CHAPTER 1

Business Planning and Market Strategy in a Nutshell

Business is a good game—lots of competition and a minimum of rules. You keep score with money.

—Nolan Bushnell

[P]lanning is necessary precisely because we cannot forecast.

—Peter F. Drucker

Most firms plan, but few firms have yet mastered strategic market planning.

—Derek F. Abell and John S. Hammond

Firms come in many shapes and sizes. Some are global titans, while others are minuscule startups that have yet to make a sale. And while some companies concentrate on a single line of goods or services, others diversify. Utah Woolen Mills, for example, is a humble single-outlet retailer, mostly of fine clothing for men and women. Yamaha, in contrast, is a giant conglomerate whose various business units make and market motorcycles, snowmobiles, watercraft, audio equipment, musical instruments, and more.

In everyday language, a business is any enterprise that strives to earn a profit. But in the vernacular of strategic management, a business is a venture that has the following characteristics:

1. Its activities focus on a single type of good or service, which may be defined narrowly (e.g., pianos) or broadly (e.g., musical instruments).

2. It operates for profit, usually in a competitive market or industry.

3. It is managed by an executive who is empowered to make major decisions and is held directly accountable for financial performance.
4. It operates independently or is readily capable of it.

Accordingly, a single business may constitute an entire company, such as Utah Woolen Mills; or it may be one of several *strategic business units (SBUs)*, such as Yamaha's musical instruments division, that form a multi-business corporation.

Box 1-1

Is Netflix One Business or Two?

Whether a business venture is best defined broadly or narrowly is not always clear. Broad business definitions reveal commonalities among various offerings and activities; narrow definitions highlight differences.

Netflix, for example, can be defined broadly as a business that obtains and distributes entertainment content, such as movies and television shows, to its customers, or subscribers. The company's traditional business is renting movies on DVD by mail, but its video streaming service has grown so much that it now accounts for much of Netflix's revenue.

Even though both services can be described as centering on acquiring and distributing entertainment content, almost everything about DVD rentals by mail differs from video streaming. For instance, copyright laws affect the two businesses very differently, and the distribution capabilities required have little in common. Consequently, defining DVD by mail and video streaming as distinct businesses works best for most planning and other managerial purposes.

Nevertheless, the two services do have something in common and do enjoy some competitive advantages that would have been lost had Netflix sprung up as two independent companies. Therefore, looking at DVD rentals and video streaming as separate businesses first and as one afterwards seems most informative and useful.

Most planning tools and guidelines introduced in this book apply as much to the business units of multi-business firms as they do to independent businesses. Moreover, they apply equally to established enterprises, ideas for brand new startups, ventures on the frontiers of technology, and lines of commerce that have endured for centuries. In large part, they also apply to not-for-profit organizations that compete for customers they call voters, patients, donors, students, or the like.

Executives who want to grow their businesses usually have a few ideas about moving forward. Often, they sense opportunities to use their business' distinctive capabilities or strategic assets as springboards for expanding a product line or entering a new market.

Netflix cofounder Reed Hastings, for example, recognized both the opportunity and the threat that video streaming posed. He sensed that, just as Netflix's DVD-by-mail service had largely displaced video rental stores, video streaming could supplant DVDs by mail and, perhaps, DVDs altogether. Accordingly, Hastings used streaming technology to add video on demand (VOD) to Netflix's offering. By that time, Netflix had accumulated two very important leverageable assets: a well-known brand name and a customer base of several million readily accessible subscribers. Branching out into VOD looked like a no-brainer; nevertheless, VOD may yet be the end of Netflix.[1] More about that later.

As is typical of entrepreneurs, Reed Hastings had some fascinating ideas he had to pursue: first, DVD rentals by mail; then, VOD. Intriguing ideas also drove Walmart's Sam Walton and Dell's Michael Dell to found their companies. Mr. Walton, an observant former J.C. Penney employee, felt compelled to give discount retailing a try in small-town America. Mr. Dell, in contrast, was a passionate computer whiz who, as a teenager, discovered he could build three PCs for the price IBM charged for one. Soon after graduating high school, he set out to challenge the global giant IBM.

Occasionally, eager entrepreneurs search for business ideas knowing only that they want to be entrepreneurs. If you are among them, look for opportunities to better serve people or organizations whose needs or preferences are not satisfied by available offerings. Alternately or additionally, look for ways to compete on price, as Sam Walton did, without sacrificing profits or compromising performance.

Much good advice for discovering business opportunities resides on the web. To find it, just search for *generating business ideas*. Neal Lurie's posted advice, for example, includes the following:[2]

- Reflect on what you love doing and what you understand much better than most people. After that, ponder the kinds of businesses that would enable you to pursue your passions profitably and use your expertise to gain a market foothold.
- Think about problems you have encountered to which you found no satisfactory solution. What kinds of gizmos or services have you looked for that you could not find?
- Which of your gizmos and gadgets should be easier to use or be more useful?
- Think about applying a successful business idea in new ways or in new places. For instance, so-called big-box stores are all based on the same general idea: Buy in volume, minimize frills, and pass a portion of the savings on to customers. This idea has been applied to home improvement products (Home Depot and Lowe's), office supplies stores (Office Depot, Office Max, and Staples), home entertainment and electronics (BestBuy), and more. Further, the big-box business model closely resembles Kmart's, Walmart's, Costco's, and Sam's Club's. Although many big-box chains now clash head on, most began in different geographic markets and expanded until they ran into each other.

Box 1-2

The Brick Clip®: A Simple Solution to a Simple Problem

To be successful, new products need not be complicated or solve complex problems. Take the Brick Clip®, for example. It solves a problem for people who want to hang the likes of pictures, wreaths, or Christmas stockings from brick fireplaces, but do not want to drill holes for hooks. The Brick Clip® provides an economical and very effective solution to their problem. As shown, the device can be clipped onto a brick with ease and can be moved or removed without leaving a trace. Millions of Brick Clips® have been sold.

Sources: http://www.google.com/patents/US4337915 and http://brickclip.com.

Give Neal Lurie's advice a try. If you do, ideas that pique your interests and stir your entrepreneurial passions should come to mind.

The ensuing chapters have much more to say about what to look for when searching for viable business opportunities. As you read them, keep in mind that, when it comes to launching or operating a business, much can be learned from books and need not be learned firsthand from experience. Learning purely from experience by trial and error often is unduly painful and quite unnecessary. Nevertheless, experience is invaluable both in running a business and in formulating a business plan, which is ample reason for writing one.

Even if you develop a business plan just for practice, you are apt to gain insights into critical aspects of market analysis, strategy, and business in general that you otherwise would miss. Because writing a business plan is among the most valuable learning experiences available to future executives and entrepreneurs, this book often refers to your venture, your plan, your strategy, and so forth with the expectation that you are, or soon will be, engaged in formulating a business plan.

This introductory chapter lays a foundation for the remainder of this book by answering the following questions:

- Why plan?
- What should business plans cover?

- What are some common types of business plans?
- How do corporate and business planning interact?
- What can you learn from this book that you may not learn elsewhere?
- What do the ensuing chapters cover?

WHY PLAN?

"Look before you leap" is good advice that captures the essence of planning. Although every business ends up competing somewhere somehow, many new ventures, as well as established enterprises, perish because too little thought was given in advance to the many factors and forces that underlie success and failure. Indeed, the business graveyard is littered with enterprises that fell victim to ill-conceived choices or drifted into oblivion like rudderless ships. This fact explains why institutions and individuals capable of providing capital generally insist on seeing a business plan before they will part with their money or approve funding.

Sound planning is the alternative to drifting. It entails envisioning a course of action, mapping it out, and justifying it with credible data, perceptive analyses, plausible assumptions, and cogent logic. A business plan is the product of planning. Although it may exist only in someone's mind, from hereon, consider it a document that serves as an organization's roadmap and tells readers why money needed to implement the plan will be well spent.

Organizations often value planning as much for the attention it focuses on key issues and the forum it provides for deliberation and debate as for the document it produces. Potentially:

- Planning helps reveal misconceptions before they become costly.
- Planning helps orchestrate effort throughout the organization.
- Planning keeps minds focused on the long run and deters short-sighted actions.
- Planning improves control by setting performance standards that indicate when corrective actions are needed.

Not every business needs a written business plan. For instance, you probably do not need one if your business consists of freelancing as a website developer. Your time would be better spent calling on prospective clients than on writing a plan. Nevertheless, you should contemplate strategies for poaching clients from rivals and acquiring clients not yet claimed by competitors. Keep your day job until you earn enough from freelancing to justify quitting.

Benefits from developing a written business plan tend to increase as money at risk increases. They tend to diminish with environmental volatility and scalability. Highly scalable businesses are flexible; they can be expanded and downsized easily in small increments, which generally means their fixed costs are low. For instance, an online business whose capacity depends predominantly on the number of its servers is much more scalable than one whose capacity can be altered significantly only by opening or closing entire manufacturing plants.

WHAT SHOULD BUSINESS PLANS COVER?

Securing funding is a business plan's paramount purpose in the minds of many entrepreneurs and executives. Consequently, business plans sometimes resemble promotional pitches that are strong on hyperbolic imagery, but weak on substance. They appeal more to emotion than reason, tend to be vague because they have not been thought through, and have the capacity to fool their authors as much as their readers.

Sound business plans are thorough and internally consistent, which means that all facets mesh. To attain perfect internal consistency, answers to critical planning questions may have to be tentative at first and revised later until all conflicts are resolved.

Even the most carefully considered plans sometimes are victimized by unforeseeable events. No amount of research and deliberation can change that. Still, a plan's chances of succeeding surely improve when the following questions are answered thoroughly and coherently with a keen eye on the future.

What Is Our Market Strategy?

Consider attaining and maintaining a prosperous fit between a business and its environment the aim of market strategy. Generally, competitive advantage and disadvantage in an ever-changing world should be the primary focal points of market strategy since they determine whether a business can or cannot compete profitably for customers. Market strategy must explain your venture's competitive rationale, including (a) why targeted customers will favor your offering in sufficient numbers to make your venture profitable and (b) what will prevent poachers from crowding you out of the marketplace.

Which Customers Comprise Our Target Market?

Target markets consist of the kinds of customers that a business tries to attract most of all. No enterprise can be all things to all people—not even Walmart, for example. Although Walmart gladly sells to the rich, the poor, and the middle classes alike, it certainly does not target everyone.

A business' target market may consist of multiple *target segments*, which are distinct submarkets within the chosen target market. Demographics and other criteria noted in Chapter 7 may be used to delimit target markets and target segments. However, market segmentation is rooted in the common observation that customers' needs, wants, and preferences tend to be diverse rather than homogeneous. Recognizing such diversity, therefore, is a critical aspect of segmenting markets and choosing target segments.

Your targeted customers should be the ones that your business can serve profitably and better than rivals can serve them. With this idea in mind, delimit the geographic bounds of your target market. These bounds might encompass no more a five-block neighborhood, or they might extend to the entire USA, North America, or even the world. Next, describe targeted segments vividly in terms of distinctive needs or preferences, demographics, lifestyle, or other variables that have strategic implications.

What Is Our Value Proposition?

Effective value propositions objectively answer the question, Why is buying from us best for our targeted customers? They reflect the buyer's, not the seller's, perspective and center on distinctive benefits that targeted customers value highly (e.g., BMW, the ultimate driving machine) or on benefits in relation to price (e.g., Lexus' affordable luxury). As you ponder your value proposition, focus on distinctive customer value and not on the finer details of selling and promoting your wares or services.

When a business' target market consists of multiple segments, the business may be well-advised to formulate an overarching value proposition that covers the entire target market, as well as value propositions tailored to fit each segment precisely. Of course, the individual value propositions must be perfectly consistent with the one developed for the entire target market.

What Is Our Business Model?

A business model explains the mechanics of the business—how the business creates value for customers and shareholders. The celebrated Dell Direct Model, for example, depicts Dell as generating revenues and profits by combining direct sales with mass customization and unparalleled inventory control.[3] Implementing the model entails allowing buyers to choose from multiple hardware options, building PCs to customer specifications, minimizing parts inventories by using just-in-time (JIT) inventory management, minimizing finished goods inventories by shipping PCs to customers as soon as they are assembled, and usually getting paid by customers before bills fall due for parts used to make PCs that have already been delivered and paid for.[4]

If you intend to open a pizzeria, for example, the questions you should answer as you model your business include the following:

- Will we operate independently or under a franchise agreement?
- How broad and how deep will our menu be?
- To what extent will we participate in creating offerings? Will we make pizzas from scratch or merely pop frozen pizzas in the oven?

Your business model must be congruent with your market strategy. Together, your strategy and business model should answer the question, Why will our venture succeed? Without a sound strategy and business model, plans are mere activity schedules, and goals are nothing more than wishful thinking.

What Market and Marketing Objectives Do We Seek?

Ambitious, yet realistic, aims with regard to revenue and profit growth, returns on funds invested in marketing initiatives and the business in total, customer satisfaction, and customer retention should be addressed in every business plan. Market share objectives should be addressed, as well, when market share is measurable.

What Is the Market Outlook?

Customarily, answers to this question focus on estimates of future market size, market share, and market growth. Deriving credible estimates can prove difficult and error prone. As a later chapter explains, it often is easier and quite sufficient to establish that the market affords ample profit potential. More important than forecasting is understanding competitive and other forces that drive market share, market growth, and market size.

How Will We Implement Our Strategy?

Strategy is useless until it is implemented. Implementing a strategy requires translating the strategy into executable activities and establishing a time line for completing the various activities. Figuring out what should be done, how it should be done, and when it should be done is no easy task.

What Resources Will We Need?

Business plans cannot be implemented without money. Therefore, itemized estimates of how much money is needed for the likes of facilities, equipment, inventory, and day-to-day operations must be included in business plans.

What Financial Results Can Be Expected?

This question should be answered by well-supported financial projections of revenues, costs, profits, and cash flow. How long the business will have to be in operation before it generates enough cash to recover all the money invested in the business is the *payback period*. It should be estimated and noted.

How Will Progress and Performance Be Monitored?

Internal and external providers of funds needed to implement business plans demand accountability. They want to know whether actual results measure up to expectations. When results fall short, accountable executives will want to know where the problems lie and what can be done to correct them.

WHAT ARE SOME COMMON TYPES OF BUSINESS PLANS?

Business plans may be written purely for internal purposes or for external purposes, such as getting a loan or attracting investors. They should sell without overselling, which means they should be compelling, yet realistic. Common kinds of business plans include the following:

- ***New venture startup plans***, which chart courses of action for businesses not yet launched and explain attendant strategies and business models.
- ***Routine annual business plans***, which extend the current annual plan without advocating major changes to the business model or strategy. They are most appropriate for successful enterprises operating in stable environments.
- ***Orienting plans***, which are for established businesses that do not have a current written business plan.
- ***Expansion plans***, which address extending an established business' geographic scope, customer scope, product scope, or the like. Usually, they should portray the incremental impact of expansion on the business and address how the business' resources and capabilities will be leveraged.

All business plans propose courses of action and include projected financial results. However, well-constructed business plans do not merely note what is to be done, but also explain why proposed actions are sound and what is needed to carry them out.

HOW DO CORPORATE AND BUSINESS PLANNING INTERACT?

In the managerial literature, *corporate* refers to the top echelon of a multi-business firm, even though not all multi-business firms are corporations in the legal sense. Corporate planning centers on managing the corporate portfolio of businesses, which entails choosing the businesses that make up the firm and allocating resources. Thus, corporate plans may call for purging the corporate portfolio of some businesses and for acquiring or developing other businesses.

Synergy is the usual motive for getting into multiple related businesses. Synergy is realized when businesses or products generate more profit jointly than they would collectively if they were independent. Often, it results from sharing development or distribution costs or a trusted brand name. For instance, the cost of developing laser technology might be shared by two very different businesses, such as home entertainment systems and commercial precision cutting systems.

Many brand names, including Apple, are exceedingly valuable synergetic assets. Developing them often is expensive and may require huge media outlays. Although such outlays can be allocated to specific businesses and products, every dollar spent promoting the iPad, for example, also promotes the iPhone, and vice versa.

Diversification into unrelated businesses may reflect limited opportunities to expand current businesses profitably. However, at times, conglomerate diversification is spawned by questionable interpretations of financial portfolio theory and the dubious premise that it increases the value of a company's stock by reducing risk. Some fluctuations in earnings among the individual businesses in a highly diversified portfolio tend to cancel out so that overall corporate earnings are more stable. Nevertheless, that venturing into unrelated businesses increases stock prices is mostly wishful conjecture.[5]

Interesting and challenging as corporate planning is, our concern is with formulating market strategies and business plans for both independent enterprises and corporate business units. The main difference between developing plans for independent businesses and developing plans for corporate business units is this: Plans for corporate business units must resonate with higher management.

In multi-business firms, corporate-level executives evaluate plans, including requests for funding, as if they were proposals. Further, top executives have the power to impose goals and constraints on business units. The extent to which they exercise that power varies greatly. In some corporations, the heads of business units are given free rein. If the businesses in their charge fail to meet expectations, they are sold as if they were underperforming stocks. In other corporations, criteria for evaluating business plans and parceling out financial resources derive directly from corporate goals. Common considerations include apparent synergy, impact on other business units, and expected returns on investment in light of risk.

WHAT CAN YOU LEARN FROM THIS BOOK THAT YOU MAY NOT LEARN ELSEWHERE?

Developing a business plan enables you to test the soundness of your ideas about launching a new venture or moving an established business forward. The price of such testing generally is much less than the price of a trial-and-error education. Many conceptual flaws can be spotted and corrected while planning and, hence, before much money is wasted. Further, planning provides a sense of direction for moving forward. Even highly experienced executives and entrepreneurs have much to gain from planning.

In business, planning serves much the same purpose as charting a route on a roadmap before driving from coast to coast. You could begin your trip simply by driving away from the ocean, hoping you will not get lost or run out of fuel on some deserted byway. But most people would derive comfort from mapping out a travel plan before heading out. Of course, making plans does not mean plans should ever be followed blindly. Adapting, modifying, and even completely revising a plan should never be ruled out. Overlooked facts and facts that could not have been known in advance of implementation always arise as the future unfolds. Ignoring them is stupid.

This book portrays effective business plans as proposals that must be backed by compelling evidence and coherent explanations to gain acceptance. It is a guide to seminal questions and perceptive answers. It is not among the many readily available planning cookbooks and templates that aim to make business planning child's play.

Instead, it provides guidelines for making your business plan sound and useful. If you are eager to see what a good business plan looks like, glance at the appendix near the end of this book.

The chapters that follow tell you not only what to look at and do, but also what to look for. The difference between looking at and looking for is not trivial. Consider a puzzle, like Sudoku. Until you learn what to look for, a Sudoku matrix is just a perplexing array of scattered numbers and blanks.

WHAT DO THE REMAINING CHAPTERS COVER?

In many business textbooks, planning is relegated to a single chapter or an appendix. In this book, it is the centerpiece and the common thread that runs through every page. As you progress through the book, your understanding of business plans, market strategy, and effective planning will deepen. An overview of each remaining chapter follows. These chapters are not intended to provide step-by-step planning instructions. Instead, they are intended to explain the nature of effective planning, highlight critical matters that should be addressed, and offer useful advice for sorting through critical issues and options.

Chapter 2: Market Strategy: The Business Plan's Cornerstone clarifies the meaning of market strategy and the nature and importance of sustainable and durable competitive advantages. It also explains several kinds of strategies and corresponding advantages.

Chapter 3: Devising a Business Model provides systematic guidelines for answering the questions, How does this business work? How does it create value for customers and shareholders?

Chapter 4: Getting a Handle on Costs and Financial Prospects outlines how the cost of implementing the business model can be estimated. It addresses both capital expenditures for the likes of facilities and equipment and operating expenditures incurred in day-to-day operations. Additionally, it explains how such cost estimates can be used to conduct a preliminary analysis of a venture's feasibility.

Chapter 5: Strategic Business Planning from Top to Bottom centers on translating strategy into executable tasks and activities. The chapter also explains functional planning, its role in overall business planning, and the relationship between strategy and tactics.

Chapter 6: Managing the Planning Process likens formulating a business strategy to developing a theory about how and why a venture will prosper. Further, it makes clear that, while effective market strategies cannot be cooked up on demand by following a recipe, you need not wait helplessly for inspiration out of the blue. The chapter also notes common planning pitfalls and offers advice on averting them.

Chapter 7: Creating Shareholder Value by Creating Customer Value is the first of several chapters that extends topics introduced earlier. Chapter 7 revisits creating value for shareholders and customers, valuing customers, and choosing target segments.

Chapter 8: Situation Analysis Concepts and Frameworks provides a concise overview of situation analysis and explains its two mainstays, internal and external examination. Additionally, the chapter introduces offensive and defensive strategic probing and outlines several concepts, frameworks, and tools that facilitate portraying, understanding, and evaluating the strategic landscape. Done well, situation analysis facilitates engineering and maintaining the best possible fit between the business and its environment.

Chapter 9: Reporting Situation Analyses offers guidelines for reporting findings effectively. Its centerpieces are two illustrative situation analysis reports that focus on Netflix's video on demand (VOD) business.

Chapter 10: Coping with Uncertainties conveys useful advice about identifying critical uncertainties and taking them into account when planning. It contrasts forecast-driven planning with scenario-based planning.

Chapter 11: Projecting Financial Results and Needs introduces a simple template for encapsulating your plan's financial implications. Getting the funding you need is unlikely without financial performance projections, often called *pro formas*. Even if you are apt to hire an accountant to develop pro formas for you, you need to understand what this chapter tells you about them.

Chapter 12: Writing and Pitching a Business Plan provides guidelines for writing convincing business plans and scripts for presenting them to potential investors or lenders.

Chapter 13: Raising Capital and Choosing a Business' Legal Structure is an elementary introduction to sources of capital and criteria for choosing whether to operate as a sole proprietorship, a partnership, or a corporation. Its aims are limited to acquainting entrepreneurs with these complex matters and to encourage consulting a qualified professional before deciding how the business will be financed and organized.

Chapter 14: Monitoring Performance explains that writing a plan is not the end of the planning process. Once a plan has been formulated and launched, results must be monitored; likely causes of differences between expected and actual results must be identified; and, depending on performance gaps and internal or external developments, the plan may have to be modified or revised completely at some point.

Appendix: A Sample Business Plan for Lynn's Hair in Style consists mostly of extensive excerpts from a well-constructed business plan. It also includes a checklist for critiquing almost any business plan. Glance at this appendix before reading the remaining chapters.

SOME GOOD ADVICE BEFORE MOVING ON

You are well-advised to try your hand at developing and writing a business plan. Even if you do so just for practice, you will learn a lot from the experience. When you do write one, heed the following advice:

- ***Don't get ahead of yourself.*** For instance, make sure you have a lucid vision of your business, including a credible value proposition, before you worry about the details of promoting your product or making a pitch to bankers or venture capitalists for financing.
- ***Stay focused.*** Ask the right questions; then search for the answers. Business plans too often brim with data that is readily available and appears relevant at first glance, but fails to shed light on any critical issue.

- ***Know your rivals and how they compete.*** For instance, if your business is small, you must understand what it faces when it encounters much larger competitors.
- ***Do not succumb to analysis paralysis,*** a disease that compels its victims to gather and analyze ever more data without ever making a decision. Realize that opportunities are fleeting and nothing is ever certain.
- ***Be prepared to think.*** Planning is puzzle solving that requires creativity and effort. Although it cannot be reduced to a recipe, it is amenable to guidelines. The guidelines offered in this book are informed by much experience and many of the most influential books and articles on market strategy, strategic management, and planning written since the late 1970s.
- ***Connect the dots.*** Connecting the dots entails explicitly linking narratives, data, analyses, and plausible assumptions to *critical questions*. Questions are critical to the extent that incorrect answers are apt to prove fatal. Questions about demand and customer price sensitivity often are critical, since the wrong answers can lead to catastrophic decisions.
- ***Make sense.*** Making sense requires more than good writing. It also requires writers to assume the role of reader and, as such, question the soundness of critical claims—claims that, if false, render the plan fatally flawed. Sound claims are grounded in valid premises and logical conclusions.

Notes

1. Netflix, "Company Timeline," available at https://signup.netflix.com/MediaCenter/Timeline
2. N. Lurie, "From Student to Entrepreneur: How to Generate and Evaluate Compelling Business Ideas Quickly," 2004, available at http://leeds-faculty.colorado.edu/moyes/html/resourses/Idea%20Exercise.pdf
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4. M. Dell, *Direct from Dell*, New York: Harper, 1999.
5. A. M. Pandya and N. V. Rao, "Diversification and Firm Performance: An Empirical Evaluation," *Journal of Financial and Strategic Decisions*, Fall 1998, pp. 67–81.