learning

- Course development
- Interactive training development
- Learning management
- Online training

Project Management and Collaboration

- Collaboration
- Document management
- File sharing
- Professional service automation
- Project planning
- Project execution
- Resource planning
- Task management
- Unified communications

Intelligent Machinery and Systems

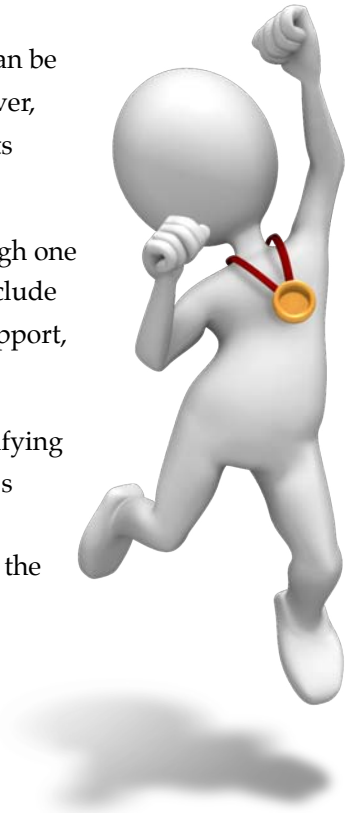


Integration of computer controlled, intelligent machines with precision motion control technologies, smart sensors, and advanced communication capabilities has created a *systems platform* for embedding process and task knowledge. These intelligent systems are dramatically changing the competitive baselines for many industries. These opportunities include the following:

- **Advanced production machinery** — This category tends to be industry specific, ranging from assembly robots to automated wire harness machines, to intelligent dispensing equipment. The competitive impact of these capabilities is very powerful.
- **Advanced packaging systems** — The incredible technology and cost reduction developments in motion and programmable control technologies, combined with new materials, have redefined packaging best practices for many products.
- **Automated product testing** — Low-cost embedded computing capabilities in many products, combined with advanced sensors, have enabled automated testing of products … both inline and end-of-line. These capabilities offer significant improvements in quality, cycle time, and cost which dramatically change the basis of competition in a market.
- **Automated material handling** — In almost every type of material handling, advanced controls and communications have changed the business performance impact of this category of equipment. From intelligent fork trucks, smart conveyors, embedded vision systems, automated storage and retrieval systems, to high-speed sorters and automated material handling equipment, these technologies have significantly improved the cost curve in many product categories.
- **Intelligent transportation systems** — Smart sensors, cellular communications, advanced mapping solutions, and cloud-based applications enable flexible, adaptive, and optimized control of logistics and supply chains. The incredible real time combination of technologies that enable intelligent transportation systems has changed the approach to inventory, purchasing, and response times in many industries.

- **Intelligent product identification** — Perhaps the most significant advancement in this category is the introduction of radio frequency identification tags. These wireless, self- or remote-powered readable/writeable devices can be as small as a grain of rice and essentially make anything they are attached to, or embedded in, a smart object. From manufacturing to medical, transportation to security, baggage handling to toll collection … these devices can reshape an industry.
- **Automated web-based sensor data collection** — Probably the best examples of a web-based sensor are the smartphone, laptop, or tablet. These devices and other products can be used as real time sensors for an endless array of emerging applications. Configurations range from simple, passive systems used for data collection to closed loop, real time systems for mobile applications. Used in medical, security, manufacturing, field service, and other industry applications, these devices have improved key cost/performance base lines.
- **Advanced office systems / solutions** — General purpose, intelligent machines are making significant impacts in back office support and processing functions of many industries. Major productivity gains are possible with these next generation products from automated mail handling, to high-speed printing/publishing, to robotic mailrooms.

Business Process Best Practices



As discussed previously, certain business process best practices can be embedded in configurable software. There are many cases, however, where a targeted best practice is best transferred using consultants and/or subject matter experts.

Typically, a business process best practice will be identified through one or more key performance indicators. These business processes include marketing, sales, business planning, IT, HR, finance, customer support, and other general functions.

Once a targeted best practice is identified, searching for and qualifying consultants that have specific experience relative to the company's requirements is critical. It is important to make sure that the consultant or subject matter expert is committed to working with the organization through the entire implementation process.

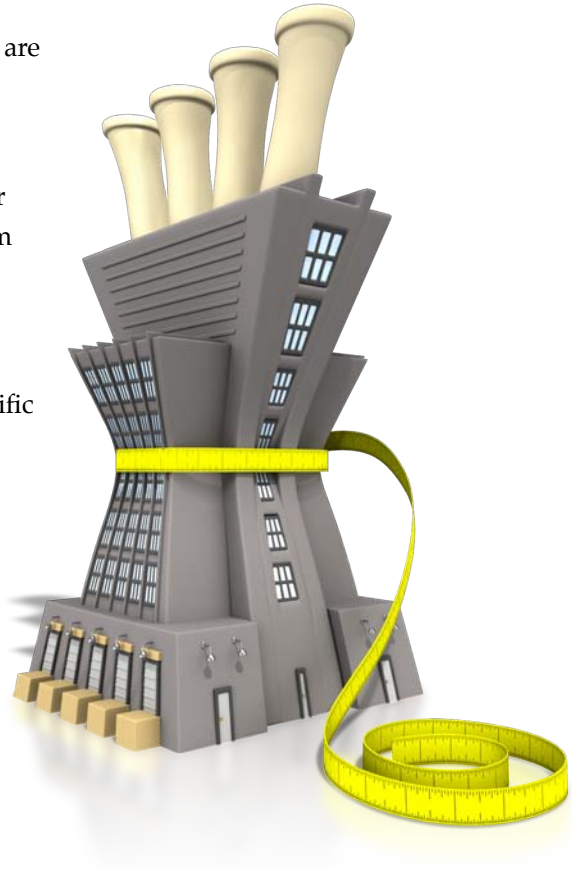
In most cases, the implementation of a best practice will include a discovery process conducted in cooperation with an external expert to define target objectives, gather information about the current situation, and gauge the organization's willingness to change. Next, a detailed plan must be developed between the expert and the company's project manager. At this point, the use of traditional consulting methods and contractual agreements is very effective. Some form of performance incentive is extremely valuable to help make sure the solution is successful.

Beyond the traditional consulting arrangement, it is critical that the transfer of process knowledge be institutionalized. This can be done with traditional classroom training and documentation. However, in many cases, it can be more effective to use online training and documentation. Many consulting teams are now developing a blended approach to training and documentation by using an optimum combination of classroom and online tools to institutionalize the knowledge transfer and training process.

Operational Process Best Practices

In addition to business process best practices, there are excellent resources available for implementing operational best practices.

The evolution of blended consulting/subject matter experts means that the client can select the optimum combination of onsite and online services, enabling highly specialized resources to be cost effective in much broader geographic situations. Typically, operational process expertise is more industry specific than business process expertise, but can usually be transferred effectively at the subprocess level.



Operational best practices are best defined using process or subprocess key performance indicators as a basis for researching and identifying optimization opportunities. These operational improvement opportunities include optimization of generalized processes, including the following:

- Assembly processes
- Documentation management processes
- Fabrication processes
- Facilities management processes
- Inventory management processes
- Supply chain management processes
- Warehouse management processes

Operational processes can also be highly application specific:

- Field service processes
- Logistics processes
- Quality management processes
- Safety processes
- Software development processes
- Technical support processes

The resource selection criteria described for business process optimization projects applies in this situation as well. However, it is even more important that operations expertise be specific to the targeted process and transferrable. The design phase needs to ensure that external experts brought onto a project clearly bring value to the specifics of the situation.

The overall contractual approach used to leverage operational expertise is similar to the business process situation and should follow the same phased approach. Also, the company seeking expert assistance must ensure that specific techniques are applied to institutionalize and implement the best practice, and that the KPIs used to select the process are applied as the final verification of project completion.

Training Program Best Practices

The impact, cost effectiveness, and flexibility of training as a business development tool has grown significantly with advancements in web-based training technologies, innovative training techniques, and interactive media. Combining web-based, computer-based, and traditional training techniques to achieve an optimum *blended* approach has proven to be strategically transformational in several industries.

High-growth, high technology industries have been early adopters of innovative training techniques and technologies, often applying a blended approach to internal training that combines traditional classroom activities with online, self-paced, interactive and collaborative courseware. Skills and competencies targeted for improvement include the following:

- Sales
- Operations
- Onboarding of global resources
- Business management
- Remote site integration/support
- Technical support

Many innovative companies are also adopting these tactics and techniques to optimize customer and supply chain relationships:

- Customer training
- Supply chain training
- Recruiting of distributors
- International partner support
- Licensee support
- Contracted services

Whether internally or externally directed, these blended training initiatives can have a major strategic impact on business performance.

Organic (Company Specific) Opportunities

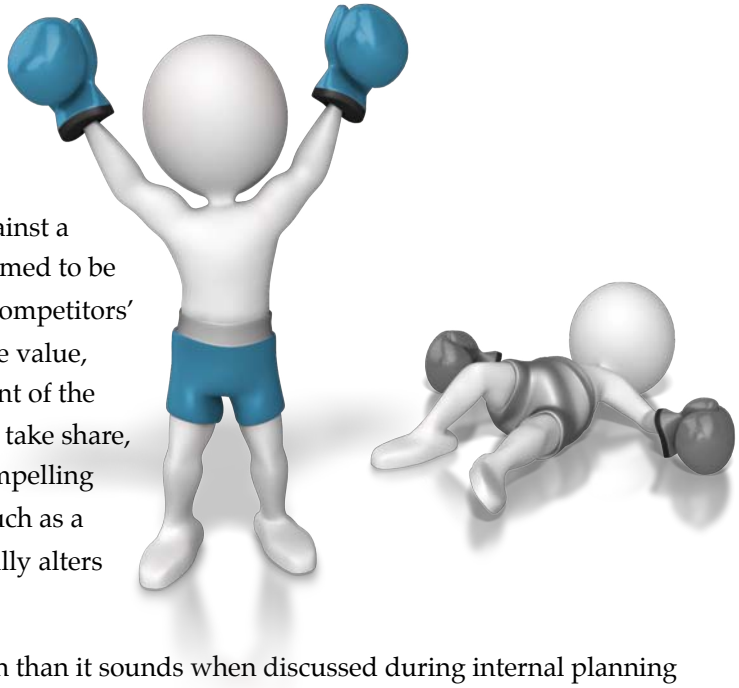
The next category of strategic business development projects focuses on organic growth strategies. Organic growth opportunities tend to be very company specific and are intended to leverage the existing capabilities of a business for the purpose of launching a new product or service, entering new markets, expanding operations, or boosting the productivity of operational processes.

In general, there are four categories of organic growth strategies:

- Take share — Sell more existing products to existing markets.
- Expand served markets — Sell existing products to new markets.
- Expand products and services — Sell new products/services to existing markets.
- Enter new business — Sell new products to new markets.

These types of projects are described as organic because they essentially build on the existing capabilities of a business, as compared to adapting a best practice or acquiring a new business or product line.

Take Share



The first organic growth strategy seeks to sell more of a business's existing products and services to the existing markets served. This *take share* approach pits one company (yours) against a group of others (direct competitors deemed to be vulnerable) in an attempt to sway the competitors' customers toward your offering. At face value, this may sound like a simple restatement of the definition for competition. But, to truly take share, a company must deliver some new, compelling advantage that wasn't offered before such as a new feature or benefit that fundamentally alters the existing value proposition.

This can be more difficult to accomplish than it sounds when discussed during internal planning meetings. A successful *take share* strategy must incrementally improve one or more of the competitive factors that customers deem to be important, and must be sustainable and defensible; affected competitors are likely to react and counterattack! These factors may include the following:

- Branding
- Product design
- Product functionality
- Quality (backed by guarantees)
- Customer experience
- Bundling of products and/or services
- Scope of supply (outscope competitors)
- Attachment to an ecosystem
- Price point (must be sustainable)
- New sales channel(s)
- Speed of delivery
- Packaging

Expand Served Markets

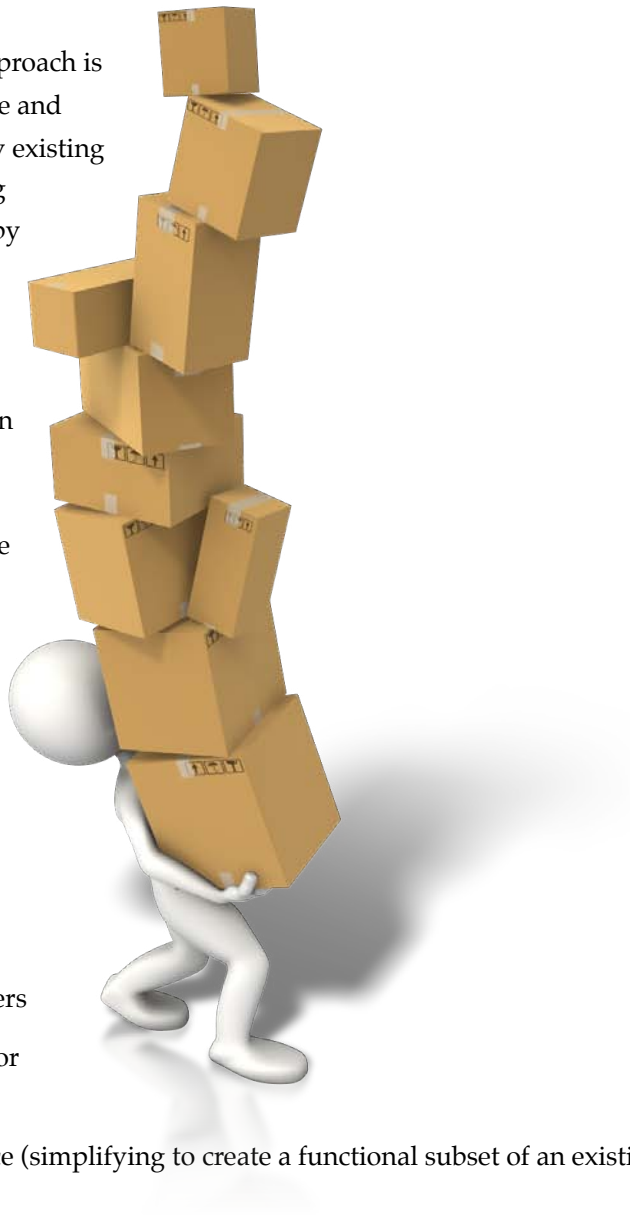
The next category of organic growth strategies is expanding served markets. This approach focuses on leveraging existing products, services, technologies, or operational capabilities to find new customers. While the leading edge of this method requires market research to identify potential new markets, and a sales team to enter these markets, there are also internal issues to consider: Operational capacity, quality constraints, supply chain issues, market expectations and technology support requirements, to name a few.

Assuming there is a valid strategic basis for considering expansion into one or more new markets, a thorough analysis of the available options should be discussed and evaluated by management. These options include the following:

- Entering new geographic markets
- Brand labeling your products or services for others
- Bundling your products or services with others
- License your products to others
- Co-branding

While viewed as an expansion of served markets from the initiator's perspective, a market expansion strategy is viewed as a take share strategy from the perspective of those competitors already serving the targeted market. Expect these competitors to defend their turf vigorously. Also consider that the grass isn't always greener on the other side.

Expand Product Offering



The mirror image of an *expand served markets* approach is an *expand products* strategy. Considering the time and energy invested in establishing a position in any existing market, it often makes sense to leverage existing knowledge, experience, and brand recognition by introducing new products and services within the familiar confines of a currently served market.

In this situation, the company believes that it can take advantage of a strong brand, an excellent sales organization, or strategic advantages developed in various sales channels to introduce new products and services more cost efficiently, with less exposure to unforeseen risks, than might be encountered when entering an unfamiliar market.

Opportunities to introduce new products within a served market include:

- New innovations
- Brand labeling of others products
- Joint venturing with one or more partners
- Developing a joint/integrated product or service bundle
- Modifying an existing product or service (simplifying to create a functional subset of an existing product or service, for example)
- Adding a new service to an existing product
- Adding a new product to an existing service

Regardless of what competitive action(s) you decide to take, be prepared for a counterattack. However, if there is a clear and compelling customer value that can be served through existing marketing/sales channels, this approach can be very effective.

Enter New Business

The most difficult and risk-prone approach to organic growth is to introduce new products or services to new served markets. This strategy is essentially entering a new business. Because of many unknowns, a management team should have some very compelling logic behind a decision to take this approach.

Examples of such logic might include opportunities that leverage existing intellectual property and/or operational capabilities, or a situation where the market for a new product or service is sufficiently similar to currently served market(s), that you can leverage existing marketing and sales capabilities to conquer new markets and competitors. A disruptive approach to a parallel market space can change the competitive situation.

In any case, this is the most difficult approach to organic growth since the company must concurrently address new markets, new products, and new competitors.

Exit / Divest Poor Performers

The third strategic business development project category is to exit or divest.

A company seeking growth should always be open to new opportunities. The business environment is constantly evolving, and businesses must be prepared to adapt and change with the times. The *COBRA 3D Business Development Process* encourages *outside the box* thinking that recognizes the potential value in new, disruptive opportunities, but also stresses the importance of aligning a business with its owners' investment objectives.

Sometimes that requires withdrawal from a declining market, whether by *cashing in* — by selling or licensing a product line or business unit while it still has market value — or by shutting down an underperforming asset that is a drain on working capital.

The decision to exit a product line or business can be very difficult. However, in many cases, divesting or exiting a business is the most significant action a company can take to improve operational and financial performance. A product line (or any severable part of the business) that is not financially viable due to structural changes in the industry, a continuously declining market, or the loss of a once compelling value proposition due to the emergence of disruptive alternatives, will squeeze profitability and may put the entire organization at risk. Once the decision is made that a product line or business unit must be eliminated, there are a number of possible divesting options to consider:

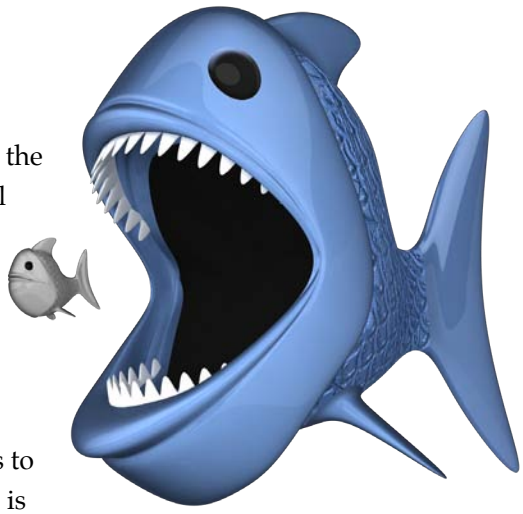
- Sell the product line or related technology
- License the product line or related technology
- Sell or shut down the entire business unit
- Shut down the product line

Expert resources are available to help a company navigate the complexities of the divesting process. These consultants can serve as independent parties for the valuation of assets to be divested and may be instrumental in finding a qualified buyer.

Whether the divesting strategy is to sell, shut down, or license an underperforming asset, it's important to eliminate the complete *vertical slice* of all costs associated with the product line or business. In most cases, the costs directly associated with a product line or business are clear. Indirect costs such as financial support, administration, HR, general management, depreciation, and other costs that can be allocated to the product line must also be eliminated.

If all associated costs are not eliminated, the remaining product lines will bear these incremental costs, putting their performance at risk.

Mergers and Acquisitions



Another tempting, yet most challenging approach to strategic business development is through mergers and acquisitions. This approach essentially attempts to leverage the financial situation of a company to buy or license additional assets include the following:

- Product lines
- Complete businesses
- Technologies

The most important factor in the decision making process is to ensure that the *risk adjusted* return on capital being invested is greater than the company's cost of capital. An acquisition for any reason other than long-term incremental growth of returns on capital, does not make sense. If the acquisition value can't be quantified to demonstrate higher long-term returns after adjusting for the risks associated with the transaction, there is no basis for proceeding.

Benefits and Risks

The potential benefits of an acquisition are listed below:

- Expanding served markets
- Adding key people and skills
- Leveraging or acquiring technology
- Achieving economies of scale
- The acquisition yields net accretive earnings
- Eliminating a competitor

These are certainly valuable benefits, but they must be balanced against potential risks: Approximately 70% of acquisitions fail to reach their targeted return on capital. These risks may include the following:

- Cultural differences
- Underperformance of the combined organization
- Inability to retain key people
- Difficulties integrating systems and processes
- Legal and/or regulatory problems
- Did we mention culture??

CASE IN POINT

A structured approach to identifying business development projects based on a winning strategy will produce clear and compelling investment opportunities.

In 1997, I became President of Benshaw, Inc., a privately held manufacturer of electronic motor controls. At that time the business had revenue of $14M and a negative $1.6M EBITDA. The company had an incredibly dedicated team of people, strong customer relations, and low overhead. However, it also had no quality or documentation processes, and only five computers in the entire company.

Over the first several months of my assignment, the management team defined a clear winning strategy that focused the business on becoming the industry leader in custom motor control solutions. With this winning strategy acting as the guiding light, the Benshaw team relentlessly executed self-funded business development projects over the next nine years, which grew the company to $108M in revenue by 2007. The following table summarizes these major projects, their sequence, type, and business result:

Business Development Project	Type of Project	Business Result
Implement company-wide business system	Adapt best practices	Established solid operational infrastructure
QA/real time data collection system	Adapt best practices	Reversed negative quality to industry leading position
LG Brand labeling agreement	M&A/strategic alliance	Gave Benshaw a complete family of motor control products
Webstore/e-commerce product packaging	Big idea + best practices	Game changer in custom controls competitive basis
Next generation motor controller	Organic big idea	Established Benshaw as technology leader in solid state motor controls
Companywide leadership/supervisor training	Adapt best practices	Motivated leadership team and established professional standards
Custom enclosure manufacturing capability	M&A/acquisition	Reduced lead times and costs by 40%
Wireharness automation systems	Adapt best practices	Improved internal quality to near 100% and reduced costs by 25% – 30%
Automatic test equipment	Adapt best practices	Improved external quality to near 100% and reduced testing costs by 50%
Sensorless motor protection product	Organic big idea	Project failed — unable to consistently predict motor problems
High voltage product development	Organic big idea	Established Benshaw as the technology leader in high voltage motor control

The key point in presenting this list of projects is that with a clear and compelling winning strategy, business development projects will be relatively easy to identify and justify, and their execution will help transform the organization.

Prioritizing Strategic Projects

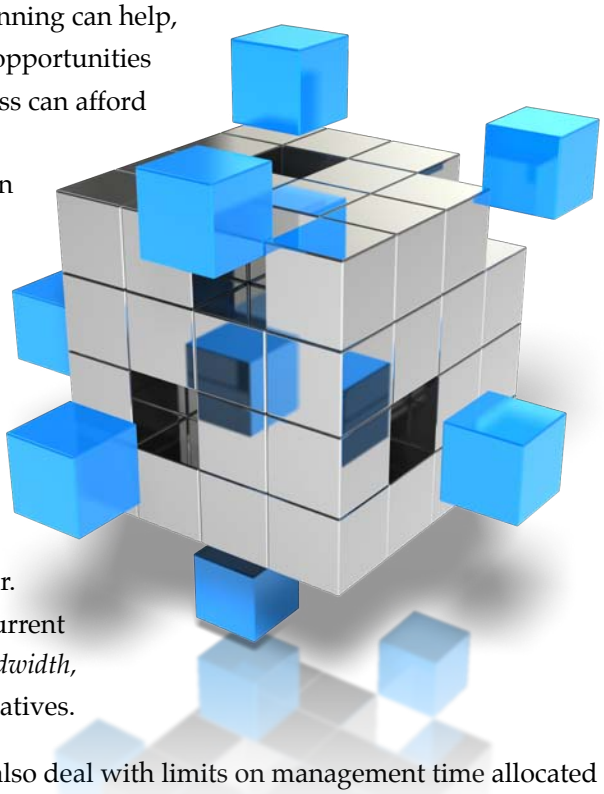
TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. The process of defining a winning strategy will likely uncover more potential investment opportunities than any business can afford to execute at one time.
2. Identifying and implementing the highest impact investment projects is one of the most critical responsibilities of the management team.
3. The business case method is the most effective technique for defining, quantifying, and ranking competing investment opportunities.
4. A business case summarizes the cost (investment) of a project and compares it to the projected benefits (return on investment).
5. An analytical, hierarchical, prioritization process (AHP) is a deterministic, repeatable method for comparing alternatives.
6. The COBRA AHP method uses strategy, COBRA $ metrics, and risk as the basis for quantifying alternative business cases.
7. A strategic filter compares a proposed project to the organization's winning strategy, operational priorities, and targeted culture.
8. COBRA $ metrics quantify the potential financial impact of an investment.
9. Project risk assessments should be based on the probability of an event (risk) occurring, the consequences of each event if it does occur, and the options available to help mitigate the probability and/or impact of such occurrences.
10. A risk adjusted project score is the summation of COBRA $ benefits adjusted for project risk.

7.1 Survival of the Fittest

The speed of change in technologies, market conditions, direct and disruptive competitors, regulatory burdens, skill supplies, and globalization of markets all create a never-ending challenge to businesses of every type and size. The shear volume of opportunities and threats that a business faces can be overwhelming and confusing.

A strategic framework for business development planning can help, but a well defined and executed review of available opportunities will often yield more potential projects than a business can afford to execute. In fact, a focused strategic planning effort will often yield 10 to 15 potential projects that offer an opportunity to positively impact business performance. These projects can range from operational enhancements, new products and services, market expansions, sales force optimization efforts, and marketing programs to divestitures and acquisitions.



While all of these investments can have some effect on business performance, very few businesses can afford 10 to 15 projects in any one year. Also, a highly focused organization that is sized to current business volumes will have limited resources, or *bandwidth*, available to address such a large number of new initiatives.

In addition to financial constraints, a business must also deal with limits on management time allocated to project sponsorship and oversight, and the scarcity of internal skills. So, while a business faces a never-ending set of challenges that warrant business optimization investments, there is always some form of constraint placed on an organization's ability to invest.

The obvious solution is to prioritize the projects that have been identified ... executing each project in sequence based on a methodical and repeatable evaluation of the potential benefits, associated risks, and execution time frames that each project brings to the table. The earliest projects to be executed should be those that move the business closest to the owners' *To Be* objectives, in the shortest possible time frame, with the least amount of risk.

7.2 The Business Case

The most effective tool for quantifying investment opportunities is the business case. Requirements for a solid business case includes a clear definition of the problem or opportunity you're trying to address, a proposed solution to that problem or opportunity, a system for measuring the expected benefits, a rough estimate of project costs, and an approximate time frame for execution.

Also, potential risks need to be identified. A $100,000 business development project that is expected to yield a $125,000 return might make sense if it involves minimal risk. But the return in this example is too small if any significant risk is identified. These risks might be an unproven technology, limited available skills, the inability to estimate project costs with any degree of confidence, an overly tight schedule, or an unproven contractor.

Likewise, a $100,000 project expected to yield a $125,000 return over ten years makes no sense (you'll lose money due to inflation, regardless of risk), while a project offering similar cost vs. return metrics might make lots of sense if the risk is low and returns can be realized in a very short period of time.

Our goal, therefore, is to identify the risk-adjusted rate of return for each project.

COBRA Business Case Worksheet

Project Manager: _____

INVESTMENTS

Project Name: ..... **Sponsor:** .....

Project Description (define problem or opportunity being addressed): .....

.....

Project Functional Business Result: .....

.....

Project Acceptance Criteria (how do we know we are done?): .....

.....

Estimated Project Timeline:

.....

Start to Finish = ... **months**

Estimated Project Costs:

Purchses $ .....

Overhead $ .....

Internal Labor $ .....

External Labor $ .....

TOTAL $ .....

Major Milestones:

1. .....
2. .....
3. .....

Major Risks:

1. .....
2. .....
3. .....

Critical Skills / Resources:

1. .....
2. .....
3. .....

BENEFITS

COBRA METRIC	FUNCTIONAL BENEFIT	QUANTIFY FUNCTIONAL BENEFIT	SAVINGS / MARGIN / PAYBACK SUMMARY					
			YEAR 1 ($)	YEAR 2 ($)	YEAR 3 ($)	YEAR 4 ($)	YEAR 5 ($)	TOTAL ($)
Cost of Goods (% Revenue)								
Operating Expense (% Revenue)								
BrandPower								
Revenue Growth (%)								
Asset Utilization (% Revenue)								
		TOTAL IMPACT ($)						

Figure 7.1: COBRA business case worksheet

Business Case Worksheet

The COBRA business case worksheet is a planning tool that is used to capture key information needed to develop a business case for strategic business development projects, and includes the following:

- Project name
- Project sponsor (principle beneficiary within the organization)
- Project description (a brief summary or *elevator pitch* for the project that identifies the problem you are solving or the opportunity you are seeking to exploit)
- Project functional business result (describe the operational benefit to the business)
- Project acceptance criteria (define the specific criteria for determining that the project has met its objectives, and final payments can be made)
- Estimated project timeline
- Start to finish time (elapsed time)
- Estimated costs (budget summary)
    - Purchases (all hardware, software, equipment, etc.)
    - Overhead (all indirect costs such as travel, phones, etc.)
    - Internal labor
    - External labor
- Major milestones (identify the most critical and/or difficult milestones that determine the project's success)
- Major risks defined and quantified as described in this chapter
- Critical skills/resources defined by skill sets and/or names
- COBRA impact (expected benefits)
    - Cost of goods as a percentage of revenue after execution
    - Operating expenses as a percentage of revenue after execution
    - BrandPower after execution
    - Revenue growth year-over-year after execution
    - Asset utilization as a percentage of revenue after execution
    - Total dollar impact years 1 to 5

Prioritization Process

There is no question that investment decisions are among the most important and difficult decisions a business can make. First and foremost, the investments made must have a high probability of moving the business forward from a competitive, operational, or cultural perspective. Secondly, leadership must try to ensure that the investments chosen are those likely to have the greatest impact on the company's performance. This requires an Analytical (quantified) Hierarchical (different filtering levels) Process (repeatable steps), or AHP. An AHP is simply a structured set of criteria, applied consistently (to ensure objectivity) in progressive steps (logical sequencing) to measure potential outcomes from different but similar activities. The *COBRA 3D AHP* uses three key steps to develop a reasonably accurate, consistent, quantified assessment of value for proposed projects.

The first step in the project prioritization process is to apply a *litmus test* to each project: A three dimensional filter for potential projects based on the organization's defined winning strategy, operational optimization targets, and preferred culture as defined through situational analyses. The next step is to quantify the expected benefits of each project using cost of goods, operating expenses, BrandPower, revenue growth, and asset utilization as key metrics. Finally, a thorough review, identification, and mitigation analysis of potential project risks is performed (an analysis that will be repeated at logical points during execution if the organization decides to move forward with the project).

Step One: Strategic Filter

The most critical step in project prioritization is the strategic filter. This may seem unnecessary since the projects being scrutinized result from the situational analysis described in earlier chapters. But it's important to remember that *creative thinking* was encouraged in the strategy development process. You're now in a more analytical mindset ... seeking to cull two, three, or four great ideas from the 10 or 15 good options identified earlier.

For example, a proposal to automate an assembly operation may, in fact, reduce the costs associated with that function, but it may also reduce the flexibility of the operation compared to a manual or semi-automated approach. If the company's winning strategy is based on enhancing the flexibility (configurability) of products, the automation effort could actually detract from the winning strategy you're trying to exercise.

Similarly, there are situations where a proposed investment might add features to an existing product with only a moderate impact to its price, whereas your winning strategy indicates that the market isn't asking for those features, and may, in fact, be seeking a simplified alternative. Or, a proposal may be made to change suppliers for a key component (to help reduce costs), while your strategy has identified reliability or faster delivery as valued product attributes.

The second dimension of a winning strategy filter considers objectives for operational competitiveness: Does the proposed project improve operations in a manner that is consistent with your long-term investment goals? It won't make much sense to spend money on a project to optimize an operation that your strategy tells you to eliminate ... or to increase throughput on a production line running at half capacity in a long-term declining market.

The third dimension is based on the organization's targeted competitive culture. If you've identified the need to improve innovation, does the proposed project fit within this objective? Does a proposed acquisition provide a quick boost in sales, but jeopardize the culture you've worked so hard to achieve? Confusing or diluting the focus of a business team is demoralizing and counterproductive.

Step Two: Estimating COBRA $ Benefits

For projects that successfully pass through your strategic filter, the next step is to use COBRA metrics to estimate expected benefits from each investment. Many organizations will likely have additional financial or operating metrics they want to use in this process. As long as these are measurable and consistent, it makes sense to add them to the COBRA metrics. The overall purpose of the COBRA metrics is to make sure that expected benefits can be quantified in a way that allows direct comparisons of the estimated impact on operational and financial performance for each proposed project.

Cost of Goods

The first element in the COBRA calculation is an estimate of the project's impact on cost of goods as a percentage of revenue. This indicates whether a project will reduce or increase the cost of a product or service relative to the price you expect to charge for it. The result should be recorded as an estimate of savings as a percentage of revenue and the corresponding dollars over three to five years. This time frame is based on each company's previously established payback time frame.

The key question is … does the proposed investment reduce the direct costs of the product, and if so, how? The major categories of COGS are the following:

- **Material costs** — These include costs for all direct and indirect materials consumed while manufacturing a product or delivering a service. Direct materials are typically evident in a finished product (paper used to produce a printed product, or sheet metal used in the manufacture of electronics cabinetry, for example), while indirect materials are incidental to a manufacturing or service delivery process (solvents used in the printing process, or welding rods used to fabricate the cabinetry).
- **Labor costs** — These include the direct material handling, put away, picking, assembly, testing, and packaging labor costs associated with a product. The costs of labor used to provide a design service, for example, would be included. In some companies, supervisory and management costs are also included in COGS. Other companies include these costs in operating expenses. It's important to categorize direct labor costs and operating labor costs in a consistent manner for purposes of comparison.
- **Factory costs** — These costs include the facility, utility, security, maintenance, and other costs associated with the building(s) where products are produced.
- **Warranty/rework costs** — These are the costs incurred to support warranty obligations directly associated with a product or service.

Operating Expenses

Next, estimate operating expense savings as a percentage of revenue. This is essentially a productivity measure that estimates a project's impact on indirect costs at a defined revenue level. Operating expense reductions (if any) after project execution should be recorded as a percentage of revenue and the corresponding dollars… once again, over three to five years.

Operating expenses may include the following:

- **Marketing costs** — This includes costs incurred for advertising, direct mail programs, sales collateral development, trade show participation, promotional product distribution, and other marketing communications programs.
- **Sales costs** — This includes all salaries, benefits and commissions paid to the sales manager and other members of the sales force, along with travel expenses, computers/software, training and recruiting expenses. It also includes commissions paid to third-party sales representatives.
- **Engineering costs** — Costs associated with research and development, engineering, and technical support, typically fall under this cost category. Some companies will further divide these costs into separate categories (engineering that is associated with day-to-day support, and strategic engineering that is associated with product development). Regardless, all are operating costs and

should include salaries and benefits, training, software, tools, computers, testing equipment, and other support resources.

- **Purchasing costs** — This includes costs for all resources needed to source, negotiate, order, inventory, and track purchases, as well as financial activities related to all purchased products and services.
- **Information systems costs** — These costs include the salaries and benefits of all IT employees, along with training, travel, and other associated employment expenses. License fees, outsourced services, maintenance contracts, upgrades, and other related expenses should also be included.
- **Financial operations costs** — These costs include all salaries and benefits paid to personnel in the financial team of the organization, along with outside services such as auditors, analysts, and their associated expenses.
- **General and administrative costs** — This will typically include senior management, general liability insurance, facility costs associated with operating expenses related to head count, legal fees, regulatory costs, administrative support personnel, and other costs that are related to the overall business but not otherwise included in COGS or OPEX.

BrandPower

BrandPower is primarily measured by pricing power, opportunity creation, WOW factors, stickiness, and key customer retention. In many cases, other COBRA metrics will capture the direct value impact for these factors. However, if a project is likely to make an impact on goodwill (an intangible asset), an estimate of this impact should be captured in the business case. A good example of BrandPower impact is the *halo* effect on other product lines when a leading edge innovation is introduced in a product line.

The intangible benefits of a project should be discussed and estimated by the management team so that they can be factored into the business case. These benefits may include the following:

- **Pricing power** — The ability to pass inflationary cost increases on to customers by increasing the price of products or services without losing market share.
- **Opportunity power** — New opportunities that arise either intentionally or unintentionally because of the perceived strength of a company's brand.
- **WOW factor** — The ability of a new product to achieve better COGS or OPEX as a percentage of revenue due to customers' perceptions of its brand strength.
- **Ecosystem power** — This is a *bolt-on* effect that creates market value through built-in hooks or capabilities to another related product or service.
- **Retention power** — This is a *trust* or *value* capability derived from brand recognition that helps keep targeted customers loyal to the company.

Revenue Growth

Revenue growth (year-over-year) is a critical criterion for any investment. While most projects will either be revenue neutral or intended to boost sales of products and services, this is not always the case. A project designed to eliminate a poor performing product or service, for example, will have an intentional negative impact on revenue (which should be offset by a positive impact on the remaining cost of goods and/or OPEX as a percentage of revenue).

In a flat or slow growth market, year-over-year increases in revenue are harder to achieve than most people realize. There are always qualified, hungry, smart competitors trying to get their *unfair* share of the same market, in addition to disruptive competitors who are either directly or indirectly trying to take share. Some of the factors that indicate a potential for positively impacting revenue are the following:

- New/better products
- New/better sales coverage
- New/better marketing programs
- Expanded product scope
- Expanded geographical scope

Asset Utilization

The final COBRA metric assesses a project's impact on asset utilization. The objective is to determine the difference between today's working capital (current assets) and CAPEX (fixed assets) requirements vs. the same requirements after executing a project, with improvements recorded as a percentage of revenue over three to five years. Improvements in either category reduce the total interest expense and capital required to operate a business, and improve the return on investment. Key elements of this category are as follows:

- **Inventory turns** — This is a measure of the average amount of inventory on hand throughout the year as a percentage of revenue. The higher the number of times the inventory is *turned* per year, the lower the cost of investments in inventory.
- **Receivables aging** — This is a measure of the average number of days it takes for a company to get paid after invoicing. A higher average increases the working capital investment required to maintain operations.
- **Trade/payables leverage** — This is the opposite of receivables aging. The greater the number of days from receipt of a supplier's invoice to payment, the higher the leverage and the lower the investment required.
- **Fixed asset utilization** — This relates to the fixed assets of a business — buildings, equipment, computers, desks, vehicles, and any other asset that is depreciated over multiple years. How effectively these assets are utilized will determine when new, incremental investments are required as a percentage of growth in revenue.

- **R&D effectiveness** — Research and development efforts may be treated as operating expenses from a financial reporting perspective. However, since you're using cash to invest in future products or services with expected paybacks, if a payback never occurs, or is less than expected, then that cash has been underutilized.

Step Three: Assessing Risks

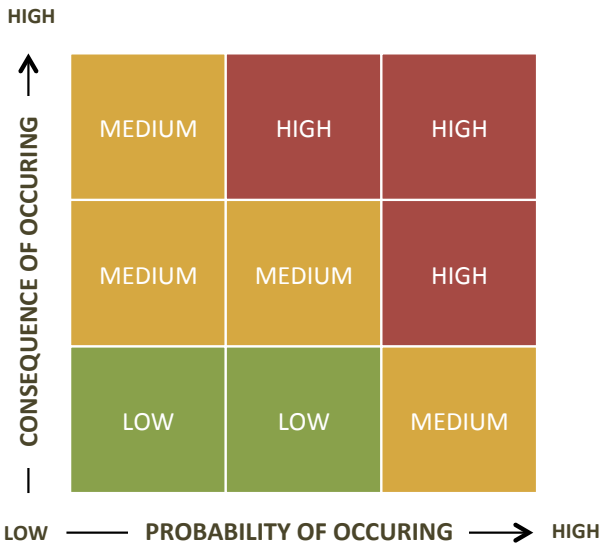


Figure 7.2: Measuring risk

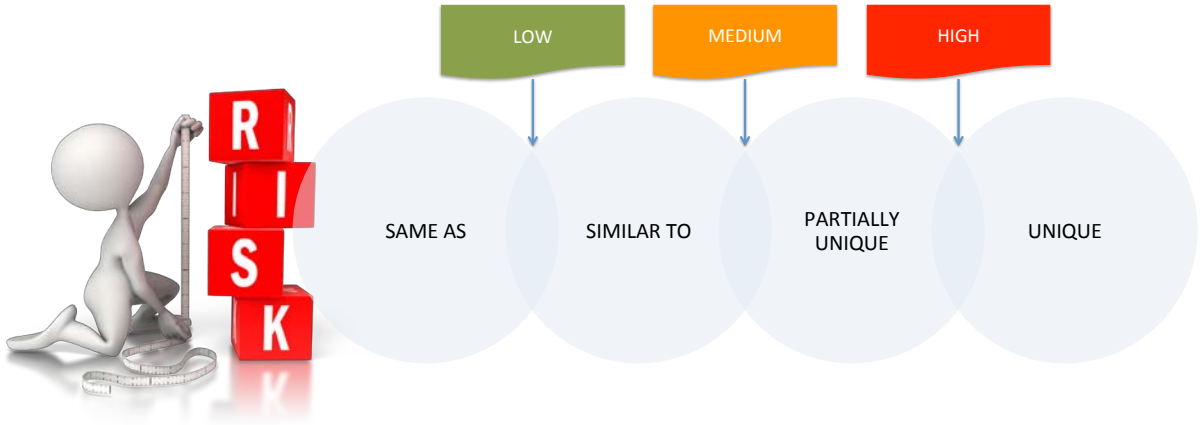
Once the COBRA metrics of a project have been estimated, the next step is to identify and quantify the potential risks associated with the project. While it would be great if every project could be modeled perfectly and executed exactly as planned, the reality is that this never happens: Project planning is an imperfect science, fraught with estimates and assumptions, and any number of things can go wrong. Faulty judgements of projected costs or benefits (or both) can occur during the planning process. Execution issues can prevent a project from reaching its full potential, such as technology integration issues, poor performance by contractors, changes in project scope that add to investment costs without adding benefit, etc. It's an imperfect world, and a fact of life that some projects will fail to meet expectations due to unforeseeable risks. Nonetheless, most risks can be identified and evaluated in advance using a risk assessment process.

As you can see in Figure 7.2, risks can be measured by their probability of occurrence, and by their potential consequence to the project's outcome. The combination of probability *and* consequence quantifies the risk. As illustrated in the chart, a low probability combined with a high consequence will yield a medium risk. A medium probability with a high consequence will yield a high risk, and so forth.

The first step in the risk assessment process is to identify all foreseeable risks. This effort requires research by the project manager and discussions with relevant experts — both internal and external — to define the major milestones of a project and scrutinize obstacles that may prevent the project execution team from reaching them.

One such risk is uncertainty. The very nature of a project — whether it is relatively routine (implementing commercial software to streamline a process) or very unique (developing a completely new product) — will imply a level of certainty or uncertainty that must be factored into the equation.

Uncertainty may stem from the maturity level of new technologies embedded in a proposed capital investment, a scarcity of the skills required to deliver a new service, the level of familiarity with a new market you're intending to serve, or the likelihood of a disruptive influence entering the market and fundamentally changing the current competitive landscape.



Other risk factors may be influenced more by your ability to execute a project than by uncertainties regarding the proposed solution: Have you allotted enough time to the project? Are you able to locate expert external resources to guide the planning and execution processes? Are you fully committed to the project, ensuring that internal staff members are able to budget sufficient time to see it through?

All identified risks (including project uncertainty) should be summarized in the business case. Next, assess the probability of occurrence for each risk. The simplest method for doing this is to use low-medium-high categories as the basis for segmentation.

Now rate the severity of each risk (potential consequences should the risk occur). Again, an overall rating scheme that the management team agrees to (low-medium-high also works well here) should be used to further classify the identified risks.

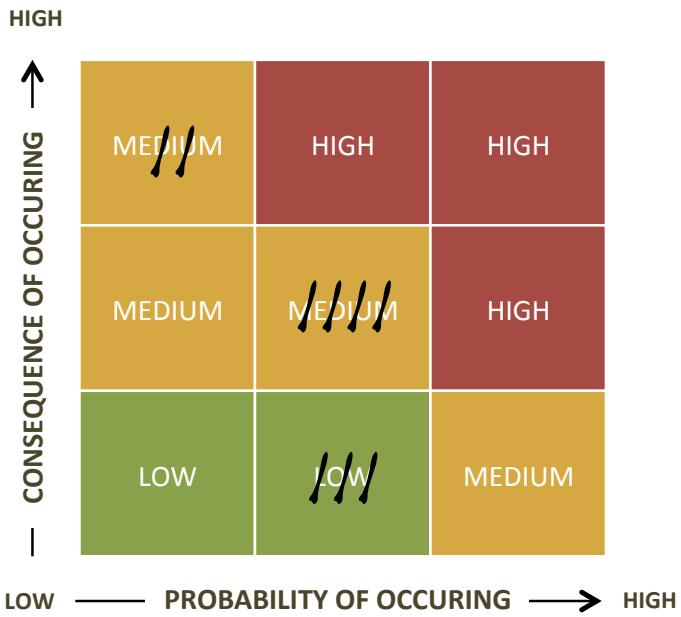


Figure 7.3: Measuring risk — project example

Your assessment now classifies each identified risk by both probability and consequence. By mapping each identified project risk to the risk measurement chart, a profile of the overall risk can be defined (see Figure 7.3). Adding the values that appear in each zone (low-medium-high) establishes an overall *risk profile index* for each project. The zone with the highest score represents the risk profile index for the project. For example, Figure 7.3 shows that the *medium* zone most accurately defines this project's risk profile.

Preparing the Business Case

The end result of the *COBRA 3D AHP* is a business case ... an objective analysis of each project candidate that management can use to prioritize potential business development projects. The apples-to-apples comparison provided by *each* business case helps mitigate the controversies and differences that often arise between members of the management team. Individuals look at problems and opportunities from different perspectives and may be influenced to varying degrees by the preferences of external experts used in situation analyses.

Figure 7.4 provides an example of a business case worksheet that can be used to record important details for each business case.

COBRA Business Case Worksheet

Project Manager: Mike Adams

Project Name: CRM/ERP Integration **Sponsor:** Controls Div.

Project Description (define problem or opportunity being addressed):
Increase sales hit rate through efficiency improvement

Project Functional Business Result: Real-time data synchronization, 24/7 field access to data, actionable intelligence

Project Acceptance Criteria (how do we know we are done?):
Full sync with legacy ERP/all direct sales team members trained

Major Milestones:
1. Functional requirements approved
2. Prototype system approved
3. Successful integration of data

Major Risks:
1. Key people availability
2. Schedule is tight – Dec. critical
3. Technology integration issues

Critical Skills / Resources:
1. Power users
2. System architect
3. SW developer

INVESTMENTS

Estimated Project Timeline:
Start by 4Q 2013

Start to Finish = 6 months **months**

Estimated Project Costs:

Purchases	$	45,000
Overhead	$	20,000
Internal Labor	$	60,000
External Labor	$	90,000
TOTAL	$	215,000

BENEFITS

COBRA METRIC	DESCRIBE FUNCTIONAL BENEFIT	QUANTIFY FUNCTIONAL BENEFIT	SAVINGS / MARGIN / PAYBACK SUMMARY			
			YEAR 1 ($)	YEAR 2 ($)	YEAR 3 ($)	TOTAL ($)
Cost of Goods (% Revenue)	–	–	–	–	–	–
Operating Expense (% Revenue)	Reduce int. sales cost by 10%	1.5mx.1	$150k	$150k	$150k	$450k
BrandPower	Faster customer response	–	–	–	–	–
Revenue Growth (%)	Improve hit rate by 10%	10mx.1	$100k	$100k	$100k	$300k
Asset Utilization (% Revenue)	Improve inventory turns	500kx.05	$25k	$25k	$25k	$75k
		TOTAL IMPACT ($)	$275k	$275k	$275k	$825k

Figure 7.4: Business case example

In the example above, the sales manager has proposed the purchase of a Customer Relationship Management (CRM) system to integrate with the company's existing Enterprise Resource Planning (ERP) system. This is not a new product from the vendor, so the software is stable. The sales team is made up of six regional directors, 35 independent sales representatives, and approximately 100 distributor sales personnel. A lack of coordination among these diverse resources has become a major sales effectiveness problem. The resulting cost, risk, milestone, skill, and scheduling assessments are summarized, and the projected COBRA metrics for the project were calculated as follows:

- Reducing internal sales support costs by 10% of $1.5M = $150K/year savings
- Improving sales team hit rate by 10% of $10M (annual proposal $) = $1M x .10 (net profits) = $100K/year savings
- Tight sales coordination improves inventory turns = $500K reduction x .05 (interest rate) = $25K/year
- Total projected savings = $275K/year, $825K over three years.

Business Case Approval


COBRA Business Case Worksheet

Project Manager: Mike Adams

Project Name: CRM/ERP Integration Sponsor: Controls Div.

Project Description (define problem or opportunity being addressed): Increase sales hit rate through efficiency improvement

Project Functional Business Result: Real-time data synchronization, 24/7 field access to data, actionable intelligence

Project Acceptance Criteria (how do we know we are done?): Full sync with legacy ERP/all direct sales team members trained

Estimated Project Timeline: Start by 4Q 2013

Start to Finish = months

Estimated Project Costs: Materials $; Software $; Internal $; External $ 90,000 ; TOTAL $ 215,000

Major Milestones:
1. Functional requirements approved
2. Prototype system approved
3. integration of data

Major Risks:
1.
2. Schedule is tight ... critical
3. Technology

Critical Skills/Resources:
1. Power users
2. System architect
3. SW developer

COBRA METRIC	DESCRIBE FUNCTIONAL BENEFIT	QUANTIFY FUNCTIONAL BENEFIT	SAVINGS / MARGIN / PAYBACK SUMMARY YEAR 1 ($)	YEAR 2 ($)	YEAR 3 ($)	TOTAL ($)
Cost of Goods (% Revenue)	–	–	–	–	–	–
Operating Expense (% Revenue)	Reduce int. sales cost by 10%	1.5M x .1	$150k	$150k	$150k	$450k
Brand Power	Faster customer response	–	–	–	–	–
Revenue Growth (%)	Improve hit rate by 10%	10M x .1	$100k	$100k	$100k	$300k
Asset Utilization (% Revenue)	Improve inventory turns	500k x .05	$25k	$25k	$25k	$75k
		TOTAL IMPACT ($)	$275k	$275k	$275k	$825k

The COBRA dollar benefit over the next three years meets the payback criteria (a $825K estimated return on a $215K investment) and the associated return on investment hurdle rate. The risks have been defined, and you're confident you can develop an effective mitigation plan. You have a seasoned project manager and your research indicates that you should have no trouble fielding a qualified project team comprised of internal and external resources.

In this situation, almost every business would be willing to invest in this project, and the project would be approved to proceed to the next steps of planning, staffing, and execution.

CASE IN POINT

Justifying an investment with a business case will increase the odds of getting more money back than the amount of money invested, within a reasonable time period.

One of our best investment decisions at Benshaw started when several of the management team were waiting in line at McDonalds to order lunch. After discussing who's getting a #1, a #3, or a #8, the group joked about how nice it would be if customers could order custom industrial controls from a numbered menu! That famous lunch conversation started a product packaging analysis that resulted in the bundling of common functions to save engineering time and enable standard wire harness based manufacturing. The IT and operations teams wondered if it was possible to stock these packaged products in a warehouse where they could be ordered online and shipped 24/7.

As the ideas progressed, the cost of the project began to take shape. A new dedicated server for the webstore would cost about $18k, plus $60k for e-commerce software. It would take about two man years (a man year is the amount of time it takes an individual to perform one year of work) to customize the software. The development and testing efforts required to pre-engineer, document, and prototype each product would take three man years and approximately $100k of unusable product:

IT hardware	$	18,000	
Webstore software	$	60,000	
IT software development	$	150,000	(2x75k man year)
Product engineering	$	225,000	(3x75k man year)
Scrapped samples	$	100,000	
Total Cost	$	**553,000**	**(+10% contingency)**

Expected benefits over the next three years of the project were defined by the team as follows:

Eliminate recurring engineering costs	$	350,000
Reduce manufacturing labor costs by 20%	$	150,000
Reduce order processing costs by 90%	$	120,000
Increase sales by 10% (3M x .15)	$	450,000
Total Benefit	**$**	**1,070,000**

After completing the above calculations, we all believed the project was clearly justified and fit the winning strategy of the business. It was launched in early 2002, and fully completed by mid 2003. The results far exceeded our expectations and clearly changed the basis for competition in our product space, driving one of our key competitors out of business in the process … Thanks McDonalds!

Planning Strategic Projects

TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. A well-defined project plan can significantly reduce the costs and risks associated with a business development project.
2. Our easy to remember technique for planning projects:
   Milestones, **A**ctivities, **S**kills, **T**iming, **E**xpenses, and **R**esources (**MASTER**).
3. A blended, waterfall/agile project management methodology is the optimum technique for planning and executing business development projects.
4. A fully committed project manager is essential to the successful planning, staffing, and execution of any project.
5. Risk management is the process of identifying, quantifying, planning mitigation actions, and resolving risks in a timely manner.
6. Project documentation begins with a solid business case, followed by a project charter and a comprehensive deliverables checklist.
7. Business development projects must be broken down into phases/gates (design, development, deployment, and debrief) to control risk and optimize the investment.
8. A work breakdown structure (WBS) is essentially a multiuser task list built around project milestones, which in turn are based on the deliverables required for each project.
9. Resource planning and scheduling is an iterative process that links qualified resources to a carefully prepared schedule of corresponding project tasks.
10. Baseline budgeting is an estimating process that quantifies all projected labor, travel, material, overhead, and other expenses prior to the launch of a planned project.

8.1 The Project Planning Process

Let's assume the following: You recognize the importance of strategic projects in the business development process. You understand that strategic business development projects are investments. You've done your homework ... assessing the current situation, developing a winning strategy, and identifying and prioritizing potential projects (investments) that support this strategy ... and you're ready to move forward with a specific project or projects.

The next steps, collectively, make up the *project planning* process:

- Appointing a project manager
- Developing a risk management plan
- Defining project phases and phase gates (key approval checkpoints)
- Developing a work breakdown structure (milestones and tasks) for each project phase
- Preparing documentation (charter, deliverables checklist, resource profiles)
- Resource planning, scheduling, and contracting
- Baseline budgeting

A well-structured project plan will exponentially decrease the risk of project failure, increase the efficiency of your project team members, and reduce overall project costs. Here's an easy to remember technique to help you **MASTER** the essentials:

- **M**ilestones — correspond with key deliverables in each project phase. Make a list of key deliverables, organize them by phase, then sequence in a logical progression ... the resulting milestones (e.g. Deliverable A completed, Deliverable B completed) form the backbone of your project's work breakdown structure.
- **A**ctivities — the actions (tasks and subtasks) your project team must take to produce each deliverable (and thereby achieve each milestone). The project manager is responsible for listing and organizing tasks in a logical sequence leading up to each milestone. Project team members can fill in their respective subtask breakdowns once the project is underway.
- **S**kills — Specific areas of knowledge required to complete all project tasks. Each skill set identified becomes a project role (e.g. mason, carpenter, roofer, electrician, plumber). Each role will eventually be filled by one or more resources (project team members).
- **T**iming — Assign a role (see above) and an estimated duration (in days) for each activity identified. Add up the days assigned to each project role (e.g. 60 man days for carpentry), and the total number of days assigned to all project roles combined, then convert man days to work days (typically a five day work week). Split roles with lengthy durations across multiple resources (e.g. add a second carpenter) and run non-dependent tasks in parallel, where possible, until the overall project duration fits your requirements.
- **E**xpenses — Project costs (labor, travel, hardware, software, materials, equipment, and overhead) must be identified and estimated as accurately as possible for each project phase.
- **R**esources — Internal/external staff must be assigned to carry out the tasks allocated to each project role. Select project team members based on the skill, experience and timing requirements identified above. Share your plan with the team as part of the onboarding process.

8.2 Project Management Methodology Requirements

The project planning process can be simplified by employing a methodology ... a standard sequence of common practices and procedures that guides all future project activity. A myriad of tools and techniques are available to institutionalize the processes involved in planning, staffing, and executing projects. All have their advocates, and some are better suited to strategic business development projects than others, but regardless of their differences, all methodologies share a common objective: To leverage best practices and reduce the learning curve for project team members.

Whether home grown, adopted, or adapted, your chosen project management methodology should provide the inherent advantages of embedded knowledge as described in Chapter 6. The most important consideration, from a business owners' perspective, is to select a methodology that is simultaneously simple (easy to convey to project team members), efficient (stripped of unnecessary bureaucracy), repeatable (applicable over a wide range of project types and complexity levels), and robust (provides sufficient project control).

A *simple and efficient* methodology is critical because it helps small and midsize organizations overcome inertia — the tendency to resist change and maintain the status quo. A complex, burdensome project management methodology will add to — rather than resolve — the challenges of business development and wealth creation.

A *repeatable* project management methodology is one that structures your business development projects so logically that it can be applied to virtually any project. Requirements become well known within your organization, and procedural *checkpoints* are easily conveyed to new internal and external project contributors.

A *robust* methodology is one that codifies the controls you have developed to mitigate potential risks and maximize potential returns from your project-based investments.

Project Management Methodology Types

When selecting a project management methodology, it's important to keep in mind that most existing methodologies were developed to support the requirements of projects unlike those you will undertake as part of the business development process. Construction companies, for example, tend to favor highly structured, waterfall-style methodologies. Projects well served by these methodologies tend to be large, well-defined, sequential in nature, and similar (from a process standpoint) to previous projects.

By contrast, professionals in *creative or inventive* industries (e.g. software developers) often favor a more iterative, agile approach. These loosely structured methodologies are well suited to projects with flexible requirements and lots of unknowns, but they require a significant learning curve and tend to work best when core contributors remain constant across many projects.

For business development projects, a blended, more *adaptive* approach is needed. The project management methodology outlined in Chapters 8, 9, and 10 provides both structure and flexibility, reflecting the more varied nature of strategic business development requirements while also recognizing the importance of embedded knowledge leverage, as illustrated in Figure 8.1 below.

COBRA - Blended PM Methodology

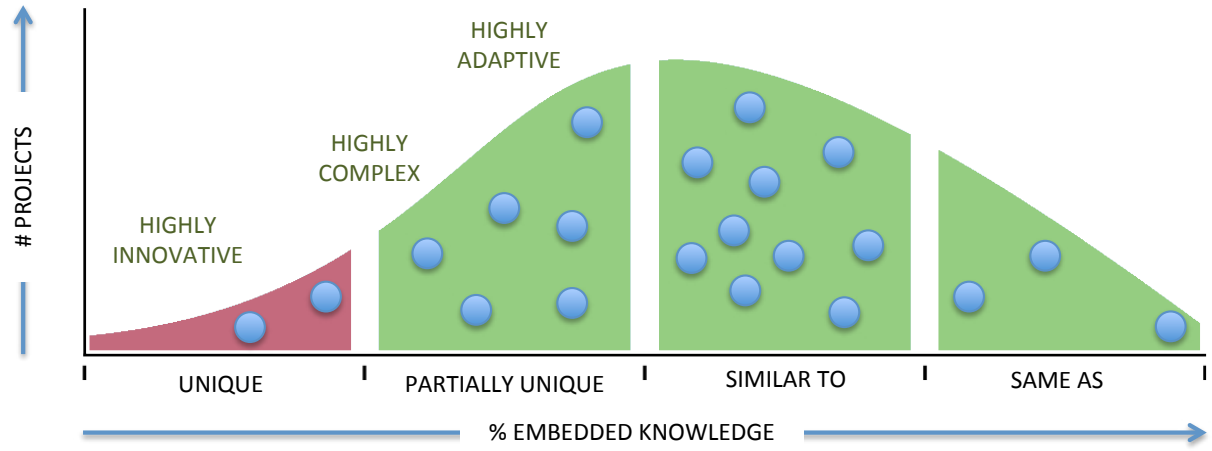
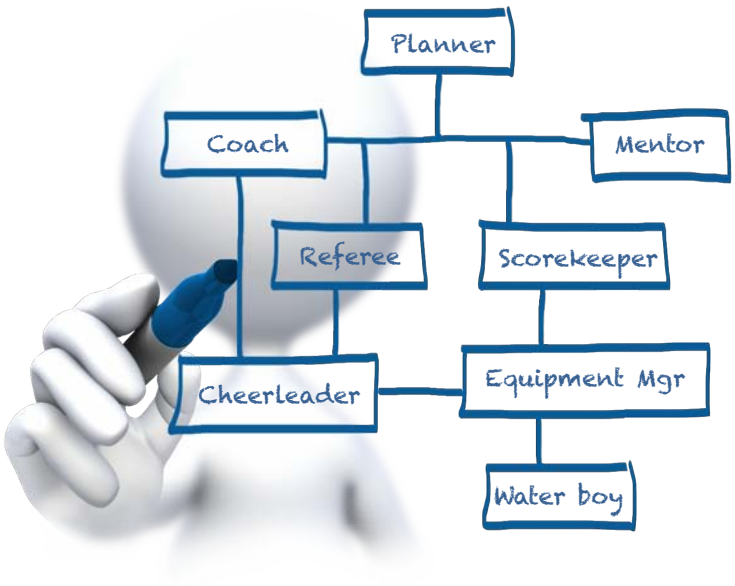


Figure 8.1: Strategic business development projects require a flexible project management methodology that can be used effectively across the full spectrum of embedded knowledge scenarios.

Project Manager Functions

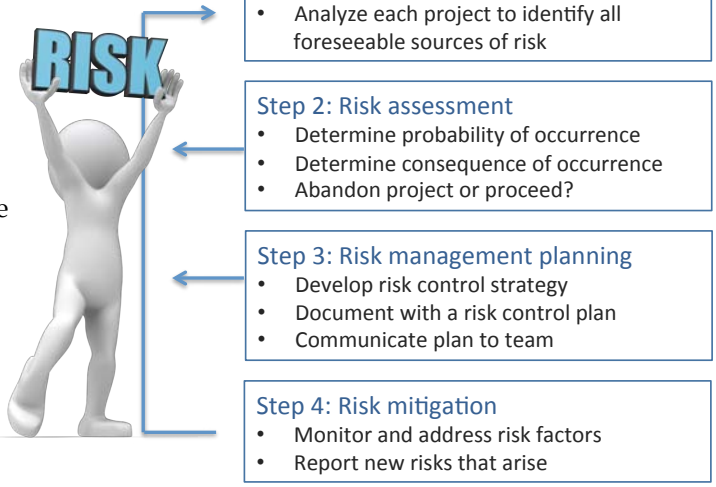
One absolute reality for consistent, successful outcomes from your strategic business development projects is that somebody has to be in charge. That *somebody*, whether internal or external, needs full authority from the project sponsor to allocate resources, resolve disputes, adapt to new challenges and opportunities, and delegate tasks. These functions are assigned to the project manager.



Considerations for selecting a project manager include the following (in order of importance): Availability, enthusiasm, leadership ability, project management experience, subject matter expertise, and estimated cost to the project (as a percentage of the overall investment). A prospective project manager must — first and foremost — have adequate time available to perform the essential functions of the role, as outlined above. The most qualified candidate may not be the best choice if they're stretched too thin with other commitments. Enthusiasm for the role — and the project's objectives — is likewise more important than leadership ability, experience, or specific subject matter expertise.

Obviously, an ideal candidate would possess leadership ability, prior experience, and some level of expertise in relevant fields of knowledge. However, given the importance of this role, it's advisable to keep an open mind (for example, don't assume that you are limited to internal staff) and understand that without a dedicated, motivated manager, your project is simply a theoretical (high risk) exercise.

8.3 Risk Management



The overall risk management process is based on thoroughly identifying known risks up front, and assessing those risks to identify high-probability/high-consequence situations (Chapter 7). These two steps are the foundation for risk management and should take place before a project reaches the planning stage. In most projects, the next step is to develop a formal mitigation plan, or risk control plan, to address the risks with medium or high probability of occurrence, and medium or high consequences if they do occur. Obviously, the decision on how detailed these mitigation plans or actions should be, and which ones are most critical to project success, will vary based on project and business circumstances.

In some cases, risk mitigation may be as simple as adding resources, or lengthening the project schedule. In other cases, you may need to buy, rather than make, some element of the proposed solution, or contract with an industry expert to help avoid the effects of an identified risk.

In cases where the consequences of an identified risk are high, or the probability of risk occurrence is high, mitigating actions should begin immediately ... before you get so deeply committed that you're hesitant to turn back. For lesser risks, you may simply acknowledge the possibility of occurrence and wait for a triggering event.

Once risk inputs, assessments, and mitigation strategies have been consolidated into a written risk control plan, the project manager should establish clear lines of communication for identification of new risks and discussions regarding risk mitigation efforts as the project evolves.

One element of risk management that is not always identified in a project's business case is the significant risk imposed when changes are made to a project once it has started. In almost all cases, the development and deployment phases of a project's execution are relatively labor intensive, time sensitive, and cost driven, which means that even small changes to the scope, time frame, resource plans, financial requirements, and acceptance criteria of a project at these stages can have significant impacts on expected results. The project manager must manage these changes very carefully.

8.4 Project Documentation

Documentation requirements should be clearly defined in your project management methodology. In fact, once you've adopted or developed a methodology, you'll have a set of standardized templates for project documentation that can (and should) be used for all future strategic business development projects. A good starting point for most strategic business development projects would include the essential tools of a business case, project charter, and deliverables checklist.

Business Case

A business case is developed during the project prioritization process (see Chapter 7). Assumptions and conclusions documented in the business case provide important information to team members at the outset of a project, and may need to be modified during the course of your project as new information becomes available.

Changes made to the business case after a project begins may have an impact on previous investment decisions and should be brought to the attention of the project's sponsor.

Project Charter

A project charter is used to introduce key project parameters to core contributors and other team members at the outset of each project phase (onboarding). The project charter is presented to the project's sponsor at the end of the design phase (phase gate meeting) to request approval to proceed. Once approved, the project charter serves as a focal point to keep everyone on track for the duration of the project.

A project charter should define the nature, objectives, stakeholders, scope, budget, schedule, and quality requirements of your project. Include a copy of the business case used to justify the project as an addendum (financial details may be redacted if necessary), and include any relevant information identified during the discovery process that may bolster or undermine original investment assumptions.

Use the following outline as a suggested project charter structure:

- Introduction (executive summary)
- Project Objectives (detailed description of desired outcomes)
- Key Stakeholders (project sponsor, project manager, other key roles)
- Project Constraints (clear definition of in-scope and out-of-scope items for this project, budgeted funds, proposed project timeline, quality requirements)
- Proposed Solution (actions you plan to take to achieve the desired outcome)
- Risk Control Plan (high-level assessment of identified risks and plans to mitigate them)
- Governance Plan (a description of responsibilities for each project team member and an outline of the dispute resolution process to be used for this project)
- Communications Plan (for progress reporting, risk mitigation, and change management)
- Approval Recommendation (based on Design phase findings)

Unlike the business case, your project charter is *not* a living document. Once drafted and approved, the project charter should not be updated or modified directly during the course of a project. This helps remedy *scope creep*, a common cause of failure for projects.

If necessary, addendums can be added to reflect changes requested by (and *only* by) the project's sponsor. Change requests originating from all other parties should be directed to the project's sponsor for consideration and approval. A project manager should not attempt to accommodate requests that are beyond the original scope of a project.

Once adopted, project charter addendums should not be updated or modified directly. New addendums can be added as required. This practice preserves a *history* of the project's development, forming an audit trail that may be useful if a project fails.

Deliverables Checklist

A deliverables checklist describes the tangible output for each project milestone. In other words, the steps you take (tasks) to arrive at each significant objective or stage of development (milestone) should always result in a deliverable.

8.5 Project Phase Gates

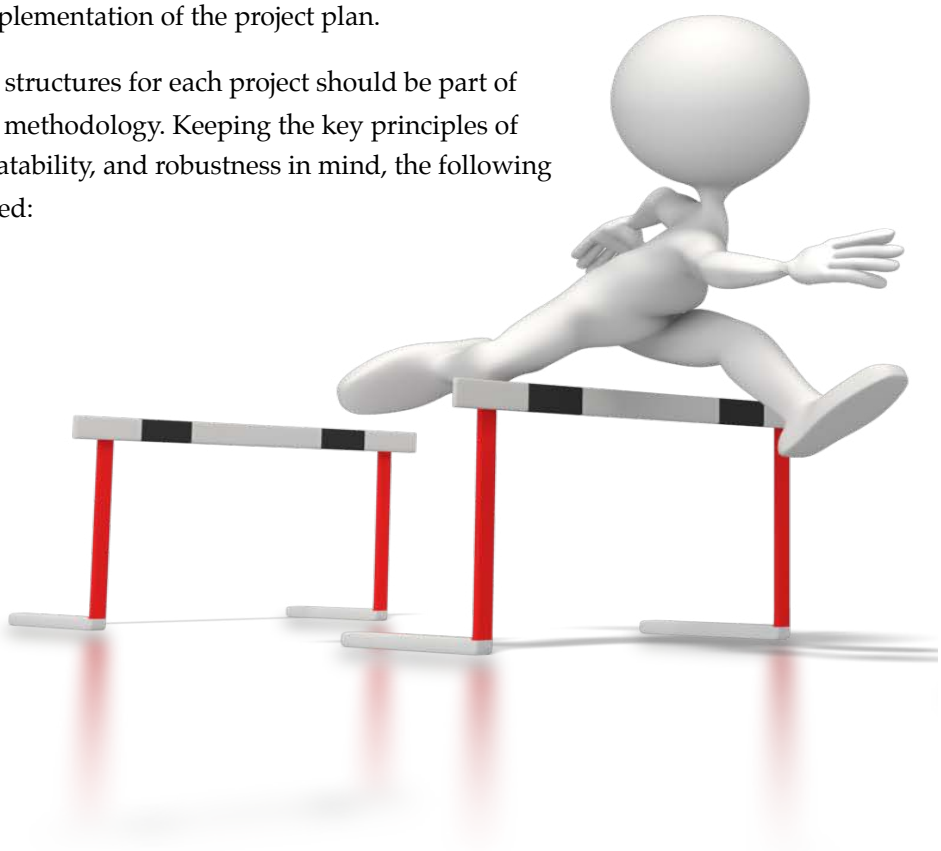
Prudent investors manage the potential losses from any strategic business development project by parsing funding commitments across multiple, logical phases. Each phase of the project coincides with an approval checkpoint — or phase gate. Each phase gate, in turn, requires the project team to provide a stated objective, a clear definition for success, a cost estimate, and a formal request to proceed.

The phase gate approval process should be applied consistently to all projects, thereby institutionalizing the concept that each project is an investment. The project's investors (business owners) expect a return on their investment, and approvals for additional project funding *are not* a foregone conclusion.

Requiring project teams to report progress and request approvals at set intervals also helps to ensure that important business objectives don't get lost in the myriad details that consume resources during daily implementation of the project plan.

The phase and phase gate structures for each project should be part of your project management methodology. Keeping the key principles of simplicity, efficiency, repeatability, and robustness in mind, the following phase structure is suggested:

- Design
- Development
- Deployment
- Debrief



Design

The design phase of a project is used to assemble, develop, and/or verify important *background* and *baseline* information prior to onboarding of additional resources. An attempt should be made to describe the solutions proposed within the project in sufficient detail to guide their development and deployment, and to validate all key assumptions made during the development of the project's business case.

If it becomes apparent that original, investment-related assumptions (e.g. project costs, risk factors, time tables, projected outcomes) were invalid, the project manager should update the business case and schedule a meeting with the project's sponsor to review these findings.

It is also critical, at this point, to define and document the acceptance criteria that will be used to determine when and if a project has met its objectives. These criteria should serve as a key reference point for the project team throughout the execution of a project.

If the original assumptions of the business case remain intact, the project manager should summarize the key elements of the project in a project charter, along with other necessary documentation. Once project documentation is completed, a work breakdown structure (WBS) can be developed (Chapter 8), resources can be identified (Chapter 9) and baseline budgets can be established (Chapter 8) for each project phase. When theses key requirements are completed, the project manager should schedule a phase gate meeting with the project sponsor. The results of this meeting define the approval and basis for moving on to the next phase … development.

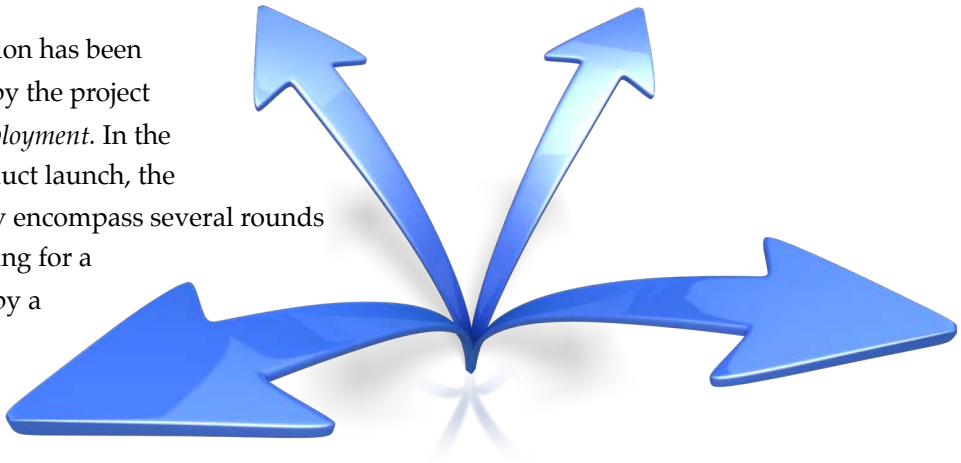
Development Phase

The development phase of a project encompasses all activities related to the detailed design, specification, and completion of the solution proposed in a project's charter. Engineering, materials specification, programming, and assembly functions are typical examples in the case of a product development project. Interviewing, short-listing, and hiring might be typical of a project intended to place a new international sales manager. In a project based on implementing a commercial software product, the development phase would include all activities related to software acquisition, configuration, customization, integration, and testing.

Activities within the development phase may be highly structured (hierarchical, sequential activities are common in projects where the steps are clearly defined), iterative (characterized by short cycles of development and refinement), or some combination of the two.

At the completion of the development phase, the project manager should schedule a phase gate meeting with the project sponsor and core team members. The project manager should present the deployment plan, baseline budget, risk management steps, and other key project information to the project sponsor in order to justify the full deployment of the solution.

Deployment Phase



After a proposed solution has been developed and tested by the project team, it is ready for *deployment*. In the case of a software product launch, the deployment phase may encompass several rounds of user acceptance testing for a beta release, followed by a formal launch announcement. In the case of an acquisition, the deployment phase might include implementation of an orientation program for employees of the acquired entity and integration of the business's systems. Once a solution has been deployed and tested (where applicable), the project manager should review the project charter to make sure all requirements and objectives have been met. How do you know when the project is complete? This sounds like a simple question, but is probably the most important question in the entire planning process.

The definition of *complete* may include complex pass/fail technical testing requirements, detailed user training and documentation requirements, validation of business results, financial measurements, or all of the above. Since these criteria will be different for every project, the key point is to ensure that a definition for success is discussed, debated, and documented in the project charter (during the design phase), and that a consensus is reached with the project's sponsor during a phase gate approval request meeting before the development phase begins. This should help prevent major problems and adjustments later in the project. The deployment phase is *complete* when the defined acceptance tests are met and any required training and documentation is finished.

Debrief Phase

Once the project manager is sure that all project objectives (acceptance tests) have been satisfied, he or she should schedule a meeting with the project's sponsor to request approval to debrief the team and close out the project.

Important side benefits are realized every time you undertake a project … *lessons learned*! As a child you got better with every attempt at tying your shoes, or riding a bike, until you achieved proficiency. The same is true when planning, staffing, and executing projects. Don't let this opportunity go to waste! Most project management methodologies culminate in a closure phase (or some variation thereof). Winding down each project with a *debrief phase* will emphasize the *gold nuggets* of embedded knowledge gained each time the project management cycle is implemented.

Maintain a centralized record of these *lessons learned*, and make a point of adding to this *knowledgebase* each time you close out a project. Report your lessons learned to project sponsors (they'll be impressed), then make this document required reading for all subsequent project managers. Just as a good chess player becomes a great chess player by learning to avoid common mistakes, your organization will become better with each new project, maximizing potential returns, and minimizing potential risks.

Once the project team is debriefed, the project manager can then take steps to release resources (human and physical) and wind down the project.

8.6 Work Breakdown Structure (WBS)

The project team's tasks, meetings, and milestones are organized using a work breakdown structure (WBS) for each phase of the project. A work breakdown structure is basically a multiuser task list built around key milestones ... simple in concept but often quite challenging to assemble. The tools used by project managers to create a work breakdown structure range from simple spreadsheets to complex applications such as Microsoft Project.

Cloud-based solutions have become popular in recent years, and new project planning tools seem to appear on an almost daily basis. Choosing the right tool can prove to be a challenge. There is no magic formula or tool that will work in every situation, but past experience does allow for consideration of a few noteworthy points:

- Adoption rates for complex project planning tools are dismal. Before shelling out hard-earned money for an expensive application, ask for references and talk to several. In many cases, you'll find that real world experiences don't match the marketing hype, particularly within the context of a strategic business development project.
- Put all referrals in perspective. A project manager who plans two or three business development projects each year will have vastly different needs than a dedicated, full-time project manager with a large, complex project portfolio to manage.
- Software updates occur frequently and learning curves for complex products can be steep. Consider essential functions (such as organizing phase gates, milestones, and tasks into a tiered work breakdown structure) and search for a tool that simplifies those functions.
- Don't make the assumption that a project planning tool with lots of shiny buttons and flashy charts will serve your needs better than one with fewer features but an efficient, user-friendly interface.
- Unless a project is very simple, the development time frame for a work breakdown structure may span days or weeks. For this reason, the planning tool should support both desktop and cloud-based development.

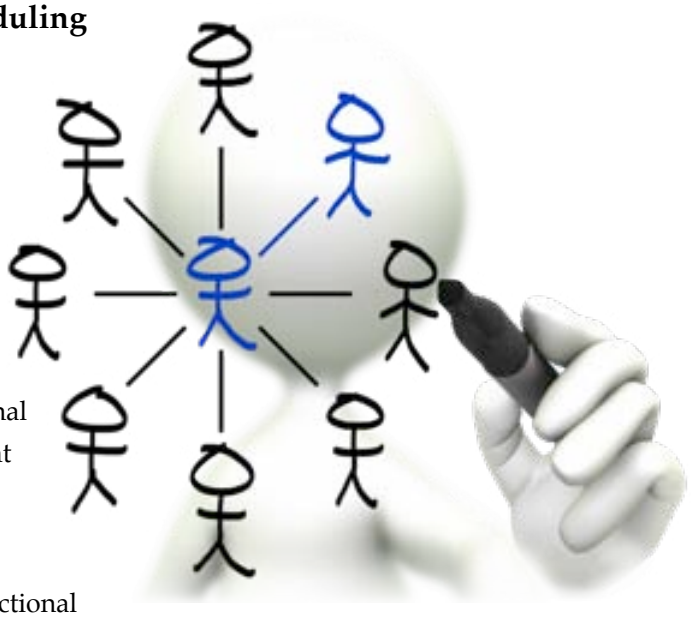
Once a project planning tool has been selected, you can begin the process of identifying and arranging activities within each phase. One of the best methods for creating a work breakdown structure is to work backward from the acceptance criteria within each phase, creating a series of related milestones that must be reached. Each milestone should reference the completion of a deliverable. Once these milestones are defined, a logical sequence for completion can be identified.

Leave space between each milestone, then move forward through the list of milestones, filling spaces with tasks that must be completed to advance from one milestone to the next. Consult with subject matter experts, where needed, to make sure you've covered the most important milestones and tasks.

Don't get carried away! In the context of strategic business development projects, a project manager should not be responsible for development of detailed subtask breakdowns. In fact, this practice is counterproductive. The role of a project manager is to structure project activity at a high level. Project team members assigned to each task will fill in the details.

These project team members, presumably experienced in the functions to which they're assigned, are often better qualified than the project manager to assess functional requirements at the subtask level. Even if that's not the case, they'll appreciate the latitude provided to structure their own daily work activities ... it's empowering and motivating.

8.7 Resource Planning and Scheduling



The cornerstone of the resource planning process is the detailed definition of skill sets, experience levels, proximity considerations, and scheduling requirements for each member of the project team, as dictated by the project's work breakdown structure. This requires a careful analysis so that all resources are clearly defined — in functional terms — at a level of detail that is sufficient for baseline budgeting and for qualifying internal and external candidates.

The experience level required for each functional area is of particular importance. In many cases, one senior, very experienced resource can act as a coordinator or lead for multiple, less experienced resources, thereby reducing costs.

Once skill sets and experience requirements have been cataloged, specified roles can be mapped to responsibilities (specific tasks) within the work breakdown structure. An estimate of each task's effort (working hours) and duration (days from start to finish) must be made.

For each role identified in the work breakdown structure, a resource profile also needs to be prepared. Each resource profile should include the following:

- Functional description (e.g. carpenter, programmer)
- Total estimated effort for this function (working hours)
- Estimated start date (scheduled start date of first assigned task)
- Estimated duration (based on estimated completion date of last assigned task)
- Experience level required (e.g. apprentice, journeyman, master)
- Special skills or other requirements needed
- Cost estimate (estimated hourly rate X total estimated effort)

8.8 Baseline Budgeting

Baseline budgets need to be estimated and approved for each phase of a project.

Labor costs often consume a large portion of the budget for business development projects. For this reason, it's important to consider the potential costs of each resource carefully.

Don't make the very common mistake of assuming that internal resources are cost free because they are being paid anyway. They're *not* free. The time spent on project activities is not typically factored into budgeted hourly rates.

In any event, specific staffing decisions (e.g. John Smith will fill the IT role on this project) have not been made at this point and are not relevant to the baseline budgeting process ... so it's best to treat internal resources no differently than external resources.

Next, review the work breakdown structure for obvious, and not-so-obvious non-labor, external purchases (testing equipment rentals, software purchases, material costs, etc.). Add these expenses to your budget estimate for each phase of the project.

Finally, apply an overhead factor. Your project team will take up space, use office supplies, make phone calls, conduct video conferences, submit travel expenses, and incur other incidental costs throughout a project's duration. These expenses are easy to overlook and impossible to itemize in advance. Develop a reasonable incidental expense ratio, include it as part of your project management methodology, and apply it consistently.

Project costs, particularly labor costs, can be difficult to estimate with precision unless there is a comparable, prior project actual baseline available as a reference. For this reason, it is important to overestimate in situations where the estimated effort and/or experience levels required are less well defined (you're guessing, after all).

CASE IN POINT

A business development project plan supported by an appropriate project management methodology (along with an effective technology platform and a dedicated project team) will help ensure that expected investment returns are realized.

The project planning process is not simply a mechanical exercise. By applying the principles outlined above, small and midsize businesses can significantly improve the overall effectiveness of their business development efforts, and minimize the risks of failure. A well-conceived project plan serves as a roadmap for success, integrating best practice processes, technologies and usability requirements.

The best way to understand the interdependencies of these factors is to review the headlines from several infamous failed projects:

California sues SAP over failed payroll/ERP system: After three years and $50 million, the state of California filed suit against SAP in 2013. Citing significant errors in payroll runs, California alleged that SAP failed to stabilize the system. SAP replied publicly that their software was not the culprit, and somewhere there must be a technology problem!

Avon halts rollout of order management system: In late 2013 Avon announced that it had halted the rollout of its new order management system and was taking a $125 million charge against earnings as a result. Avon claimed that while the technology worked well, the application was so complex and difficult to use, that its salespeople were leaving the company in droves. Sounds like a business process problem!

US Army cancels its Uniformed Camouflage Pattern Project: After several years of use and approximately $5 billion invested, the US Army cancelled its Uniform Camouflage Pattern uniforms in 2012 because they made troops easier to see rather than more protected by the camouflage pattern. Apparently, the recommendations of Army users were overridden by senior management and politics. A clear case of not seeing the usability requirements (pun intended)!

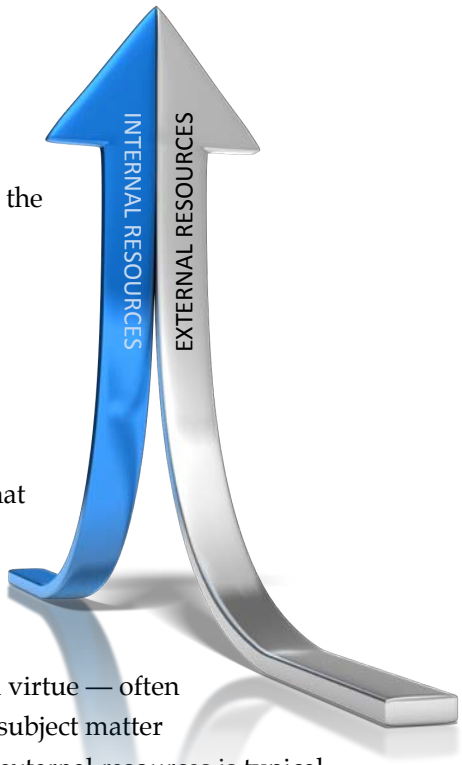
HP's perfect storm of ERP problems: In 2004 HP attempted to centralize all ERP systems in North America. The project failed and eventually cost HP $160 million in lost revenue. HP's CIO later explained, "We had a series of small problems, none of which individually would have been too much to handle." Technology, business process, and usability failures — the perfect storm!

Staffing for Success

TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. Business development projects typically require — and almost always benefit from — a combination of internal and external skills and perspectives.
2. Project team performance is a function of both skills and motivation.
3. Matching specific individuals (resources) to the skill/experience/availability requirements of each task in a project's work breakdown structure is the essence of project staffing.
4. The project manager is responsible for all project staffing decisions, subject to any limitations or guidelines imposed by the project's sponsor.
5. The major categories of business development skill sets are: Business, marketing, sales, information technology, operations, and engineering.
6. External resources bring unique, high value capabilities and experience to a project team.
7. Web/cloud based project planning, staffing and execution software tools create a real-time, embedded-best-practice framework for project management.
8. Web/cloud based communications, coordination, and control tools create a real-time, embedded-best-practice framework for anywhere/on-demand project team collaboration.
9. Online legal services have put the capabilities of a large corporate legal team in the hands of SMB management teams.
10. Onboarding best practices must be used for internal and external resources to create an effective project team.

9.1 Project Teams



With the overall project plan defined, the next step is to begin staffing your project. This is a critical step, because no matter how well a project is planned, or how well it is managed, without the necessary skills, experience, and time commitments, the project is destined to fail.

Keep in mind that most small and midsize businesses today are staffed to match existing revenue/sales volumes. Few, if any, resources are readily available within the firm to fully staff your portfolio of strategic business development projects.

In addition, business development projects often require skills that are not available internally or are very scarce. This dual constraint of limited resources and scarce skill sets is very typical of most highly optimized businesses.

Therefore, an effective project team will — both by necessity and virtue — often combine internal expertise with external resources (consultants, subject matter experts, and/or support staff). This combination of internal and external resources is typical for most strategic business development projects and is the team model that more and more successful projects are built upon.

The project manager is responsible for identifying and acquiring internal and external resources. This may require negotiation with (sometimes reluctant) department heads to reserve the time of internal resources and coordination with HR/legal department personnel to process the necessary paperwork for externally sourced resources. The project sponsor may arbitrate and make the final decision on any conflicts.

9.2 Team Performance

The overall performance of the project team is based on two critical factors. The first is the definition and selection of the core skills and experience levels necessary to execute a project based on its scope, complexity, and schedule. The second major factor for success is the project team's motivation, which is derived from a clarity of purpose and a clear definition of responsibilities.

Team motivation is often the deciding factor between low, medium, or high performance. A highly skilled team that is not motivated will, at best, perform at an average or medium level. A team with low skill levels — or the wrong skill sets — will deliver poor performance regardless of how well they are motivated.

So, the key to assembling a high performance team is to carefully select resources with appropriate skills and experience levels, and to make sure they're motivated throughout the project execution process. Following are the key elements of motivating skilled teams:

Clearly defined objectives: In addition to ensuring that project objectives are clearly defined, individuals on the project must understand their roles, responsibilities, and all relevant procedural expectations. Overall project success should be clearly linked to each individual's performance expectations.

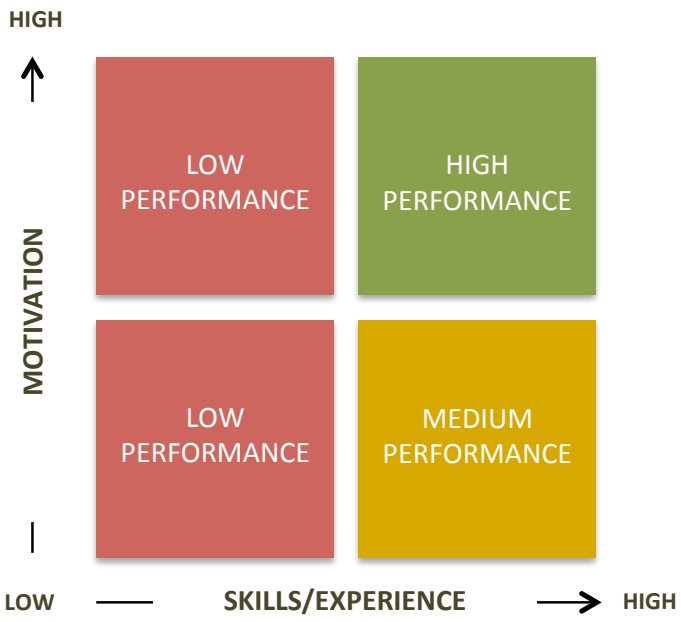


Figure 9.1: Project team performance

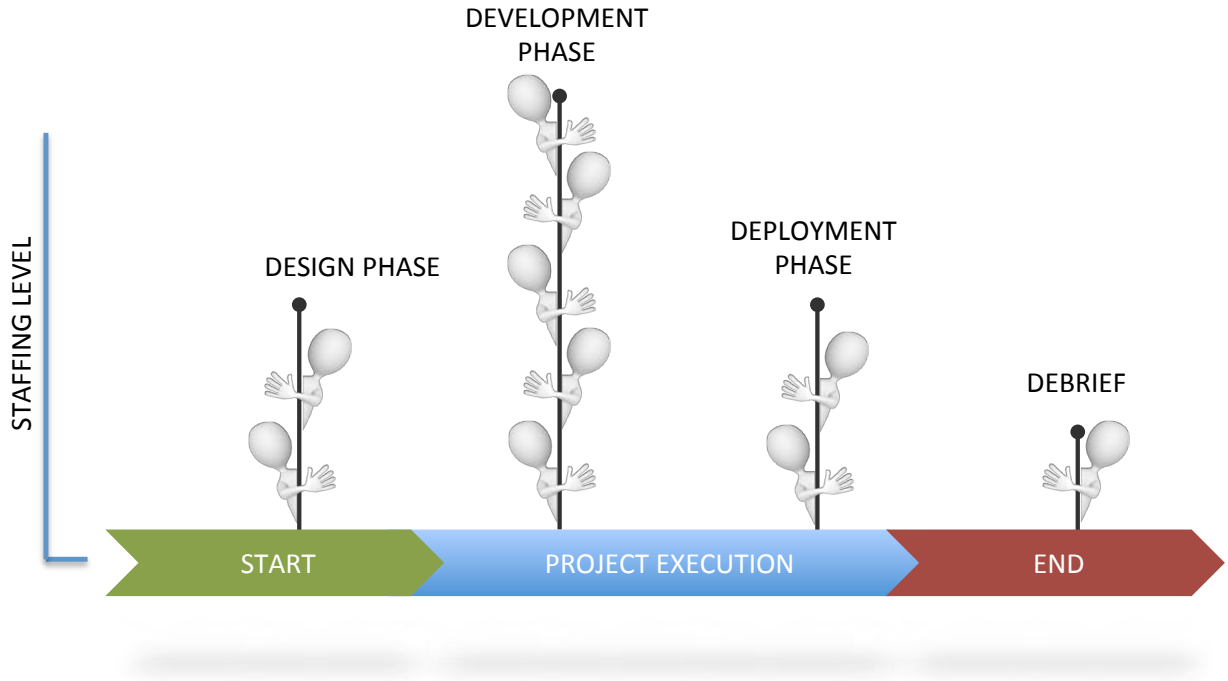
Project team empowerment: As obvious as this may sound, a project team cannot succeed without full support from the project's sponsor, and the project sponsor must have the authority to provide the necessary level of support. There will be situations when the team's efforts may interfere or conflict with day-to-day operations. During these conflicting situations, leadership must empower the team to remain focused on project activities so that the strategic objectives of each project are realized.

Effective onboarding: This is an essential process! Every member of the project team, whether internal or external, must have confidence in the capabilities and commitment of the rest of the team. The charter, team composition, management commitment, and importance of each individual must be clear to *everyone* involved in the project.

Well-defined rules for rapid issue resolution: Nothing demoralizes and confuses a team more than issues being ignored or deferred. Project governance policies must be decided, documented, and communicated in a timely manner, or the result will be negative motivation and direction.

9.3 Staffing Process

The project staffing process is a challenging combination of skills definition, project clarity, and coordination. The essence of the project team staffing challenge is that the necessary resources start at zero, rise to one or two, rapidly increase to six, seven, or higher, then decline to one or two, then to zero. This is the basic profile of nearly every project. The only significant change from one project to another is the magnitude of the ramp (typically peaking during the development phase), and the time it takes to debrief and redeploy team members at the end of the project.



The overall staffing process should include the following steps:

- **Matching resource profiles to people** — The resource profiles prepared during project planning (Chapter 8) define your staffing requirements ... now it's time to put a face (or faces) to each profile. Specific individuals that fit the requirements of each role must be identified. If a resource is internal, time and priorities to the project must be committed and assigned. If using an external resource, the necessary contracting procedures must be completed.
- **Establishing a team structure** — The team structure must clearly define project roles and responsibilities:
  - The roles each skill set and individual plays in the overall project execution.
  - The responsibilities each member has to the project from the tasks list, deliverables, and schedule perspective.
- **Onboarding** — Before the development phase begins, a well-defined and executed onboarding process must be in place. Every project team member — including internal resources — should be treated like a new hire. An effective onboarding process ensures that everyone understands the objectives of the project, important constraints, and other requirements enabling the team to achieve optimum performance.

Match Resources to Skills / Schedule

The next step is to specify whether resources must be internal, external, or a combination of both. The differentiators here are the specific skills and experience levels needed. In addition, if there are internal resources with the necessary skills that clearly cannot be made available for the project, an external resource should be specified.

RESOURCE DESCRIPTION	EXPERIENCE	EST EFFORT	SOURCE	PROXIMITY	EST START DATE
Arch	h	50 hours	Internal	On site	March 2013
Ge tractor	High	100 hours	External	On site	April 2013
Ca e	as er	250 hours	External	On site	March 2013
Carp	pr entice	400 hours	Internal	On site	April 2013
Plumb	eyman	50 hours	External	On site	July 2013

Once the function, experience level, estimated effort, and source have been defined, the next step is to define the proximity requirement for each resource. This is a key factor based on the required effort onsite vs. remote or online. In many cases, some blending of onsite and online capabilities will be the optimum combination. This specification will determine the number and depth of resources available.

The final step is to specify the estimated start date for each resource as dictated by the project schedule. The sequencing of resources, to match activities outlined in the work breakdown structure, is essential to meet the targeted schedule and to keep other resources fully productive.

Qualify External Resources

In almost all strategic business development projects, external resources will be deployed to ensure that necessary skills are available when needed to meet the project's schedule and other coordination requirements. These resources may be general-knowledge consultants, or subject-matter experts with specific knowledge or experience that benefits the project. In some cases, general purpose support staff may also be needed to complete the team.

Regardless of the overall composition of the team, external resources should bring significant value to the project:

- **Unique skill sets** — By nature, most contracted resources work on a diverse set of projects across multiple industries. As a result, they accumulate unique sets of skills and valuable perspectives that may not be available internally.
- **Transferrable knowledge** — The wide range of projects encountered requires that contract resources be flexible in applying their skills and adaptable to many different situations. Over time, this cultivates an ability to effectively transfer their experiences/knowledge to future projects.
- **Creativity/innovation** — Because of the wide variety of projects, business situations, team configurations and application differences, the external, experienced resource can bring a powerful, creative, and innovative capability to the project team.
- **Variable cost (per project)** — Since contracted resources are hired on a project basis, associated costs end when the project is complete. This financial flexibility yields the best overall result for a business since labor costs (and value received) are specifically applied to a strategic business objective. No recurring, fixed labor costs remain when the project is completed.
- **Catalyst for change** — It is often very difficult for an organization to change a well-entrenched process or set of functions. External experts can bring perspective, credibility, and confidence to new ideas ... thereby serving as a catalyst for change.
- **Added capacity** — A contract resource brings incremental, functional capability to the project team. In many cases, project resources become qualified, on-demand resource capacity for other strategic initiatives or enhancements in the future.

- **Objectivity** — This is one of the most important capabilities that external resources bring to a project. Because they are not tied to a legacy system or process, they tend to have a very unbiased view of the best approach to a new opportunity or technology.

There is a wide range of highly qualified, external resources available for strategic business development projects. These resources can be categorized into the following general skill sets, which are explained in more detail in the following sections:

- Business
- Marketing
- Sales
- Information technology
- Operations
- Engineering

Business Skills

Business skills can be categorized into specific functional areas. Depending on project requirements and the level of experience a resource brings to the team, these skills are often highly transferrable and leverageable:

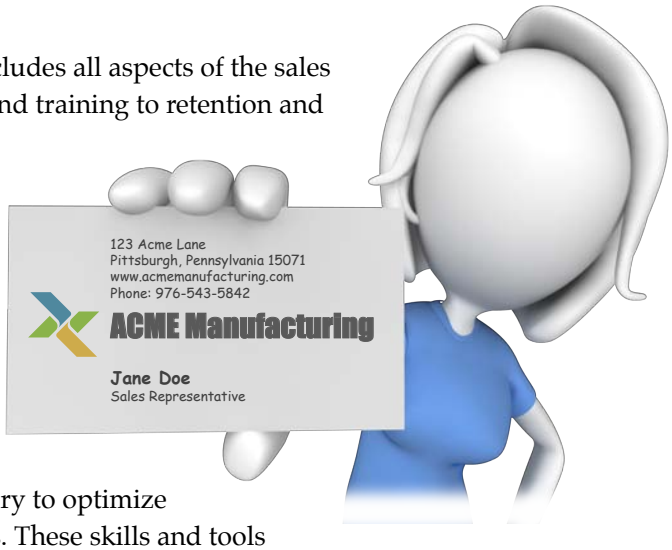
- **Management consulting** — This category ranges from strategic planning experts to detailed business analysis of structure, function, and culture. Experienced management consulting resources can bring unique and powerful insights to a general business issue, as well as a very specific solution to a complex situation.
- **Financial management** — This category includes experts in budget planning, capital structure, sourcing of capital, financial performance analysis, cash flow forecasting, auditing, regulatory compliance, domestic and international taxes, debt collection, receivables management, inventory analysis, and others.

- **Human resource management** — HR skills are usually very transferrable. Key HR functions include recruiting, hiring, and evaluation of personnel; benefits administration; payroll processing and management; employee training and performance; attendance management; resource scheduling and other activities that relate to the optimization of human capital.
- **Administrative** — These duties are also key to the support of active, focused teams. Administrative functions include researching information, storing information, coordinating travel and meeting schedules, buying equipment and supplies, preparing team documents, and coordinating all forms of communication.

Marketing Skills

- **Marketing management** — This category ranges from competitive analysis to product planning, product management, demand analysis, pricing strategy development, advertising, trade show management, e-marketing, search engine optimization (SEO), social media engagement, website/webstore design, promotional design, channel analysis, distribution planning and marketing strategy formulation, as well as many other specialized skills
- **Marketing communications** — These functions include activities required to evaluate and measure attitudes and opinions within a market (or customer base) toward the sponsoring organization. Also included are the creative functions (branding, design, writing, and other communication skills) required to convey a compelling message to customers, employees, surrounding communities, or the public in general as they relate to enhancing the perception of the business.
- **Market research and analysis** — Detailed business, market and competitive intelligence, international market analysis, export details, import regulations, and other very specialized analysis are included in this category.

Sales Skills



- **Sales management** — This category includes all aspects of the sales development process, from recruiting and training to retention and compensation strategies for key sales personnel. It also includes managing the sales delivery / customer acquisition process, from lead generation and tracking to team coordination, account management, and overall relationship management.
- **Sales Operations** — These functions include the operating processes necessary to optimize sales team performance on a daily basis. These skills and tools include compensation plan implementation; integration of technology tools such as CRM, reporting, and analytics; territory design and optimization; customer segmentation and measurements of effectiveness.
- **Sales Training** — These capabilities include all aspects of formal and informal training that optimize the performance of sales personnel. This includes product knowledge, sales skills, account management, territory management, time management, and other similar skills needed to maximize sales team effectiveness.

IT/Information Systems Skills

There are well over 100 categories of technical/IT certifications related to major, different operating systems, programming environments, databases, networks, communications techniques, support technologies, applications, security schemes, architectures, etc. As a result, every project must be carefully analyzed to ensure that appropriate skill sets and experience levels are secured within the following general categories:

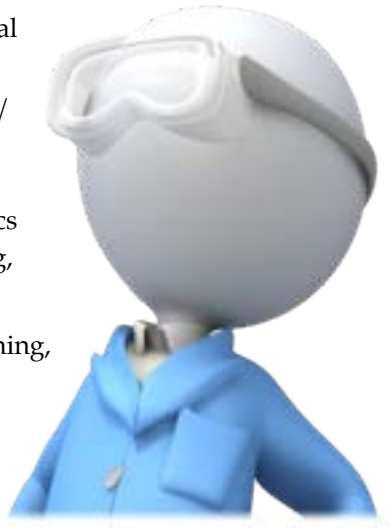
- Architect/systems design level
- Business process analysis and modeling
- Technical analysis
- Security design and analysis
- Database design
- Programming
- Messaging and communications
- Project management
- Web development
- Networking
- Data mining
- Test/quality assurance
- Systems administration

Operational Skills

Operations-based skill sets are highly functionally specialized, but can typically be applied across a wide range of industries and businesses. These skill sets are usually categorized as follows:

- **Manufacturing processes** — The overall set of manufacturing processes can be generally categorized into fabrication of components or subassemblies, physical assembly of these components or subassemblies, technical integration — either mechanically and/or electronically — and the final or in-line testing of the product.
- **Supply chain management** — Supply chain management relates to the specification, selection, qualification, and optimization of all the externally sourced elements of the company's deliverables. This can include hardware, software, services, licenses, facilities, transportation, and aftermarket functions.
- **Quality management** — Detailed, practical experience in this category is essential to delivering products or services to specifications. ISO standards and other industry/process specific regulatory or specification standards have evolved to create sets of global best practices, quality techniques, methods, and transferrable technologies.
- **Factory / process automation** — The technologies that enable factory (discrete products) and process (batch, continuous, or web products) automation are highly transferrable. These intelligent, dynamic systems based on smart sensors, smart machines, and optimized systems-user interfaces are powerful tools and excellent investments. These technical and operational skills are highly transferrable and leverageable across industries.
- **Logistics management** — These skills and technologies have evolved rapidly to create intelligent, dynamically configurable delivery and resupply systems that are highly transferrable. Combined with smart packaging and tracking technologies, these precision logistics systems can change the complete inventory, manufacturing, or aftermarket competitive basis of a business.
- **Facilities management** — These skills include energy optimization, security, air quality, sustainability designs/practices, traffic and people flows, and physical productivity strategies that will have significant business performance impact over extended time frames in all business situations.

Engineering Skills



While engineering skills typically fall into categories based on formal education areas, their transferability usually has a high learning curve associated with the specific nature of the individual products/projects. Following are the major engineering categories:

- **Mechanical engineering** — Applies the principles of physics and materials science to the design, analysis, manufacturing, and maintenance of mechanical systems.
- **Metallurgical engineering** — Relates to the extraction, refining, alloying, and fabrication of metals.
- **Electrical engineering** — Deals with the design/study of electricity, electronics, and electromagnetism. Typically deals with systems and machines.
- **Electronic engineering** — Deals with the design/study of electronic systems including computers, communication systems, integrated circuits, and printed circuit boards.
- **Chemical engineering** — Applies chemistry, physics, biology, and mathematics to process raw materials into useful products.
- **Industrial engineering** — Associated with the optimization of complex processes or operational systems including the integration of people, information, equipment, and processes.
- **Structural engineering** — Deals with the design, analyses, and optimization of structural components and systems to achieve design or safety goals.
- **Environmental engineering** — The application of science and engineering disciplines to improve the natural environment.
- **Civil engineering** — Related to the design, construction, and maintenance of the physical and naturally built environment.
- **Architectural engineering** — Applies engineering and building design technologies to commercial, industrial, and residential facilities.
- **Field Service / commissioning** — Field service and commissioning skills require product knowledge and experience with the integration of engineering and/or information systems technologies. These skills are separated from the design, manufacturing, or development expertise by the nature of field installation, commissioning, testing, and troubleshooting. These functions require specific experience and broad technical capabilities. These skills/experiences tend to be very project/equipment/systems specific and must be defined and sourced to match the exact technical requirements.

9.4 Optimize Team Structure

Technology has redefined best practices and dramatically reduced the complexity of project staffing. Specifically, cloud-based software, web-based communications, and *anywhere* mobile capabilities have reduced the impact of proximity considerations.

The ability to conduct collaborative, *all in*, 24/7, interactive, information-based meetings online enables possibilities for collaboration that cannot easily be achieved with onsite meeting scenarios. Coordination, communication, and control functions have been added to powerful online project collaboration software functionality, for project execution. These capabilities now define the optimum configuration and proximity of resources.

With such high-powered, cost-effective capabilities available, the optimum project staffing solution can now be focused on skills and experiences, avoiding the constraints once imposed by proximity considerations. Traditional, onsite expert resources are expensive and inflexible. By contrast, external partners can be tapped wherever they reside, will compete for your business (helping you keep costs in check), and are easily dismissed when a project is completed. As a result, most large, global consulting practices now provide over 50% of their billable hours using online resources/services.

Some capabilities can be provided purely by online/remote resources. These tend to be the least expensive and are the best approach for project functions where proximity is not a concern. Some types of software development, graphics design, documentation, administrative support, and other functions fit in this category. This approach enables the project team to draw from a global resources pool, but requires the best online tools for coordination, communication, and control.

Most projects, today, can benefit from a blended approach to proximity considerations. Using blended methods yields the best of both the onsite and the online approaches. The resources can be onsite when necessary, and do their work online as appropriate. This technique reduces travel time and costs, and enables the project to draw from a regional or even global resource pool. The blended method is also becoming the most effective, since communication and collaboration tools enable teams to have their entire knowledge libraries, reference sources, and creative tools available online for simultaneous, seamless use among team members. In many cases, these supercharged online collaboration capabilities are more practical and effective than person-to-person capabilities.

Overall, the evolution of a blended approach to project staffing has increased the resource pool, reduced travel costs/time, and enhanced team productivity. These trends will continue to accelerate for the foreseeable future.

Apply Contracting Best Practices

The development of online legal services has put the capabilities and flexibility of a large corporation's legal department at the fingertips of small and midsize businesses. These services have been developed as configurable, online guides for businesses facing many types of legal situations. From a project contracting perspective, these services offer quick, cost-effective starting points for contracting with project resources.

There are numerous online legal support services available, including Legalzoom, CorpNet, USLegalSupport, and RocketLawyer. These services are constructed so that the user can select their state or jurisdiction and the type of business situation they are researching, then drill down to a certain type of legal document. At the next step, the user fills in a series of questions to create the end result … a legal document.

Obviously, these services have to be used with all the clear disclaimers on the chosen legal services website. However, these tools give small and midsize businesses a great, cost-effective starting point for contracting with external resources, including the following:

- Defining scope of services
- Defining fee structure/payment terms
- Defining length of agreement/schedule
- Defining confidentiality/non-disclosure conditions
- Defining termination provisions
- Defining the legal jurisdiction

The process of sourcing such legal documents helps project and contract managers zero in on critical / complex issues that may need to be discussed with a local law firm or business attorney. These professionals are best suited to resolving disputes, fine tuning agreements, and negotiating favorable outcomes for other difficult situations.

Apply Onboarding Best Practices

The final and most important step in successfully staffing the project team is the onboarding process. At this point there should be one project team, not an internal team and an external team. If the team has been properly configured, there will be an optimum balance between internal and external experts, supported by internal and/or external staff.

To create a *Winning Team*, all members must be treated as *new hires* to the project. This approach will ensure that all members have the same basic understanding of the project, their responsibilities, and their purposes/contributions to the team. Each project and company will have its own onboarding techniques and checklists. However, for project teams, they should include (but not be limited to) the following checklist:

- Detailed explanation of the project charter and the business case
- Detailed explanation of the project's structure, documentation requirements, library/information availability, and other project information tools
- Detailed governance/ethics/business rules and principles guiding the project team
- Detailed explanation of the project plan, including the schedule, work breakdown structure, milestones, and phase gates
- Explanation of the project meeting schedule and attendance/participation expectations
- Detailed discussions and training on the following operational/execution issues that will face the project team:
    - How does the team identify, discuss, and resolve issues?
    - What types, details, and timing of reports are required?
    - What are the critical criteria for the phase gate score cards?
    - What, if any, is the expected communications protocol between project team members?
    - What project methodology is the team using and why?
    - What project management, execution, coordination, communication, and collaboration software tools are being used, along with the necessary training so that all team members are confident in the use of these tools?

A project team that has a clear charter to execute a compelling business case, fully staffed with skilled/experienced/available resources, using the best project execution software tools available, where all members have been fully onboarded … will be a *winning team*! This team will almost always outperform expectations from both the company's and the individual team member's perspectives. If any of these elements are missing, the results may be less than ideal.

CASE IN POINT

Staffing a project with qualified, experienced, high value resources — using a blended approach with onsite and online subject matter experts — is now a global best practice, and has made these capabilities affordable for SMB companies.

Ironically, Fortune 1000 companies with extensive in-house specialists, technology expertise, and business process skills are far more likely to use external, expert resources than small and midsized companies. Historically, the primary reason was the cost of these experts and their geographic locations. This situation has changed dramatically in the last five years, as more and more expert resources have become independent contractors or small businesses. This fact, combined with the power of the Internet, has enabled 50% to 100% of temporary, project work to be contracted to experts doing their work virtually anywhere, using an online or blended approach to project staffing.

Real time, cloud-based project planning, staffing, and execution software combined with real time communication (voice, face-to-face, online data), collaboration, and coordination capabilities enable a project manager to control a project much more effectively than with prior tools. These web-based capabilities enable 24/7 anywhere resources, delivering highly reusable embedded knowledge, and significant cost reductions in project staffing.

Probably the best way to illustrate the value of external resources is to look at how such expert resources are used by Fortune 1000 companies to create value. Accenture, for example, is among the largest consulting companies in the world. Accenture is generally considered a leader in continued innovation, business process/information technology integration, and strategic consulting. The company has approximately 280,000 employees in 120 countries, generating $29 billion in revenue in 2013.

Approximately 50% of Accenture's services are provided online. Most clients are engaged in a long term relationship with Accenture, which means the cost of their services has been justified over many years. So, logically, Accenture delivers significantly greater than $29 billion in value to their customers, probably closer to $60 billion or roughly $250 thousand per employee.

The skills, experience, and technologies that Accenture uses to deliver value to its Fortune 1000 customers are also available to SMB companies through small, independent consultants and professional service organizations. The power of web communications, cloud software, mobile technologies, and social networks has leveled the playing field!

Project Execution

TEN THINGS YOU WILL LEARN IN THIS CHAPTER

1. Project execution is the equivalent of "Game Day" in sports!
2. Project coordination is the process of managing the efforts of the team, to enable them to work together effectively.
3. Project communication is the process of enabling the exchange of information between two or more people.
4. Project collaboration is the process of two or more team members working together to achieve a common objective.
5. Project control is the process of monitoring performance against defined targets related to scope, budget, schedule, and quality.
6. Online/cloud-based project execution toolkits have dramatically reduced the costs, risks, and complexities of successful project completion.
7. Task management is the process of dynamically adjusting to unplanned events in order to support the original, underlying objectives of a project's sponsor.
8. Multichannel communications capabilities are essential to support diverse, geographically distributed resources.
9. Project control functions must include real-time tools for scope, budget, schedule, and quality control.
10. Document management functions must support file sharing, version control, and collaborative editing capabilities.

10.1 Game Day!

It's show time! While planning and staffing a project (design phase), the project manager's work takes center stage. Working alone, or with the assistance of a very small design staff, the project manager is essentially responsible for all day-to-day project activity. A quick daily meeting may be all that's needed to keep a project moving. But as the project team expands, activities will often run in parallel, and the project manager's role begins to change.

Looking at the work breakdown structure, one might easily assume that the project manager has delegated all future responsibilities and has very little left to do. In reality, however, the project manager has plenty on his or her plate. If you *were* to plot the project manager's assignments to a schedule, it would look something like this:

MONDAY: Coordinate, Communicate, Collaborate, Control

TUESDAY: Coordinate, Communicate, Collaborate, Control

WEDNESDAY: Coordinate, Communicate, Collaborate, Control

THURSDAY: Coordinate, Communicate, Collaborate, Control

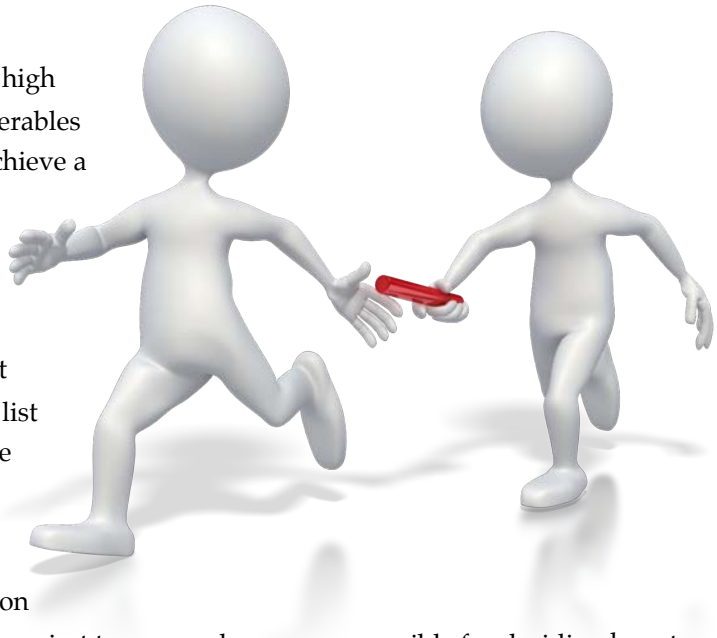
FRIDAY: Coordinate, Communicate, Collaborate, Control

As you can see, there's more to this role than meets the eye! An effective project manager quickly transitions from master planner and solo practitioner to coach, cheerleader, equipment manager, score keeper, and referee.

The four quintessential functions of project management – coordination, communication, collaboration and control – are applied in repeating cycles for the duration of the project. The entire team participates in the process, but it is the project manager's job to keep things running smoothly ... greasing the squeaky wheel, recalibrating when things don't go as planned, and passing out well-deserved praise when important milestones are accomplished ahead of schedule.

A good project manager need not be an expert in any of the skills or professions that are represented by other team members, as they come and go throughout the course of a project. However, he or she must be up to the challenges of coordinating their activities and facilitating real-time, open lines of communication to foster collaboration.

10.2 Project Coordination



A well-conceived project plan provides a high level overview of key activities and deliverables that must be completed successfully to achieve a project's objectives. The project plan is a great reference tool — essential for project coordination — but it's important to remember that in the context of strategic business development projects, a project plan is not an itemized list of every conceivable activity that will take place during the course of a project.

Rather, the purpose of a project plan is to plot the primary tasks, like waypoints on a map or plays in a playbook. Individual project team members are responsible for deciding how to move from one point to another. By allowing project team members to fill in the next level of detail — the intermediate tasks and subtasks that propel the project from one primary task to the next — you effectively leverage their collective expertise and experience.

There may be situations throughout the project execution cycle where tasks need to be reassigned, removed, or edited. Depending on the nature of the project and the size of the project team, it may be desirable to limit task management change capabilities to *core contributors*. The core of the project team is usually comprised of a small group of senior level advisors whose experience in the principal subject matter is critical to a project's success.

10.3 Project Communication

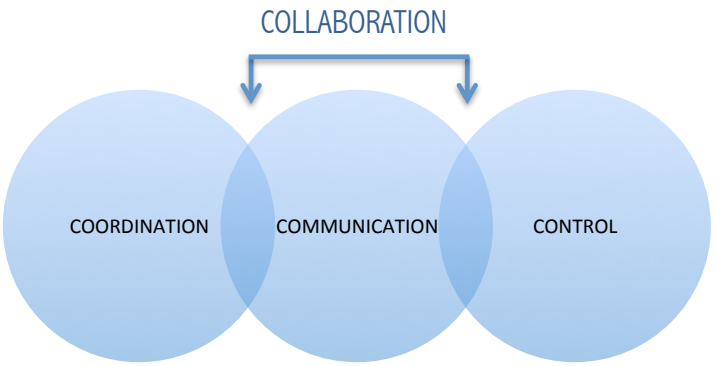
Project communication is the exchange of information between two or more people where the purpose is purely informational. As a project unfolds, initial assumptions about task durations, staffing levels, team member availability, risk assessments, etc., are bound to fall short of reality. This is quite normal. In fact, a good project manager recognizes that all project plans are essentially out-of-date the day after they're conceived. People get sick. Bad weather strikes. Mistakes are made.

An unprepared project manager will rush back to the drawing board, reworking initial assumptions again and again, in a futile attempt to keep up with this parade of changes. A well-prepared project manager, by contrast, will do the following:

- Anticipate such eventualities and factor them into the original plan
- Maintain contingency plans (e.g. identify back up resources for key project roles)
- Reassign resources temporarily to address a backlog

The well-prepared project manager will use effective and open communications to identify and explain these circumstances in a timely manner. Open lines of communication ensure that everyone involved in a project is up-to-speed on new developments, aware of the impact these developments may have on dependent or related tasks, and fully engaged in the process of finding solutions.

10.4 Project Collaboration



Collaboration occurs when two or more individuals work together to achieve a common objective. In the context of a project, collaboration sits at the intersection between coordination and communication, and communication and control. It is a *bidirectional* process, part of a continuous feedback loop that balances the importance of individual responsibilities with a project's overall objectives.

In this context, collaboration is connecting the right people with the appropriate information to produce a common deliverable. Examples of common deliverables are the development of an idea, the creation of a design, the writing of a proposal, the editing of a document, or any other common goal of the collaborating team. Collaboration closes the coordination, communication, and control loop by returning and receiving vital feedback to/from project team members in a timely manner.

10.5 Project Control

All project managers face constraints when executing assigned projects. Some of these constraints are unplanned and undesirable (e.g. an unexpected lack of resources due to illness, scheduling conflicts, etc.), while others are imposed intentionally by the project sponsor to protect his or her original investment objectives.

Voluntary constraints (a project's scope, budget, schedule, and quality requirements) form important boundaries for the project team, by defining the four corners of the *playing field* within which they must operate. Each boundary, or parameter, is interrelated. Changing one will almost certainly have an adverse impact on one or more of the others. For example, a change that expands the scope of a project may have the following impact:

- Increase costs, which jeopardizes the budget
- Increase the project team's workload, thereby jeopardizing the schedule
- Force a faster pace for development, potentially jeopardizing quality

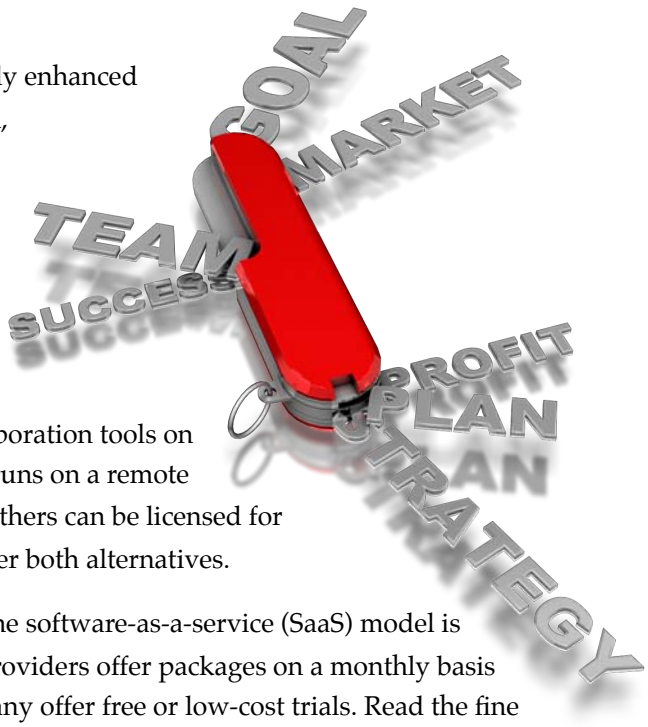
Involuntary, unplanned constraints are *risks*. Project risks that are foreseeable (change requests, for example) should be identified and addressed in a project's business case (see Chapter 7), while proposed remedies or countermeasures should be outlined in the project charter (Chapter 8). Unforeseen risks must be managed as they arise.

The processes used by a project manager to monitor a project's performance against the defined parameters for scope, budget, schedule, and quality — and to manage any risks that threaten to derail them — are known as project controls. Since risks appear in every project, these controls should be defined in your project management methodology, and the tools used to implement them should be included in your project execution toolkit.

The following are important elements of project control:

- **Risk management** — tracking the status of identified risks (documented in the business case and project charter) and mitigation efforts, as well as encouraging project team members to report any signs of emerging threats to the project's success
- **Quality management** — reviewing work product deliverables to ensure that established standards are maintained
- **Resource optimization** — reassigning and/or supplementing existing resources, as necessary, to keep a project on its planned trajectory and schedule
- **Procurement management** — approving or denying requested expenditures
- **Project reporting** — summarizing progress, expenses vs. budget, and risk status in preparation for the next phase gate meeting with a project's sponsor

10.6 Toolkit



Collaboration within a fast-paced project is greatly enhanced when real-time, cloud-based project coordination, communication, and control technologies are made available to all members of the project team. Internal systems that are inaccessible to external resources or only available through a slow VPN (virtual private network) connection should be avoided.

Software options are abundant. Most of the collaboration tools on the market are offered as a service (the software runs on a remote server managed by the service provider), while others can be licensed for installation on your own servers. A select few offer both alternatives.

If you're not already using a collaboration tool, the software-as-a-service (SaaS) model is an attractive option to consider. Most software providers offer packages on a monthly basis with no long-term commitment required, and many offer free or low-cost trials. Read the fine print carefully to make sure you understand how monthly charges are calculated; it doesn't make sense to waste time or money on a trial product that doesn't fit your requirements.

Locally installed software has advantages as well. In most cases, you'll have more options available to configure the software to the specific needs of your organization, and you'll retain control of your data at all times (the project collaboration software marketplace is quite volatile). Look for a tool that is modular (core features can be supplemented with optional, add-on modules) and well supported. Check support forums, if available ... you'll get a sense of the product's stability and the company's commitment to resolving bugs that invariably arise.

Whether you're leaning toward a self-hosted or leased (SaaS) solution, the following features should be considered essential for business development project collaboration:

Task Management Capabilities

Collaboration requires both structure and flexibility. A *to-do* list may be just the ticket for keeping track of personal activities, but it doesn't provide the context needed in a collaborative environment, where each individual's tasks are an integral part of a larger plan. At the other end of the spectrum, top-down tools that can only be updated (or understood) by the project manager, don't provide the flexibility needed to deal with changes quickly.

An effective multiuser task management application should include these capabilities:

- Support the original work breakdown structure
- Present that structure in a manner that is easily understood by users
- Allow project team members to insert, assign, edit, and remove tasks and subtasks without impacting the overall project schedule
- Display important information about each task … assignee, task description, estimated effort (hours), scheduled start date, estimated duration (days), predecessors, status, etc.
- Allow project team members to discuss tasks and share related files
- Enable automatic notifications... new assignments, status updates, etc.
- Provide a personalized task list for each team member

Communication Channels

Project communication occurs in many forms: Quick status updates, lengthy debates over specific aspects of the project's development, formal and informal discussions, etc. A project collaboration tool that offers multiple channels for ad hoc communication, and the ability to schedule formal team meetings, will greatly simplify the collaboration process.

These useful communication features for project team collaboration should be included:

- Chat/presence
- Commenting capabilities
- Threaded discussion forums
- Project activity subscriptions and reminders
- Audio/video conferencing capabilities
- Electronic white boards

Project Control Features

Effective project control requires real time management of the scope, budget, scheduling, and quality of the project teams efforts. These factors must be clearly visible to the project manager:

- **Scope** — A project's scope must be clearly defined in the project charter. This won't matter, however, if the project charter is not readily available within the project execution environment. Look for a tool that places the project charter and other important project information in a prominent location within its navigation interface.
- **Budget** — Time and expense tracking tools that allow direct entry by project team members are an invaluable aid to the project manager in his or her effort to maintain control over expenditures. The ability to attach electronic copies of vendor estimates, invoices, receipts, and other expense related records is a useful capability, as are item-level discussion tools for requests and approvals, and automatic email notifications sent to the project manager when new expenses or expense requests are submitted.
- **Schedule** — Activity schedules are never set in stone. Reality — in the form of unplanned project constraints — always intervenes. A good project execution platform should anticipate this reality and provide project managers with simple tools for modifying activity schedules. Ideally, the rescheduling of activities within a phase will *not* automatically alter the phase's target completion date.
- **Quality** — In the context of a strategic business development project, quality is the measure of each deliverable's ability to fulfill its intended purpose. A *high* quality project deliverable meets or exceeds the sponsors requirements, while a *low* quality deliverable falls short of the stated requirements. A good project execution toolkit will provide — at minimum — a checklist of project deliverables. After all, a missing deliverable can't fulfill the sponsor's requirements! A workflow approval process that imposes quality checks prior to the release of a deliverable is a very effective function.

Document Management Features

The availability of online tools for co-authoring and editing of project documentation and deliverables will help streamline an otherwise tedious and time-consuming process. Likewise, a centralized document repository where project team members can upload and download the latest versions of documents in common formats (pdf, docx, doc, pptx, ppt, xlsx, xls, jpg, png etc.) will prove very useful over the course of almost any project.

Integration

The capabilities available to project managers from today's software — from planning to coordination, communication, collaboration, and control — are both powerful and efficient when integrated effectively. The combined capabilities are the functional equivalent of the difference between a wrench and a power tool or a bike and a car.

So take the time to research your options. A well-stocked project execution toolkit can dramatically reduce the cost, time, and risk involved in executing strategic business development projects, and will pay for itself many times over.

CASE IN POINT

Successful execution of business development projects on a consistent basis requires coordination, communication, and control.

With a well-conceived project plan and a complete project team in place (all necessary skills and experience levels are represented), the final and most difficult step is project execution. Successful execution of projects on a consistent basis requires close coordination, open lines of communication, and careful control of risk factors and available resources.

The *MIT Sloan Management Review* published an excellent article titled "What Great Projects Have in Common" in the Spring of 2011[1]. After a decade of research and the analysis of over four hundred projects, the authors identified seven common characteristics of great projects:

1. A great project involves creating a unique competitive advantage and/or an exceptional value for its stakeholders.
2. These projects began with a long period of project definition that was dedicated to defining a powerful vision with a clear need and selecting the best execution approach.
3. Great projects create a revolutionary project culture. The execution of great projects often requires a different project culture, which can spread to an entire organization.
4. A great project needs a highly qualified project leader who is unconditionally supported by top management.
5. Great projects maximize use of existing knowledge, often in cooperation with outside organizations.
6. These projects have integrated development teams with fast problem-solving capabilities and the ability to adapt to business, market, and technology changes.
7. Great project teams have a strong sense of partnership and pride.

In addition to validating our strategies and processes, these seven characteristics are a great leadership guide and checklist for the project team as they battle the realities of project execution. Well executed projects are truly a collaborative effort, and can be major drivers of organizational change and competitive leadership.

1 "What Great Projects Have in Common" — Dov Dvir and Aaron J. Shenhar, MIT Sloan Management Review Magazine, Spring 2011.

Glossary

Acquisition

A term that is used when a company buys most, if not all, of another target company and assumes ownership and control of the target organization.

Amortization

Refers to the expensing of acquisition costs minus the residual value of *intangible* assets, such as patents and goodwill as determined by IRS rules.

Analytical hierarchical process (AHP)

A structured set of criteria applied consistently, in progressive steps, to measure potential outcomes from different but similar activities.

Asset utilization

Measures the effectiveness of an organization's investments, and the effectiveness of its efforts to manage short- and long-term assets over time.

Balance sheet

Financial summary of the assets, liabilities, and equity of the business. A balance sheet represents what is owned by the business and what is owed by the business, providing a snapshot of a business's financial position at a specific point in time.

Bandwidth

Available capacity for performance of project related activities.

Benchmarking

In the context of strategic business development, benchmarking is the process of comparing a business's processes and performance metrics against top performers in a specific industry or market segment, or against top performers regardless of industry.

Best practices

Generally accepted, formally and/or informally standardized methods, procedures, and processes for performing a specified function or process. By definition, best practices are proven to be superior to previous, less successful alternatives.

BrandPower

A breakdown of the measures used to determine a business's brand strength, as determined by its ability to deliver and sustain value propositions made to customers in a chosen market.

Business case

A document that summarizes the reasoning/justification for initiating a business development project.

Capital expenditures (CAPEX)

Money spent to acquire or upgrade physical assets such as buildings and machinery.

Capital structure

The ratio of equity vs. debt investors of a business. The higher the ratio of debt to equity, the higher the leverage of the equity investors.

Closed loop process

A closed loop is one in which feedback is received from the output and compared to a set point. Action is then taken to adjust the process to the set point.

COBRA

An acronym used to define the operational performance of a business. Cost of goods sold, Operating expenses, BrandPower, Revenue growth, and Asset utilization. This measure of operational performance helps a business identify structural strengths or weaknesses that may ultimately impact financial performance, thereby enhancing or reducing a business's ability to create value for investors.

Collaboration

The act of working with others toward a common objective.

Commodity

A product or service that is supplied without noticeable differentiation across market(s).

Competitive advantage

A characteristic (or group of characteristics) that distinguishes one product, service, or company as superior to others in a given market.

Competitive benchmarking

Continuous process of comparing a firm's practices and performance measures with that of its most successful competitor(s).

Competitive moat

Decisive efforts taken to protect a winning strategy. Successive layers of defense make it more difficult for competitors to mimic, duplicate, or supersede a business's success.

Compounded annual growth rate (CAGR)

Measures the year-over-year compounded growth rate of a market or investment.

Constraint

Any variable (known or unknown) that may have an impact on a project's desired outcome. Voluntary constraints (scope, budget, schedule, quality requirements) are desirable. Involuntary constraints pose a risk.

Cost of goods sold (COGS)

The direct material, labor, and factory overhead costs that go into the manufacture and delivery of a product or service.

Critical path

A critical path is the sequence of project activities that adds up to the longest overall duration. This determines the shortest time possible to complete the project.

Culture

A shared set of ideas, beliefs, attitudes, values, norms, and expectations within a specified group (business sector, industry, organization, division, or department).

Customer relationship management (CRM)

A way for a business to manage all aspects of their relationships with customers (current and future) whether they are sales or service related.

Dead money

A business that consistently generates a lower return on invested capital than its weighted average cost of capital.

Debrief phase

The final phase of a project. The debrief phase begins when all project objectives have been satisfied. Project team members typically meet to discuss lessons learned and (hopefully) celebrate the success of their efforts, after which the project manager can dismiss resources and close out the project. Remember to record lessons learned each time you close out a project … they will add to the project knowledge base moving forward.

Deliverables checklist

A document that describes the tangible output(s) for each project milestone. In other words, the steps you take (tasks) to arrive at each significant objective or stage of development (milestone) should always result in a deliverable.

Deployment phase

After a proposed solution has been developed and tested internally by the project team, it is ready for *deployment* to specified end users. The deployment phase encompasses all of the steps taken to transition a solution into broader circulation and use.

Depreciation

Refers to expensing a certain portion of the value of *tangible* fixed assets to the income statement each year. Essentially it is an annual allowance for the wear and tear, deterioration, or obsolescence of the property as determined by IRS rules.

Design phase

The first phase of a project. The design phase is used to elaborate upon the preliminary project descriptions and documentation provided with the project's business case, and to assemble, develop, and/or verify important background or baseline information prior to onboarding of additional resources. Attempts should be made to validate or disprove all assumptions made during the development of the projects business case before moving on to the next steps.

Development phase

The development phase encompasses all activities related to the design, specification, and completion of a solution proposed in a project's charter, including internal (project team) testing to ensure that project objectives have been met.

Direct competitor

A company that offers substantially similar goods or services within a specific market.

Disruptive

A business strategy that disrupts the normal basis for competition in a market with a non-linear solution.

Divesture

Partial or full disposal of an asset or organization that is not performing well, in order to fulfill a desired business objective.

EBITDA

Earnings Before Interest, Taxes, Depreciation, and Amortization. EBITDA is essentially the operational profitability of a business without including cost factors that can vary depending on a business's capital structure, taxing jurisdiction, or investment situation/requirements.

Economic profit

Economic profit is essentially the difference between the actual return on invested capital and the weighted average cost of capital.

Embedded knowledge

Knowledge that can be *packaged* and transferred for the use and benefit of others. This includes public knowledge (available through research) and proprietary knowledge (such as software).

Empowerment

The extension or sharing of power, trust, and responsibility with employees of an organization so that they are motivated to work aggressively for the good of the organization. Empowered employees identify with the organization and tend to have a strong bond and sense of ownership of the business.

Enterprise resource planning (ERP)

The process of managing information across all functions of an organization … typically facilitated by the use of one or more integrated business management software applications.

Food chain

A concept that is used to represent the flow of products through various intermediate channels to the eventual end user. Food chain can also be used to refer to the served markets of the business.

Income statement

A summary of the annual flow of transactions from a business's customers into the business and then on to the business's suppliers. An income statement essentially captures the volume of dollars flowing through the business.

Innovation

The process of translating unique ideas or inventions into marketable goods and services.

Intellectual property

Any creation of the mind that an be legally protected by patent, trademark, or copyright.

Key performance indicators (KPIs)

Performance metrics designed to evaluate success against established benchmarks.

Learning curve

A graphical representation of the rate of change in the time it takes to perform a given activity the more times it is performed.

Market capitalization

The total value of the issued shares of a business. It is equal to the number of shares multiplied by the share price.

Mega trends

Global, sustained, macro economic forces that impact businesses, economies, society, cultures, and personal lives, thereby defining our future world and its increasing pace of change.

Methodology

The use of specific practices, procedures, and rules to solve a specific problem or issue. In business, there are many methodologies used depending on the industry and process.

Mission statement

A brief summary of an organization's purpose. A well-crafted mission statement articulates what a business is trying to achieve and why it's possible.

MRP

Materials requirements planning or manufacturing resource planning.

Negative feedback loop

Continued negative feedback/resistance impeding the performance of the business. A negative feedback loop drives underperformance.

Net operating profit after tax (NOPAT)

A business's after-tax, calculated operating profit.

OCAI

Organizational Cultural Assessment Instrument.

Onboarding

Methods, procedures, and processes through which new employees acquire the necessary knowledge and skills to become effective team members.

Operating expenses (OPEX)

All the indirect costs a business incurs during the specified time period. These costs support all activities needed to market, sell, service, purchase, invoice, insure, and otherwise continue the operations of the business.

Organic Growth

The process of growing a business by leveraging *existing* capabilities, compared to growth through acquiring new capabilities using mergers and acquisitions.

Original equipment manufacturer (OEM)

A company who purchases components from multiple sources and assembles them into a final product, and re-markets them under its brand.

Overhead

Ongoing, indirect costs necessary to support direct operations.

Phase gate

An approval checkpoint requiring project sponsor approval to proceed. Phase gates should occur at the end of each project phase.

Project charter

A document that defines the nature, objectives, stakeholders, scope, budget, schedule, and quality requirements for a project. Once approved, the project charter serves as a focal point to keep everyone on track for the duration of the project.

Project control

The process of monitoring key project parameters (scope, budget, schedule, and quality requirements) and managing or mitigating any risks that threaten to derail them (force a deviation from established benchmarks).

Project description

Brief summary, or *elevator pitch*, of the project. The project description should succinctly identify the problem you are solving or the opportunity you are seeking to exploit.

Project documentation

Documentation requirements should be clearly defined in your chosen project methodology. Therefore, there will be a standardized set of templates for project documentation that can (and should) be used for all future strategic business development projects. These should include the business case, project charter, and deliverables checklist.

Project management methodology

A standard sequence of common practices and procedures that guides project activity.

Project manager

The person who is appointed to coordinate and oversee all project activities; this person may either be internal or external to the organization.

Project sponsor

A high-ranking representative for the principle beneficiary of a project's intended outcome. A project intended to improve sales force efficiency, for example, would primarily benefit the sales department … and should be sponsored by the sales manager.

Quality

The degree to which a project (or deliverable) fulfills its intended purpose.

Return on invested capital (ROIC)

A calculation used to determine how well a business is using its capital. ROIC gives a sense of how well money is being used to generate returns for both stock and bond holders.

Return on investment (ROI)

An accounting of benefits accrued to an investor through a specific investment activity, or to a series of activities performed within a specific time frame.

Revenue

Income that an organization receives over a specified period of time from its normal business activities: the sale of products or services.

Risk

An involuntary constraint that may have a negative impact on a project's scope, budget, schedule, or quality requirements.

Risk management

The process of identifying and assessing project risks to identify high probability/high consequence situations. Risk management should begin before a project reaches the planning stage and continue throughout the project execution process.

SaaS

Software as a Service.

Served market

The segment(s) of the total market that an organization actively attempts to serve.

Six Sigma

A methodology that focuses on a measure of quality that is near perfection. Six Sigma is a data-driven approach that is meant to eliminate all defects; any defect outside of customer expectations is considered a Six Sigma defect.

SMART

An acronym representing well-defined project objectives: Specific, Measurable, Attainable, Realistic and Timely.

SMBs

Small and midsize businesses.

Stickiness

Qualities of a product or service that positively influence repeat purchase decisions. Customers influenced by such qualities are less inclined to switch to competing products or services.

Strategy

A high level plan that is used to obtain a position of advantage over counterparts; a strategic advantage is necessary in a business sense to outperform competitors.

Subprocess

The set of task level processes that make up a business or operational process.

Sustainability

A characteristic that portrays the ability to succeed over time through implementation of good business practices and a successful business strategy.

SWOT/D

An acronym that is used to describe a proven way to frame the major issues facing a business (strengths, weakness, opportunities, threats, and disruptive forces).

Value proposition

A promise of value made to customers and potential customers. The value proposition explains why a consumer should buy a product, or use a service, instead of other similar market offerings.

Virtual intellectual property

An asset that may not be legally protected, but is nonetheless unique to the market in some way.

Virtuous circle

Continued positive feedback that is constantly reinforced, thereby enabling maximum performance.

Vision statement

A declaration of an organization's aspirations, worded from the employees' perspective. A good vision statement motivates an organization to work toward a defined legacy, with intrinsic value, that will extend beyond the tenure of any individual.

VPN

Virtual Private Network.

Weighted average cost of capital (WACC)

The rate that a company is expected to pay, on average, to all its security holders to finance its assets.

Winning strategy

A plan to acquire, develop, and preserve a competitive advantage in one or more profitable and/or growing served markets with a clearly defined value proposition. Must be supported by operational capabilities that can sustain and defend the desired market position.

Work breakdown structure (WBS)

A multi-user task list that outlines what every participant in a project is responsible for completing throughout the duration of a project.

Working capital

The cash available for day-to-day operations of an organization … essentially the business's short-term financial resources.

BUSINESS & INVESTING

What you do today, when you don't HAVE to do anything, makes you what you want TO BE three years from now ... when it's too late to do anything about it!

In the midst of all that's required to keep things running smoothly, it is easy for the managers and owners in a small or midsize business to lose sight of long-term objectives, and quite difficult to find the time for planning, staffing and execution of projects that can address emerging threats and opportunities. As business owners and managers ourselves, the authors of this book have been there. We learned to recognize the direct link between past successes and the forward planning efforts that made them possible, and wished for a straightforward, practical, repeatable approach to the process.

Thus began a three year journey to identify, organize, streamline and document the essential ingredients of "strategic business development" from a small or midsize business owner's perspective. The process was enlightening, and the result ... well it's in your hands ... enjoy!

"Clearly explains the key ingredients for long-term success in a small to midsize business."

James Stossel
Investment Advisor,
Woodbury Financial
Services

"Distills the strategic business development process into understandable steps and presents them using a 'How To' approach that takes all the mystery out of the process."

Steve Copp
President and CEO,
TCI, Inc.

"Practical, actionable guidance for the entire management team."

Bob Godfrey
President,
BizTech Management
Consultants

About the authors …

Francis X. Livingston is a University of Pennsylvania alumnus. After completing Westinghouse's Graduate Engineering program, Fran held sales, engineering and management positions at Westinghouse, followed by an appointment to the White House Executive Exchange Program as Special Assistant to the Secretary of the Army. Returning to the private sector, Fran held senior management positions at Westinghouse, AEG/Daimler, Siemens Electrocom and Benshaw Corporation. During his ten year tenure as CEO, Benshaw grew from $14M (– $1.6M EBITDA) to $100M in sales, and was eventually sold for $105M. Fran currently provides management consulting services for SMB clients worldwide and is the founder of Project Execution Network, a professional services automation startup.

Amber M. Alke joined the Red Bull Marketing team while earning a bachelor's degree from the University of Pittsburgh. Amber held positions in beverage marketing and distribution sales management before returning to school for her MBA. Amber holds professional certifications in online marketing, cultural benchmarking and contingent workforce management, and currently works with Project Execution Network as Director of Marketing and Sales.

George J. Stewart is an alumnus of Clarion University and President of Stewart Communications, Inc., a corporate/marketing communications consultancy serving FORTUNE Global 500 clients. George also serves as President of Carnegie Printing Company (a fifth-generation graphic design, printing and fulfillment business), Secretary/Treasurer for Motivation Associates, Inc. (a promotional products distributorship) and Chief Technology Officer at Project Execution Network.

Publisher:
Project Execution Network LLC

FIRST EDITION