Chapter 3
Strategic Management and the Entrepreneur

Vision without action is a daydream. Action without vision is a nightmare.
—Japanese Proverb

One ship drives east and another drives west
with the self-same winds that blow;
'Tis the set of the sails
And not the gales
That tells them the way to go.
—Ella Wheeler Wilcox

LEARNING OBJECTIVES

Upon completion of this chapter, you will be able to:

1. **UNDERSTAND** the importance of strategic management to a small business.
2. **EXPLAIN** why and how a small business must create a competitive advantage in the market.
3. **DEVELOP** a strategic plan for a business using the nine steps in the strategic planning process.
4. **DISCUSS** the characteristics of low-cost, differentiation, and focus strategies and know when to employ them.
5. **UNDERSTAND** the importance of controls such as the balanced scorecard in the planning process.

Learning Objective

Few activities in the life of a business are as vital—or as overlooked—as that of developing a strategy for success. Too often, entrepreneurs brimming with optimism and enthusiasm launch businesses destined for failure because their founders never stop to define a workable strategy that sets them apart from their competition. Because they tend to be people of action, entrepreneurs often find the process of developing a strategy dull and unnecessary. Their tendency is to start a business, try several approaches, and see what works. Without a cohesive plan of action, however, these entrepreneurs have as much chance of building a successful business as a defense contractor attempting to build a jet fighter without blueprints. Companies lacking clear strategies may achieve some success in the short run, but as soon as competitive conditions stiffen or an unanticipated threat arises, they usually "hit the wall" and fold. Without a basis for differentiating itself from a pack of similar competitors, the best a company can hope for is mediocrity in the marketplace.

In today's global competitive environment, any business, large or small, that is not thinking and acting strategically is extremely vulnerable. Every business is exposed to the forces of a rapidly changing competitive environment, and in the future small business executives can expect even greater change and uncertainty. From sweeping political changes around the planet and rapid technological advances to more intense competition and newly emerging global markets, the business environment has become more turbulent and challenging to business owners. Although this market turbulence creates many challenges for small businesses, it also creates opportunities for those companies that have in place strategies to capitalize on them. Historically important, entrepreneurs' willingness to create change, to experiment with new business models, and to break traditional rules has become more important than ever.

Perhaps the biggest change business owners face is unfolding now: the shift in the world's economy from a base of *financial* to *intellectual* capital. "Knowledge is no longer just a factor of production," says futurist Alvin Toffler. "It is the *critical* factor of production."[1] Today, a company's intellectual capital is likely to be the source of its competitive advantage in the marketplace. **Intellectual capital** is comprised of three components:[2]

intellectual capital—*a key source of a company's competitive advantage that is comprised of (1) human capital, (2) structural capital, and (3) customer capital.*

1. *human capital*, the talents, skills, and abilities of a company's workforce.
2. *structural capital*, the accumulated knowledge and experience that a company possesses. It can take many forms including processes, software, patents, copyrights, and, perhaps most important, the knowledge and experience of the people in a company.
3. *customer capital*, the established customer base, positive reputation, ongoing relationships, and goodwill a company builds up over time with its customers.

Increasingly, entrepreneurs are recognizing that the capital stored in these three areas forms the foundation of their ability to compete effectively and that they must manage this intangible capital base carefully. Every business uses all three components in its strategy, but the emphasis they place on each component varies.

A Company Example

For example, ***The Container Store****, a Dallas-based chain that sells a complete line of storage and organization products, relies heavily on human capital as the basis for its competitive advantage in the marketplace. The company subjects all job applicants to a thorough screening process, carefully selecting only those who demonstrate a passion for what lies at the heart of its competitive edge: customer service. Most of the Container Store employees have college degrees, something that its competitors cannot claim. The company also invests significant capital in its employees, spending 10 times the industry average on employee training and development! Because of its employee-friendly policies, The Container Store is consistently listed on* Fortune*'s "100 Best Companies to Work For" list. The company is growing rapidly and with just 28 locations is generating more than $300 million in sales!*[3]

This knowledge shift will create as much change in the world's business systems as the Industrial Revolution did in the agricultural-based economies of the 1800s. The knowledge revolution will spell disaster for those companies who are not prepared for it, but it will spawn tremendous opportunities for those entrepreneurs equipped with the strategies to exploit these opportunities. Management legend Jack Welch, who masterfully guided General Electric for many years, says, "Intellectual capital is what it's all about. Releasing the ideas of people is what we've got to do if we are going to win."[4] However, in practice, releasing people's ideas is

much more difficult than it appears. The key is to encourage employees to generate a large volume of ideas, recognizing that only a few (the best) will survive. According to Gary Hamel, author of *Inside the Revolution*, "If you want to find a few ideas with the power to enthrall customers, foil competitors, and thrill investors, you must first generate hundreds and potentially thousands of unconventional strategic ideas. Put simply, you have to crush a lot of rock to find a diamond."[5] In other words, small companies must use the creative techniques discussed in Chapter 2 as one source of competitive advantage.

The rules of the competitive game of business have changed dramatically. To be successful, entrepreneurs can no longer do things in the way they've always done them. Fortunately, successful entrepreneurs have at their disposal a powerful weapon to cope with a hostile, ever-changing environment: the process of strategic management. **Strategic management** involves developing a game plan to guide a company as it strives to accomplish its vision, mission, goals, and objectives and to keep it from straying off its desired course. The idea is to give the owner a blueprint for matching the company's strengths and weaknesses to the opportunities and threats in the environment.

strategic management—*the process of developing a game plan to guide a company as it strives to accomplish its vision, mission, goals, and objectives and to keep it from straying off course.*

BUILDING A COMPETITIVE ADVANTAGE

Learning Objective

2. Explain why and how a small business must create a competitive advantage in the market.

The goal of developing a strategic plan is to create for the small company a **competitive advantage**—the aggregation of factors that sets a small business apart from its competitors and gives it a unique position in the market superior to its competition. From a strategic perspective, the key to business success is to develop a unique competitive advantage, one that creates value for customers and is difficult for competitors to duplicate.

A Company Example

Early in its existence, the ***Blockbuster Video*** *chain gained a significant advantage over rival video rental stores when it negotiated a deal with the major movie studios to purchase videos for just $6 each, plus 40 percent of the rental fees. The agreement meant that Blockbuster could lower the cost of its inventory to less than one-tenth of that of its competitors, who were still paying an average of $65 per video! Blockbuster's significantly lower costs meant that it could stock thousands more video titles than any of its rivals, enabling the company to offer customers a tangible benefit (greater selection and in-stock guarantees) while creating a sizable competitive advantage in the market.*[6]

Building a competitive advantage alone is not enough; the key to success is building a *sustainable* competitive advantage. In the long run, a company gains a sustainable competitive advantage through its ability to develop a set of core competencies that enables it to serve its selected target customers better than its rivals. **Core competencies** are a unique set of capabilities that a company develops in key areas, such as superior quality, customer service, innovation, team building, flexibility, responsiveness, and others that allow it to vault past competitors. Typically, a company is likely to build core competences in no more than five or six (sometimes fewer) areas. These core competencies become the nucleus of a company's competitive advantage and are usually quite enduring over time. Markets, customers, and competitors may change, but a company's core competencies are more durable, forming the building blocks for everything a company does. To be effective, these competencies should be difficult for competitors to duplicate, and they must provide customers with an important perceived benefit. Small companies' core competencies often have to do with the advantages of their size—for example, agility, speed, closeness to their customers, superior service, and ability to innovate. In short, their smallness is an advantage, allowing them to do things that their larger rivals cannot. The key to success is building these core competencies (or identifying the ones a company already has) and then concentrating them on providing superior service and value for its target customers.

competitive advantage—*the aggregation of factors that sets a small business apart from its competitors and gives it a unique position in the market superior to its competition.*

core competencies—*a unique set of lasting capabilities that a company develops in key operational areas that allow it to vault past competitors.*

A Company Example

Blockbuster Video's early market dominance in the video rental business has not gone unchallenged. One of the most serious challenges comes from ***Netflix***, *a small company that has created a unique online DVD rental service. Software entrepreneur Reed Hastings saw the World Wide Web as a way to revolutionize the delivery of videos to consumers and launched the company in 1997 by investing his own money and raising $120 million in equity capital. For a monthly subscription fee, customers can log onto the Netflix Web site and pick the movies they*

want to rent and the order in which they want to receive them. The order goes to the Netflix regional distribution center (there are 12 centers with plans to expand to 25) that is closest to the customer, where employees fill the order. Customers can keep a DVD as long as they want without incurring any late fees, and shipping (both ways) is free. When a customer returns a DVD, a computer scans it, looks up the next video on the customer's order, and sends it out. About 95 percent of DVDs come in and go out on the same day. Netflix is building its competitive advantage on several core competencies. Hastings created the business system that drives Netflix using his extensive knowledge of computer software. One venture capitalist says, "[Netflix's] film recommendation software, its merchandising, and the inventory control systems are so sophisticated. It isn't that they couldn't be replicated, but they're hard to do, and it'll take a lot of money, time, and commitment to get it right as Netflix has." CineMatch, the company's proprietary film suggestion software, uses customers' ratings from past films they have rented to suggest new ones. Netflix also has entered into revenue-sharing deals with 50 film distributors, including most of the major studios, giving it an inventory of more than 13,500 titles, including lesser-known, niche films as well as box office hits. The largest Blockbuster Video stores have 7,000 to 8,000 titles. One of the most important issues Netflix faces is market size. Can the company increase its customer base from 742,000 to its target of 8 million within eight years?[7]

No business can be everything to everyone. In fact, one of the biggest pitfalls many entrepreneurs stumble into is failing to differentiate their companies from the crowd of competitors. Entrepreneurs often face the challenge of setting their companies apart from their larger, more powerful competitors (who can easily outspend them) by using their creativity and the special abilities their businesses offer customers. Developing core competencies does *not* necessarily require a company to spend a great deal of money. It does, however, require an entrepreneur to use creativity, imagination, and vision to identify those things that it does best and that are most important to its target customers. Businesses have an infinite number of ways to create a competitive edge, but building strategy around a company's core competencies allows it to gain a sustainable competitive advantage based on what it does best.

A Company Example

*For example, **Tom's of Maine** has built its reputation over the past 35 years as a back-to-nature company that sells all-natural personal care products with environmentally friendly packaging and donates 10 percent of its pretax profits to charity. Founder Tom Chappell's company competes in the same industry as giants such as Unilever, Colgate-Palmolive, and Procter & Gamble by focusing on its base of environmentally conscious customers and by promoting itself as a company "working with nature to make a difference." Gearing up for growth, Tom's of Maine recently introduced a line of herbal remedy products as well as a line of toothpastes for adults and children. Like all of its other products, the new toothpastes contain no artificial flavors, dyes, sweeteners, or preservatives, nor are they tested on animals. Tom's of Maine is the only company to have a complete line of all-natural fluoride toothpastes that are approved by the American Dental Association. The toothpastes and all of the company's product extensions are based on its core competency of developing and manufacturing all-natural, environmentally friendly products that meet the highest standards of quality and safety. Another core competency is the company's stellar reputation among a loyal customer base as a business with a deep sense of ethics and social responsibility.*[8]

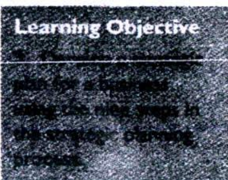
When it comes to developing a strategy for establishing a competitive advantage, small companies such as Tom's of Maine have a variety of natural advantages over their larger competitors. Small businesses often have narrower product lines, more clearly defined customer bases, and more specific geographic market areas than big businesses. Entrepreneurs usually are in close contact with their markets, giving them valuable knowledge on how to best serve their customers' needs and wants. Because of the simplicity of their organizational structures, small business owners are in touch with employees daily, often working side by side with them, allowing them to communicate strategic moves firsthand. Consequently, small businesses find that strategic management comes more naturally to them than to larger companies with their layers of bureaucracy and far-flung operations.

Strategic management can increase a small company's effectiveness, but entrepreneurs first must have a process designed to meet their needs and their business's special characteristics. It is a mistake to attempt to apply a big business's strategic development techniques to a small business because a small business is not a little big business. Because of their size and their particular characteristics—

small resource base, flexible managerial style, informal organizational structure, and adaptability to change—small businesses need a different approach to the strategic management process. In developing a strategic management procedure for a small business, an entrepreneur should:

- Use a relatively short planning horizon—two years or less for most small companies.
- Be informal and not overly structured; a shirt-sleeve approach is ideal.
- Encourage the participation of employees and outside parties to improve the reliability and creativity of the resulting plan.
- Not begin with setting objectives, as extensive objective setting early on may interfere with the creative process of strategic management.
- Maintain flexibility; competitive conditions change too rapidly for any plan to be considered permanent.
- Focus on strategic *thinking*, not just planning, by linking long-range goals to day-to-day operations.

THE STRATEGIC MANAGEMENT PROCESS



Strategic planning is a continuous process that consists of nine steps:

Step 1. Develop a clear vision and translate it into a meaningful mission statement.
Step 2. Assess the company's strengths and weaknesses.
Step 3. Scan the environment for significant opportunities and threats facing the business.
Step 4. Identify the key factors for success in the business.
Step 5. Analyze the competition.
Step 6. Create company goals and objectives.
Step 7. Formulate strategic options and select the appropriate strategies.
Step 8. Translate strategic plans into action plans.
Step 9. Establish accurate controls.

Step 1. Develop a Clear Vision and Translate It into a Meaningful Mission Statement

VISION. Throughout history, the greatest political and business leaders have been visionaries. Whether the vision is as grand as Martin Luther King, Jr.'s "I have a dream" speech or as simple as Ray Kroc's devotion to quality, service, cleanliness, and value at McDonald's, the purpose is the same: to focus everyone's attention on the same target and to inspire them to reach it. The vision touches everyone associated with the company—employees, investors, lenders, customers, and the community. It is an expression of what the owner stands for and believes in. Highly successful entrepreneurs are able to communicate their vision and their enthusiasm about that vision to those around them.

A vision is the result of an entrepreneur's dream of something that does not exist yet and the ability to paint a compelling picture of that dream for everyone to see. A clearly defined vision helps a company in three ways:

1. *Vision provides direction.* Entrepreneurs who spell out the vision for their company focus everyone's attention on the future and determine the path the business will take to get there.
2. *Vision determines decisions.* The vision influences the decisions, no matter how big or how small, that owners, managers, and employees make every day in a business. This influence can be positive or negative, depending on how well defined the vision is.
3. *Vision motivates people.* A clear vision excites and ignites people to action. People want to work for a company that sets its sights high.

Vision is based on an entrepreneur's values. Explaining how an entrepreneur's values are the nucleus around which a company grows, author and consultant Ken Blanchard says, "Winning companies first emphasize values—the beliefs that you, as the business owner, have about your employees, customers, quality, ethics, integrity, social responsibility, growth, stability, innovation, and flexibility. Managing by values—not by profits—is a powerful process."[9] Successful entrepreneurs build their businesses around a set of three to six core values, which might range from respect for the individual and innovation to creating satisfied customers and making the world a better place.

A Company Example

In 1957, eighteen years after they had launched the company bearing their names, Bill Hewlett and Dave Packard were pleased with their company's rapid growth but were concerned that the business might lose its "small company atmosphere." The ***Hewlett-Packard*** *cofounders took 20 of their best employees to an upscale resort in California's wine country (on one of the first recorded corporate retreats) to define the type of culture HP would foster. By the end of the retreat, the team had drafted a set of values that ultimately became the basis of "the HP Way," the highly admired culture the company is known for even today.*[10]

Indeed, truly visionary entrepreneurs see their companies' primary purpose as more than just "making money." One writer explains, "Almost all workers are making decisions, not just filling out weekly sales reports or tightening screws. They will do what they think best. If you want them to do as the company thinks best too, then you must [see to it that] that they have an inner gyroscope aligned with the corporate compass."[11] That gyroscope's alignment depends on the entrepreneur's values and how well he or she transmits them throughout the company.

The best way to put values into action is to create a written mission statement that communicates those values to everyone the company touches.

mission statement—*an enduring declaration of a company's purpose that addresses the first question of any business venture: What business are we in?*

MISSION. The **mission statement** addresses the first question of any business venture: What business are we in? Establishing the purpose of the business in writing must come first in order to give the company a sense of direction. "If you don't reduce [your company's purpose] to paper, it just doesn't stick," says the owner of an architectural firm. "Reducing it to paper really forces you to think about what you are doing."[12] As an enduring declaration of a company's purpose, a mission statement is the mechanism for making it clear to everyone the company touches "why we are here" and "where we are going."

A Company Example

Truett Cathy, founder of the highly successful restaurant chain ***Chick-fil-A****, recalls a time when his business was struggling because of intensifying competition from big hamburger chains. With 200 outlets at the time, the company was struggling to keep operating costs under control as inflation threatened to push them ever higher. Cathy scheduled an executive retreat at a lake outside of Atlanta, where managers could relax and talk about their concerns and ideas for the company. His oldest son Dan, director of operations, asked, "Why are we in business? Why are we here?" Cathy was about to tell his son that this retreat was no time to dwell on philosophical issues because there were bigger problems to solve. "Then," recalls Cathy, "I realized he was serious. His question both challenged and inspired us." In the ensuing brainstorming session, the group defined values that became Chick-fil-A's mission statement: "To glorify God by being faithful stewards of all that is entrusted to us. To have a positive influence on all who come in contact with Chick-fil-A." With their purpose clearly defined, the management team went on to lead the company in a growth spurt, where sales climbed 30 percent a year. Today the company has more than 1,000 restaurants across the country (none of which are open on Sundays).*[13]

Without a concise, meaningful mission statement, a small business risks wandering aimlessly in the marketplace, with no idea of where to go or how to get there. The mission statement sets the tone for the entire company and focuses its attention on the right direction.

ELEMENTS OF A MISSION STATEMENT. A sound mission statement need not be lengthy to be effective. Some of the key issues an entrepreneur and employees should address as they develop a mission statement for the company include:

- What are the basic beliefs and values of the organization? What do we stand for?
- Who are the company's target customers?
- What are our basic products and services? What customer needs and wants do they satisfy?
- Why should customers do business with us rather than the competitor down the street (or across town, on the other coast, on the other side of the globe)?
- What constitutes value to our customers? How can we offer them better value?
- What is our competitive advantage? What is its source?
- In which markets (or market segments) will we choose to compete?
- Who are the key stakeholders in our company and what effect do they have on it?

Pepper . . . and Salt

THE WALL STREET JOURNAL

FROM THE WALL STREET JOURNAL - PERMISSION, CARTOON FEATURE SYNDICATE

"Please pardon our appearance while we re-think our original theme."

A company's mission statement may be the most essential and basic communication that it puts forward. If the people on the plant, shop, retail, or warehouse floor don't know what a company's mission is, then, for all practical purposes, it does not have one! The mission statement expresses the firm's character, identity, and scope of operations, but writing it is only half the battle, at best. The most difficult part is living that mission every day. *That's* how employees decide what really matters. To be effective, a mission statement must become a natural part of the organization, embodied in the minds, habits, attitudes, and decisions of everyone in the company every day. According to the *Workplace 2000 Employee Insight Survey*, 89 percent of employees say their companies have mission statements. Unfortunately, only 23 percent of workers believe their company's mission statement has become a way of doing business![14] One business writer claims, "If what you say about your firm's values and mission isn't true, you're in worse trouble than if you'd never articulated it in the first place."[15] Five years after founding Field Trip Factory Inc., a business that organizes life skill educational field trips for students, Susan Singer saw the need to update the company's mission statement. At a company retreat, she and her employees decided that their existing mission statement no longer reflected what the company actually stood for and did. A brainstorming session yielded a new mission statement that Singer says is helping her company improve its bottom line. "It became so clear what we do versus what we want to be," she says.[16]

A well-used mission statement serves as a strategic compass for a small company.

A Company Example

Ben & Jerry's Homemade Inc. *relies on a three-part mission statement that its managers and employees live out every day; consider the message its sends to company stakeholders:*[17]

> Product Mission: To make, distribute & sell the finest quality all natural ice cream & euphoric concoctions with a continued commitment to incorporating wholesome, natural ingredients and promoting business practices that respect the Earth and the Environment.
>
> Economic Mission: To operate the Company on a sustainable financial basis of profitable growth, increasing value for our stakeholders & expanding opportunities for development and career growth for our employees.

Social Mission: To operate the company in a way that actively recognizes the central role that business plays in society by initiating innovative ways to improve the quality of life locally, nationally & internationally.

Underlying the mission of Ben & Jerry's is the determination to seek new and creative ways of addressing all three parts, while holding a deep respect for individuals inside and outside the Company and for the communities of which they are a part.

A company may have a powerful competitive advantage, but it is wasted unless (1) the owner has communicated that advantage to workers, who, in turn, are working hard to communicate it to customers and potential customers and (2) customers are recommending the company to their friends because they understand the benefits they are getting from it that they cannot get elsewhere. *That's* the real power of a mission statement. Table 3.1 offers some useful tips on writing a mission statement.

Step 2: Assess the Company's Strengths and Weaknesses

strengths—*positive internal factors that a company can use to accomplish its mission, goals, and objectives.*

Having defined the vision for her company and translated that vision into a meaningful mission statement, an entrepreneur can turn her attention to assessing company strengths and weaknesses. Building a successful competitive strategy requires a business to magnify its strengths and overcome or compensate for its weaknesses. **Strengths** are positive internal factors that a company can use to accomplish its mission, goals, and objectives. They might include special skills or knowledge, a positive public image, an experienced sales force, and many other factors.

TABLE 3.1

Tips for Writing a Powerful Mission Statement

Sources: Adapted from Ken Blanchard, "The New Bottom Line," *Entrepreneur*, February 1998, pp. 127–131; Alan Farnham, "Brushing Up Your Vision Thing," *Fortune*, May 1, 1995, p. 129; Sharon Nelton, "Put Your Purpose in Writing," *Nation's Business*, February 1994, pp. 61–64; Jacquelyn Lynn, "Single-Minded," *Entrepreneur*, January 1996, p. 97.

A mission statement is a useful tool for getting everyone fired up and heading in the same direction, but writing one is not as easy as it may first appear. Here are some tips for writing a powerful mission statement:

- *Keep it short.* The best mission statements are just a few sentences long. If they are short, people will tend to remember them better.
- *Keep it simple.* Avoid using fancy jargon just to impress outsiders such as customers or suppliers. The first and most important use of a mission statement is inside a company.
- *Get everyone involved.* If the boss writes the company mission statement, who is going to criticize it? Although the entrepreneur has to be the driving force behind the mission statement, everyone in the company needs the opportunity to have a voice in creating it. Expect to write several drafts before you arrive at a finished product.
- *Keep it current.* Mission statements can get stale over time. As business and competitive conditions change, so should your mission statement. Make a habit of evaluating your mission statement periodically so that it stays fresh.
- *Make sure your mission statement reflects the values and beliefs you hold dear.* They are the foundation on which your company is built.
- *Make sure your mission statement includes values that are worthy of your employees' best efforts.* One entrepreneur says that a mission statement should "send a message to employees, suppliers, and customers as to what the purpose of the company is aside from just making profits."
- *Make sure your mission statement reflects a concern for the future.* Business owners can get so focused on the present that they forget about the future. A mission statement should be the first link to the company's future.
- *Keep the tone of the mission statement positive and upbeat.* No one wants to work for a business with a pessimistic outlook on the world.
- *Consider using your mission statement to lay an ethical foundation for your company.* This is the ideal time to let employees know what your company stands for—and what it won't stand for.
- *Look at other companies' mission statements to generate ideas for your own.* Two books, *Say It and Live It: The 50 Corporate Mission Statements That Hit the Mark* (Currency/Doubleday) and *Mission Statements: A Guide to the Corporate and Nonprofit Sectors* (Garland Publishing), are useful resources.
- *Make sure that your mission statement is appropriate for your company's culture.* Although you should look at other companies' mission statements, do not make the mistake of trying to copy them. Your company's mission statement is unique to you and your company.
- *Use it.* Don't go to all of the trouble of writing a mission statement just to let it collect dust. Post it on bulletin boards, print it on buttons and business cards, stuff it into employees' pay envelopes. Talk about your mission statement often, and use it to develop your company's strategic plan. That's what it's for!

Weaknesses are negative internal factors that inhibit a company's ability to accomplish its mission, goals, and objectives. Lack of capital, a shortage of skilled workers, and an inferior location are examples of weaknesses.

Weaknesses—*negative internal factors that inhibit the accomplishment of a company's mission, goals, and objectives.*

Identifying strengths and weaknesses helps owners understand their business as it exists (or, for a start-up, will exist). An organization's strengths should originate in the core competencies that are essential to gaining an edge in each of the market segments in which the firm competes. The key to building a successful strategy is using the company's underlying strengths as its foundation and matching those strengths against competitors' weaknesses.

One effective technique for taking this strategic inventory is to prepare a "balance sheet" of the company's strengths and weaknesses (see Table 3.2). The positive side should reflect important skills, knowledge, or resources that contribute to the firm's success. The negative side should record honestly any limitations that detract from the company's ability to compete. This balance sheet should analyze all key performance areas of the business—human resources, finance, production, marketing, product development, organization, and others. This analysis should give owners a more realistic perspective of their businesses, pointing out foundations on which they can build future strengths and obstacles that they must remove for business progress. This exercise can help entrepreneurs move from their current position to future actions.

Step 3: Scan the Environment for Significant Opportunities and Threats Facing the Business

OPPORTUNITIES. Once entrepreneurs have taken an internal inventory of company strengths and weaknesses, they must turn to the external environment to identify any opportunities and threats that might have a significant impact on the business. **Opportunities** are positive external options that a firm can exploit to accomplish its mission, goals, and objectives. The number of potential opportunities is limitless, so entrepreneurs need to analyze only those factors that are most significant to the business (probably two or three at most).

Opportunities—*positive external options that a firm can exploit to accomplish its mission, goals, and objectives.*

When identifying opportunities, an entrepreneur must pay close attention to new potential markets. Are competitors overlooking a niche in the market? Is there a better way to reach customers? Can we develop new products that offer customers better value? What opportunities are trends in the industry creating? For instance, analysts predict that the restaurant industry as a whole in the United States will grow by just 2 percent a year until 2010. This uninspired growth is causing problems for many segments of the industry; the profits of fast-food chains such as McDonald's and Burger King are under pressure as firms emphasize low-cost (and low-profit) value meals. Full-service restaurants offer the freshly prepared foods diners are demanding now, but for them speed and efficiency remain a serious challenge as busy customers demand ever-faster service. The *real* opportunity for growth in the restaurant industry is occurring in the middle ground, the "fast casual" segment. The restaurants experiencing the greatest success are those that focus on dinner, the most popular meal for customers outside the home, outpacing both breakfast and lunch combined. Diners also spend 40 percent more on dinner than on lunch. Café Express, a chain of fast-casual restaurants in which Wendy's

TABLE 3.2

Identifying Company Strengths and Weaknesses

Strengths (Positive Internal Factors)	Weaknesses (Negative Internal Factors)

International is an investor, uses "oasis tables," where customers can customize their dishes with a variety of toppings, ranging from parmesan cheese to capers. The chain benefits not only from satisfied customers getting exactly what they want quickly but also from lower labor costs because a smaller waitstaff is required. Many fast-casual chains are experiencing profit margins that are two to three times higher than those in other segments of the industry.[18]

Opportunities almost always arise as a result of factors that are beyond entrepreneurs' control. Constantly scanning for those opportunities that best match their companies' core competencies and strengths and then pouncing on them ahead of competitors is the key to success. As horrific as they were, the terrorist attacks on the United States, which posed serious threats to thousands of small businesses, also created unusual opportunities for others.

A Company Example

After the attacks, ***Tempest Publishing****, a small publisher of books and reports on bio-terrorism, saw demand for its daily terrorism reports and books such as* First Responder Chem-Bio Handbook *skyrocket. Founder Ben Venzke was able to boost significantly both sales and profits as the company's books began to outsell the popular Harry Potter books on Amazon.com. Another company,* ***Big Toys Coach Works****, experienced a huge increase in the demand for its customized, specially outfitted sports utility vehicles that come complete with bulletproof, bomb-resistant bodies and features such as wireless Internet access, televisions, refrigerators, and bars.*[19] *The majority of the company's customers are corporate executives, movie stars, and other VIPs in search of security and who are capable of buying customized vehicles whose prices can run upwards of $175,000!*[20]

threats—*negative external forces that inhibit a company's ability to achieve its mission, goals, and objectives.*

THREATS. Threats are negative external forces that inhibit a company's ability to achieve its mission, goals, and objectives. Threats to the business can take a variety of forms, such as competitors entering the local market, a government mandate regulating a business activity, an economic recession, rising interest rates, technological advances making a company's product obsolete, and many others. Many small retailers face a threat from "big box" retailers such as Wal-Mart, Home Depot, Circuit City, and others offering lower prices because of their high-volume purchasing power, huge advertising budgets, and megastores that attract customers from miles around. Kenneth Stone, a professor at Iowa State University and a leading researcher on Wal-Mart's impact on small companies, says that after Wal-Mart entered Iowa in 1983, 23 percent of drugstores and 45 percent of hardware stores disappeared.[21] However, small businesses with the proper strategies in place do *not* have to fold in the face of intense competition.

A Company Example

After Wal-Mart, Home Depot, and Lowe's opened next to their second-generation small hardware store in Greenville, South Carolina, Terry and Debbie Dobson changed their competitive strategy and refocused their business more on gifts and less on the standard hardware items their larger rivals sold. The Dobsons now rely on a focus strategy that emphasizes unique gifts and home décor items with a distinctively local flavor and specialty hardware items overlooked by their big box competitors. The Dobsons continue to set their business apart by offering a high level of personal service, including knowledgeable, long-time employees and a home delivery service that customers love![22]

Although they cannot control the threats themselves, entrepreneurs such as the Dobsons must prepare a plan for shielding their businesses from these threats.

Figure 3.1 illustrates that opportunities and threats are products of the interactions of forces, trends, and events outside the direct control of the business. These external forces will have a direct impact on the behavior of the markets in which the business operates, the behavior of competitors, and the behavior of customers. Table 3.3 provides a form that allows business owners to take a strategic inventory of the opportunities and threats facing their companies.

A Company Example

As part of updating the business plan for his small metal-plating business, ***AlumiPlate Inc.****, David Dayton prepared an analysis of the company's strengths, weaknesses, opportunities, and threats (a SWOT analysis) and found it to be an extremely useful part of the planning process. Dayton and his 14 employees identified high barriers to new competitors as one of AlumiPlate's major strengths and its proprietary aluminum coating technology as its greatest opportunity. The team saw the inability to produce a high-volume production demonstration as the company's greatest weakness, and its greatest threat was the heavy demands being placed on key personnel. Dayton and his employees went on to explore the ways AlumiPlate could use its strengths to exploit the best opportunities facing it; they also considered the ways in which its weaknesses make it vulnerable to threats.*[23]

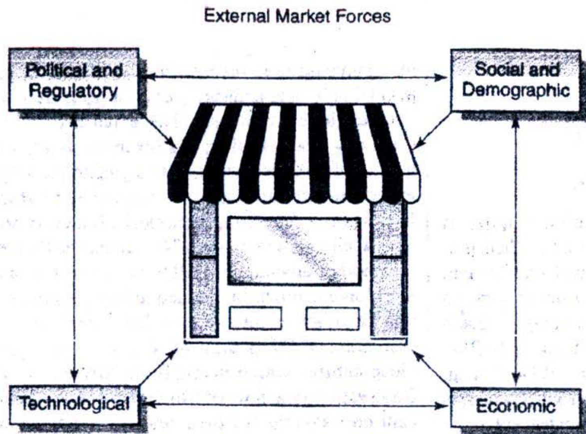


FIGURE 3.1 The Power of External Forces

These interactions of strengths and weaknesses and opportunities and threats can be the most revealing aspects of using a SWOT analysis as part of a strategic plan. This analysis also requires entrepreneurs to take an objective look at their businesses and the environment in which they operate as they address many issues fundamental to their companies' success in the future.

Step 4: Identify the Key Factors for Success in the Business

Every business is characterized by controllable variables that determine the relative success of market participants. Identifying and manipulating these variables is how a small business gains a competitive advantage. By focusing efforts to maximize their companies' performance on these key success factors, entrepreneurs can achieve dramatic market advantages over their competitors. Companies that understand these key success factors tend to be leaders of the pack, whereas those that fail to recognize them become also-rans.

key success factors—*the factors that determine a company's ability to compete successfully in an industry.*

Key success factors come in a variety of different patterns depending on the industry. Simply stated, they are the factors that determine a company's ability to compete successfully in an industry. Many of these sources of competitive advantages are based on cost factors such as manufacturing cost per unit, distribution cost per unit, or development cost per unit. Some are less tangible and less obvious but are just as important, such as superior product quality, solid relationships with dependable suppliers, number of services offered, prime store locations, available customer credit, and many others. For example, one restaurant owner identified the following key success factors:

- tight cost control (labor costs, 15–18 percent of sales, and food costs, 35–40 percent of sales)
- trained, dependable, honest in-store managers
- close monitoring of waste
- careful site selection (the right location)
- maintenance of food quality

TABLE 3.3 Identifying Opportunities and Threats

Opportunities (Positive External Factors)	Threats (Negative External Factors)

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Something New, Something Blue

The past few years have been brutal to the airline industry as terrorism, economic recession, and war have taken their toll. Companies with long histories have experienced turbulence in their operating and financial performances, forcing some to declare bankruptcy. Yet there are bright spots among the black clouds of this troubled industry, and one of those is JetBlue Airlines. Launched in February 2000 by David Neeleman, JetBlue has quickly become one of the biggest success stories in the industry, generating a load factor (average percentage of seats filled) of more than 80 percent, the highest in the industry. Neeleman modeled his company after another success story in the airline industry and a company with which he has experience—Southwest Airlines. In 1993, Southwest founder Herb Kelleher bought Morris Air, a discount carrier that Neeleman had founded, for $128 million and hired Neeleman. The restless entrepreneur was not happy in a structured environment he did not control, and he was fired from Southwest.

Because he had signed a five-year noncomplete agreement when he sold Morris Air to Southwest Airlines, Neeleman was legally prevented from doing what he really wanted to do: launch another airline. While he waited for the five-year restriction to expire, Neeleman started Open Skies, a ticketless airline reservation system, which he later sold to Hewlett-Packard for $22 million. In 1997, he began planning the airline that would become JetBlue, incorporating what he had learned at Morris Air and from the many airline executives he had peppered with questions over the years. Neeleman had proved one thing at Morris Air—that innovative, high-quality airline service coupled with low fares will attract a strong and loyal base of customers—and he decided to follow that strategy again.

JetBlue's success stems from several strategic moves. First, like Southwest Airlines, the company flies only point-to-point routes rather than the traditional hub-and-spoke routes its larger rivals fly. The hub-and-spoke system feeds planes from smaller cities into a few central points, allowing carriers to serve small markets such as Altoona, Pennsylvania, and Asheville, North Carolina. The problem with the system is that it creates logistical nightmares because a delay anywhere in the system ripples throughout. The result is that JetBlue planes spend an average of 12 hours a day in the air, compared to just 9 to 11 hours a day for its competitors—an important difference because planes are generating revenue only when they are in the air. Plus, its on-time performance record of 83 percent tops the industry.

Unlike Southwest, however, JetBlue focuses on longer flights and uses larger planes. JetBlue's average flight is 1,055 miles versus Southwest's 528 miles. Southwest jets seat 135 passengers, and JetBlue's planes accommodate 162 passengers. Both companies use only one type of jet (Boeing 737s for Southwest and Airbus A320s for JetBlue), which enables them to keep maintenance costs low. "That way we don't have to spend money and time training our pilots, flight attendants, and technicians on different models," says Neeleman. Rather than purchase used planes, the new planes in JetBlue's fleet mean that its maintenance costs, for now, are lower than any other carrier in the industry. Neeleman also decided to upholster every seat in leather; this luxury costs $15,000 more per plane, but it sends an important signal to passengers, and the leather surfaces are easier to maintain and last much longer. JetBlue provides no in-flight meals, but every seatback contains a television that offers 24-channel satellite reception.

Another advantage JetBlue has over its rivals is that its workforce is nonunion, which means its labor cost is below that of other airlines and it has more flexibility in job assignments. Pilots even pitch in to help flight attendants clean cabins, which keeps flight turnaround times short. Reservation takers work from their homes, creating significant cost savings for them and for the company. Because the company offers stock options to its workers, employees often are willing to work for lower salaries.

Wanting to avoid the mistake of making passengers feel like cattle, Neeleman is fanatical about his company's customer service. He hitches a ride on at least one flight a week, always chatting with customers and asking for feedback from them. It is not uncommon for him to pitch in to help baggage handlers load and unload planes. Neeleman insists on being paged whenever a JetBlue flight is more than one minute late. (He even takes his pager to bed!) "Employees at other airlines get so caught up in procedure—rules, rules, rules—that they often forget there is a paying customer there," he says. Even the company's Web site focuses on simplicity and ease of use, and customers have responded; half of its fares are booked online (compared to the industry average of 10 percent), which saves the company $5 per transaction. The essence of JetBlue's strategy is to excel at offering low-cost features that its competitors overlook, that make a positive impression on customers, and that distinguish its brand.

The future poses challenges for JetBlue. How much longer can the company keep labor unions at bay? Unionization would boost labor costs by 25 percent, erasing a major cost advantage. In a related issue, as employees mature, they are more likely to demand traditional benefits and pension plans rather than rely on stock options for their retirement. As the company's fleet grows older, its maintenance costs will rise; one expert estimates that by the time its planes are seven years old, maintenance costs will increase 25 percent over current levels to $1.6 million each per year. Finally, can JetBlue beat the odds and growing pains to survive? Since 1980, entrepreneurs have launched 27 airline companies that went public, but only eight have survived.

1. Go online to the JetBlue Web site or to business magazine Web sites to learn more about JetBlue. Prepare an analysis of the company's strengths, weaknesses, opportunities, and threats.

2. Identify the sources of JetBlue's competitive advantages. Are these sources sustainable?

3. What strategic advice can you offer David Neeleman to ensure JetBlue's future success?

Sources: Melanie Wells, "Lord of the Skies," *Forbes*, October 14, 2002, pp. 130–138; "How to Shake Up a Calcified Industry," *Business 2.0*, December 2002/January 2003, p. 92; Amy Goldwasser, "Something Stylish, Something Blue," *Business 2.0*, February 2002, pp. 94–95; JetBlue Airways, www.jetblue.com.

TABLE 3.4

Identifying Key Success Factors

List the specific skills, characteristics, and core competencies that your business must possess if it is to be successful in its market segment.

Key Success Factor	How your company rates . . .
1	Low 1 2 3 4 5 6 7 8 9 10 High
2	Low 1 2 3 4 5 6 7 8 9 10 High
3	Low 1 2 3 4 5 6 7 8 9 10 High
4	Low 1 2 3 4 5 6 7 8 9 10 High
5	Low 1 2 3 4 5 6 7 8 9 10 High

Conclusions:

- consistency
- cleanliness
- friendly and attentive service from a well-trained waitstaff

These controllable variables determine the ability of any restaurant in the market segment to compete. Restaurants lacking these key success factors are not likely to survive, but those that build their strategies with these factors in mind will prosper. However, before any entrepreneurs can build a strategy on the foundation of the industry's key success factors, they must identify them. Table 3.4 presents a form to help owners identify the most important success factors in the industry and the implications for their companies.

Entrepreneurs must use the information gathered to analyze their businesses, their competitors, and their industries to isolate sources of competitive advantage. They must then determine how well their businesses meet these criteria for successfully competing in the market. Highly successful companies know and understand these relationships, but marginal competitors are mystified by the factors that determine success in that particular business. For example, a small manufacturer of cosmetics may discover that shelf space, broad exposure, efficient distribution, and long production runs are crucial to business success. On the other hand, a small retail chain owner may find that broad product lines, customer credit, personalized service, capable store management, and reliable sources of supply determine success in that industry.

Step 5: Analyze the Competition

When a recent survey asked small business owners to identify the greatest challenge they faced in the coming year, the overwhelming response was *competition*.[24] In another survey, CEOs across the globe said the World Wide Web and e-commerce will increase the ferocity of the competition they face in the future. Twenty percent said that e-commerce will *completely* reshape the ways in which they do business.[25] As these studies suggest, keeping tabs on rivals' movements through competitive intelligence programs is a vital strategic activity. "Business is like any battlefield. If you want to win the war, you have to know who you're up against," says one small business consultant.[26] Unfortunately, most businesses are not very good at competitive intelligence; 97 percent of U.S. businesses do not systematically track the progress of their key competitors.[27] The primary goals of a competitive intelligence program include the following:

- Avoiding surprises from existing competitors' new strategies and tactics.
- Identifying potential new competitors.
- Improving reaction time to competitors' actions.
- Anticipating rivals' next strategic moves.

COMPETITOR ANALYSIS. Sizing up the competition gives business owners a more realistic view of the market and their company's position in it. Yet not every competitor warrants the same level of attention in the strategic plan. *Direct competitors* offer the same products and services, and

customers often compare prices, features, and deals from these competitors as they shop. *Significant competitors* offer some of the same products and services. Although their product or service lines may be somewhat different, there is competition with them in several key areas. *Indirect competitors* offer the same or similar products or services only in a few areas, but their target customers seldom overlap yours. Entrepreneurs should monitor closely the actions of their direct competitors, maintain a solid grasp of where their significant competitors are heading, and spend only minimal resources tracking their indirect competitors.

A competitive intelligence exercise enables entrepreneurs to update their knowledge of competitors by answering the following questions:

- Who are our competitors? Where are they located? (The Yellow Pages is a great place to start.)
- What distinctive competencies have they developed?
- How do their cost structures compare to ours? Their financial resources?
- How do they market their products and services?
- What do customers say about them? How do customers describe their products or services, their way of doing business, and the additional services they might supply?
- What are their key strategies?
- What are their strengths? How can our company surpass them?
- What are their primary weaknesses? How can our company capitalize on them?
- Are new competitors entering the business?

A small business owner can collect a great deal of information about rivals through low-cost competitive intelligence (CI) methods including the following:

- Read industry trade publications for announcements and news stories about competitors.
- Ask questions of customers and suppliers on what they hear competitors may be doing. In many cases, this information is easy to gather because some people love to gossip.
- Regularly debrief employees, especially sales representatives and purchasing agents. Experts estimate that 70 to 90 percent of the competitive information a company needs already resides with employees who collect it in their routine dealings with suppliers, customers, and other industry contacts.[28]
- Attend trade shows and collect competitors' sales literature.
- Watch for employment ads from competitors; knowing what types of workers competitors are hiring can tell you a great deal about their future plans.
- Conduct patent searches (see Chapter 2) for patents that competitors have filed. This gives important clues about new products they are developing.
- Environmental Protection Agency reports can provide important information about the factories of manufacturing companies, including the amounts and the kinds of emissions released. A private group, Environmental Protection, also reports emissions for specific plants.[29]
- Learn about the kinds and amounts of equipment and raw materials competitors are importing by studying the *Journal of Commerce Port Import Export Reporting Service (PIERS)* database. These clues can alert an entrepreneur to new products a competitor is about to launch.
- If appropriate, buy competitors' products and assess their quality and features. Benchmark their products against yours. The owner of a mail-order gourmet brownie business periodically places orders from her primary rivals and compares their packaging, pricing, service, and quality to her own.[30]
- Obtain credit reports on each of your major competitors to evaluate their financial condition. Dun & Bradstreet and other research firms also enable entrepreneurs to look up profiles of competitors that can be helpful in a strategic analysis.
- Publicly held companies must file periodic reports with the Securities and Exchange Commission (SEC), including quarterly 10-Q and annual 10-K reports. These are available at the SEC's Web site.
- Check out the resources of your local library, including articles, computerized databases, and online searches. Press releases, which often announce important company news, can be an important source of competitive intelligence. Many companies supply press releases through the PR Newswire. For local competitors, review back issues of the area newspaper for articles on and advertisements by competitors.
- Use the vast resources of the World Wide Web to learn more about your competitors. The Web enables small companies to uncover valuable competitive information at little or no cost. (Refer to our Web site at www.prenhall.com/zimmerer for an extensive listing of more than 1,200 useful small business Web sites.)

- Visit competing businesses periodically to observe their operations. Tom Stemberg, CEO of Staples, a chain of office supply superstores, says, "I've never visited a store where I didn't learn something."[31]

Using the information gathered, a business owner can set up teams of managers and employees to evaluate each competitor and make recommendations on specific strategic actions that will improve the firm's competitive position against each.

Entrepreneurs can use the results of their competitive intelligence efforts to construct a competitive profile matrix for their most important competitors. A **competitive profile matrix** allows owners to evaluate their firms against major competitors on the key success factors for that market segment. The first step is to list the key success factors identified in Step 5 of the strategic planning process (refer to Table 3.4) and to attach weights to them reflecting their relative importance. (For simplicity, the weights in this matrix add up to 1.00). In this example, notice that product quality is weighted twice as heavily (twice as important) as is price competitiveness.

competitive profile matrix—*a tool that allows business owners to evaluate their company against major competitors on the key success factors for that market.*

The next step is to identify the company's major competitors and to rate each one (and your company) on each of the key success factors:

If factor is a:	Rating is:
Major weakness	1
Minor weakness	2
Minor strength	3
Major strength	4

Once the rating is completed, the owner simply multiplies the weight by the rating for each factor to get a weighted score and then adds up each competitor's weighted scores to get a total weighted score. Table 3.5 shows a sample competitive profile matrix for a small company. The results should show which company is strongest, which is weakest, and which of the key success factors each one is best and worst at meeting. By carefully studying and interpreting the results, entrepreneurs can begin to envision the ideal strategy for building a competitive edge in their market segments.

KNOWLEDGE MANAGEMENT. Unfortunately, many small companies fail to gather competitive intelligence because their owners mistakenly assume that it is too costly or simply unnecessary. In reality, the cost of collecting information about competitors and the competitive environment typically is minimal, but it does require discipline. Thanks in large part to the Internet, "All companies, large and small, have virtually the same access to information," says competitive intelligence consultant Leonard Fuld.[32] Identifying and organizing the information a company possesses and then getting it efficiently to those who need it when they need it is the real challenge. In an age where knowledge is the primary source of a company's competitive edge, the key is learning how to *manage* the knowledge and information a company accumulates. A study by software firm Business Objects found that 90 percent of managers admit they make most of their decisions using instinct because they lack the right information when they need it![33]

Knowledge management is the practice of gathering, organizing, and disseminating the collective wisdom and experience of a company's employees for the purpose of strengthening its competitive position. "Knowledge management allows you to determine the explicit knowledge that is somewhere in your organization and that you can leverage rather than having to reinvent the wheel," says Dorothy Leonard-Barton, author of *Wellsprings of Knowledge*.[34] Business owners

knowledge management—*the practice of gathering, organizing, and disseminating the collective wisdom and experience of a company's employees for the purpose of strengthening its competitive position.*

TABLE 3.5

Sample Competitive Profile Matrix

Key Success Factors	Your Business			Competitor 1		Competitor 2	
			Weighted		Weighted		Weighted
(from Step 5)	Weight	Rating	Score	Rating	Score	Rating	Score
Market Share	0.10	3	0.30	2	0.20	3	0.30
Price Competitiveness	0.20	1	0.20	3	0.60	4	0.80
Financial Strength	0.10	2	0.20	3	0.30	2	0.20
Product Quality	0.40	4	1.60	2	0.80	1	0.40
Customer Loyalty	0.20	3	0.60	3	0.60	2	0.40
Total	1.00		2.90		2.50		2.10

who practice knowledge management realize that knowledge is power and that managing it can produce huge benefits. Because of their size and simplicity, small businesses have an advantage over large companies when it comes to managing employees' collective knowledge.

The first step in creating a knowledge management program is to take an inventory of the special knowledge a company possesses that gives it a competitive advantage. This involves assessing the knowledge bank that employees at all levels of the organization have compiled over time. The second step is to organize the essential knowledge and disseminate it throughout the company to those who need it. High-tech solutions such as e-mail, computerized databases, document sharing, and special knowledge management software that allows many different employees to work on a project simultaneously are important tools, but low-tech methods such as whiteboards, Post-it Notes, and face-to-face meetings can be just as effective in small companies. "To understand and respond to the kaleidoscopic patterns of new opportunities and potential dangers to its mission, an organization must mobilize the distributed intelligence of its members and listen to the collective knowledge of the whole," says one expert.[35]

A Company Example

For Ben Farrell, owner of ***Phase Two Strategies****, a San Francisco public relations firm, keeping up with news stories about clients and their industries is essential. Farrell and his staff used to spend many hours poring over stacks of magazines and newspapers to sift out the information they needed. Recently, however, Phase Two Strategies switched to Lexis-Nexis Tracker, an online news retrieval service that allows staffers to set up search criteria and then create a Web page with hyperlinks to relevant stories. The new system not only saves time and increases productivity, but it also allows Phase Two Strategies to serve its customers more effectively.*[36]

A Company Example

Shari Franey, CEO of ***Performance Personnel****, a staffing company with offices in six locations across Pennsylvania, also uses e-mail and voice-mail systems as part of her company's knowledge management program. These tools worked well, but Franey quickly saw their limitations and instituted a series of meetings designed exclusively to allow employees to share useful information with one another. The meetings disseminate vital information throughout the company and build a sense of camaraderie among employees.*[37]

Step 6. Create Company Goals and Objectives

Before entrepreneurs can build a comprehensive set of strategies, they must first establish business goals and objectives, which give them targets to aim for and provide a basis for evaluating their companies' performance. Without them, it is impossible to know where a business is going or how well it is performing. The following conversation between Alice and the Cheshire Cat, taken from Lewis Carroll's *Alice in Wonderland*, illustrates the importance of creating meaningful goals and objectives as part of the strategic management process:[38]

"Would you tell me please, which way I ought to go from here?" asked Alice.

"That depends a good deal on where you want to get to," said the Cat.

"I don't much care where . . . ," said Alice.

"Then it doesn't matter which way you go," said the Cat.

A small business that "doesn't much care where" it wants to go (i.e., one that has no goals and objectives) will find that "it really doesn't matter which way" it chooses to go (i.e., its strategy is irrelevant).

goals—*the broad, long-range attributes a business seeks to accomplish; they tend to be general and sometimes even abstract.*

GOALS. Goals are the broad, long-range attributes that a business seeks to accomplish; they tend to be general and sometimes even abstract. Goals are not intended to be specific enough for a manager to act on but simply state the general level of accomplishment sought. Do you want to boost your market share? Does your cash balance need strengthening? Would you like to enter a new market or increase sales in a current one? Do you want to develop new products or services? Researchers Jim Collins and Jerry Porras studied a large group of businesses and determined that one of the factors that set apart successful companies from unsuccessful ones was the formulation of very ambitious, clear, and inspiring long-term goals. Collins and Porras called them BHAGs ("Big Hairy Audacious Goals," pronounced "bee-hags") and say that their main benefit is to inspire and focus a company on important actions that are consistent with its overall mission.[39]

Addressing these broad issues will help you focus on the next phase—developing specific, realistic objectives.

OBJECTIVES. **Objectives** are more specific targets of performance than goals. Common objectives concern profitability, productivity, growth, efficiency, markets, financial resources, physical facilities, organizational structure, employee welfare, and social responsibility. Because some of these objectives might conflict with one another, it is important to establish priorities. Which objectives are most important? Which are least important? Arranging objectives in a hierarchy according to their priority can help an entrepreneur resolve conflicts when they arise. Well-written objectives have the following characteristics:

objectives—*more specific targets of performance, commonly addressing areas such as profitability, productivity, growth, and other key aspects of a business.*

They are specific. Objectives should be quantifiable and precise. For example, "to achieve a healthy growth in sales" is not a meaningful objective; however, "to increase retail sales by 12 percent and wholesale sales by 10 percent in the next fiscal year" is precise and spells out exactly what management wants to accomplish.

They are measurable. Managers should be able to plot the organization's progress toward its objectives; this requires a well-defined reference point from which to start and a scale for measuring progress.

They are assignable. Unless an entrepreneur assigns responsibility for an objective to an individual, it is unlikely that the company will ever achieve it. Creating objectives without giving someone responsibility for accomplishing it is futile.

They are realistic, yet challenging. Objectives must be within the reach of the organization or motivation will disappear. In any case, managerial expectations must remain high. In other words, the more challenging an objective is (within realistic limits), the higher the performance will be. Set objectives that will challenge you and your employees.

They are timely. Objectives must specify not only what is to be accomplished but also when it is to be accomplished. A time frame for achievement is important.

They are written down. This writing process does not have to be complex; in fact, the manager should make the number of objectives relatively small, from five to fifteen.

The strategic planning process works best when managers and employees are actively and jointly involved in setting objectives. Developing a plan is top management's responsibility, but executing it falls to managers and employees; therefore, encouraging them to participate broadens the plan's perspective and increases the motivation to make the plan work. In addition, managers and employees know a great deal about the organization and usually are willing to share this knowledge.

Step 7. Formulate Strategic Options and Select the Appropriate Strategies

4. Discuss the characteristics of low-cost, differentiation, and focus strategies and know when to employ them.

By this point in the strategic management process, entrepreneurs should have a clear picture of what their businesses do best and what their competitive advantages are. They also should understand their firms' weaknesses and limitations as well as those of its competitors. The next step is to evaluate strategic options and then prepare a game plan designed to achieve the stated mission, goals, and objectives.

STRATEGY. A **strategy** is a road map of the actions an entrepreneur draws up to fulfill a company's mission, goals, and objectives. In other words, the mission, goals, and objectives spell out the ends, and the strategy defines the means for reaching them. A strategy is the master plan that covers all of the major parts of the organization and ties them together into a unified whole. The plan must be action oriented; it should breathe life into the entire planning process. An entrepreneur must build a sound strategy based on the preceding steps that uses the company's core competencies and strengths as the springboard to success. Joseph Picken and Gregory Dess, authors of *Mission Critical: The 7 Strategic Traps That Derail Even the Smartest Companies*, write, "A flawed strategy—no matter how brilliant the leadership, no matter how effective the implementation—is doomed to fail. A sound strategy, implemented without error, wins every time."[40]

strategy—*a road map of the actions an entrepreneur draws up to fulfill a company's mission, goals, and objectives.*

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Snow and Soda: A Profitable Mix

The Crowleys truly are a family of entrepreneurs. Chris and Ralph Crowley manage the bottling plant their great-grandfather, Denis, purchased in 1916. Today a fourth-generation family business with $200 million in annual sales, Polar Beverages is the second-largest independent soft-drink bottler in the nation and the largest in the Northeast. Their younger siblings, David, Jeff, and Carolyn, operate a nearby ski resort, Wachusett Mountain, which they rescued from near bankruptcy in 1982. Since then, the younger Crowleys have transformed Wachusett Mountain into one of the most popular winter resorts in New England. What's surprising is how this generation of Crowleys learn from each other as they run what seem to be totally disparate and unrelated businesses and then apply their knowledge to their respective companies. It's a talent they learned from their late father. "A lot of what we do at the ski area is directly linked to our experience watching Dad run Polar," says David.

Although many ski resorts have struggled to survive in recent years (the number of resorts across the United States has dropped from 735 in 1982 to just 483 in 2003), Wachusett has earned a profit every year since the Crowleys bought it. The Crowleys generate an operating profit margin of about 35 percent, compared to the national average of 12 percent. This family of entrepreneurs has developed a strategy that works well for both businesses, and, surprisingly, many of the elements are common to both businesses. For instance, both the bottling plant and the ski resort share a common threat: unused capacity. In the bottling plant, one hour of downtime means that 72,000 bottles of soft drinks or water do not get bottled, a fact that is not lost on Chris and Ralph. However, the younger Crowleys recognize that unused capacity at their ski resort means lost revenue as well. To keep unused capacity to a minimum, they market the resort to specific target groups at different times of the day. In other words, the Crowleys do not see their target market as simply "skiers." David explains, "It's seniors, housewives, and third-shift factory workers from 9 A.M. to 2:30 P.M., teenage groups [from] 3 P.M. to 7 , and race clubs and families who like lower ticket prices [from] 7 P.M. to 10 P.M." On weekends, families and "night owls" are the primary customers. The result is that the resort is filled with customers almost every minute of its 14 hours of operation a day.

One of their most successful strategies has proved to be working with local schools to provide afternoon activities for children. They came up with the idea when they first took over Wachusett Mountain 20 years ago, and the program has been expanding ever since. On a typical afternoon when school is over, 65 yellow school buses pull up and deposit 2,500 teenagers ready to ski and have fun! Sales of burgers and fries skyrocket. Around 7 P.M., long after most ski resorts have closed, the teens have gone home, and a new crowd emerges: ski racers and singles. More than 800 adult racers belong to the Wachusett Racing League, and most of them are devoted skiers. The Crowleys recently began targeting corporate customers with the addition of Mountain Suite, luxury boxes with beautiful views and easy access to everything. A suite rents for $350 a day or $50,000 for the season. In their second year of operation, the suites generated enough revenue to cover the mortgage on the lodge expansion.

Another highly successful tactic stems from the Crowleys' clear understanding of their customers and also is aimed at minimizing unused capacity. The Century Pass allows skiers to use the slopes in off-peak hours at greatly reduced prices ($189 for a Century Pass versus $595 for an unlimited annual pass). Wachusett sells 15,000 Century Passes a year, and the steady stream of customers generates a handsome profit in food and beverage sales as well.

A few years ago in the Polar plant, Chris and Ralph noticed that the 20-liter jugs of bottled water they were producing left a lot of wasted space on their delivery trucks. So they redesigned the bottles—they are shaped like squat rectangles—and found immediate benefits. "They pack more efficiently, don't break as much, and cost $1.50 less each to make." Seeing a parallel in their ski operation, the younger Crowleys focused their attention on the "truck" they have to fill and empty as efficiently as possible: the rental shop, where 3,000 skiers and snowboarders arrive at 7:30 on weekend mornings. Skiers spend an average of 50 minutes in the typical rental shop, but Carolyn and Jeff have managed to cut that time to 10 minutes! "It's like the [bottling] plant," explains Carolyn. "You're watching bottles go through the manufacturing process and making sure none of them sit still too long." One technique that works for Wachusett is not allowing customers to try on ski boots; servers simply ask what size a customer wears and give them the appropriate pair. The resort stocks step-in snowboard bindings only to speed up that process as well.

On the surface, Polar Beverages and Wachusett Mountain do not appear to have much in common, but the family members who run both businesses see enough overlapping aspects to use the lessons learned in one operation to make the other more effective and efficient as well. While watching 1,200 cans a minute whir past as one of his machines fills cans of Polar Orange Dry Soda, Chris Crowley exclaims, "Look at all those skiers getting on chairlifts."

1. Explain the core competencies that Wachusett Mountain has built. What is the source of its core competencies?

2. Identify Wachusett Mountain's strengths, weaknesses, opportunities, and threats.

3. Explain how Wachusett Mountain uses knowledge management to build a competitive advantage. What other steps would you suggest the company take in this area?

Sources: Paul Hochman, "Crossing Over," *FSB*, December 2002/January 2003, pp. 71–73; Polar Beverages, www.polarbev.com; Wachusett Mountain, www.wachusett.com

A Company Example

Don Todrin and Fred Seibert, cofounders of **True Confections**, *compete quite successfully in the $20 billion-a-year candy industry dominated by three giants, Nestlé, Hershey, and Mars. The small company succeeds by concentrating on a niche, selling entertainment-licensed candies mainly through novelty, gift, and fashion stores as well as on the Web. Their candy wrappers feature stars such as Scooby Doo, SpongeBob Squarepants, and characters from* Austin Powers *and* The Lord of the Rings. *"We're not really selling chocolate bars," says Todrin. "We're selling entertainment impulse items." True Confections is built on Todrin's background in the confectionery business and Seibert's experience at entertainment companies Hanna-Barbera, Nickelodeon, and MTV. The two entrepreneurs use their company's size to their advantage, quickly shifting their product line to include on their wrappers the latest "hot" characters.*[41]

A successful strategy is comprehensive and well integrated, focusing on establishing the key success factors that the manager identified in Step 4. For instance, if maximum shelf space is a key success factor for a small manufacturer's product, the strategy must identify techniques for gaining more in-store shelf space (e.g., offering higher margins to distributors and brokers than competitors do, assisting retailers with in-store displays, or redesigning a wider, more attractive package).

THREE STRATEGIC OPTIONS. Obviously, the number of strategies from which the small business owner can choose is infinite. When all the glitter is stripped away, however, three basic strategies remain. In his classic book, *Competitive Strategy*, Michael Porter defines these strategies: (1) cost leadership, (2) differentiation, and (3) focus (see Figure 3.2).[42]

COST LEADERSHIP. A company pursuing a **cost leadership strategy** strives to be the lowest-cost producer relative to its competitors in the industry. Low-cost leaders have a competitive advantage in reaching buyers whose primary purchase criterion is price, and they have the power to set the industry's price floor. This strategy works well when buyers are sensitive to price changes, when competing firms sell the same commodity products, and when companies can benefit from economies of scale. Not only is a low-cost leader in the best position to defend itself in a price war, but it also can use its power to attack competitors with the lowest price in the industry.

cost leadership strategy—*a strategy in which a company strives to be the low-cost producer relative to its competitors in the industry.*

There are many ways to build a low-cost strategy, but the most successful cost leaders know where they have cost advantages over their competitors, and they use these as the foundation for their strategies. For instance, because it is not unionized, JetBlue Airlines has a significant advantage over its rivals in labor cost. Its labor cost is just 25 percent of revenues compared to 33 to 44 percent of revenues for its competitors, and the company uses this to deploy its fleet of planes more efficiently and more profitably than its competition.[43]

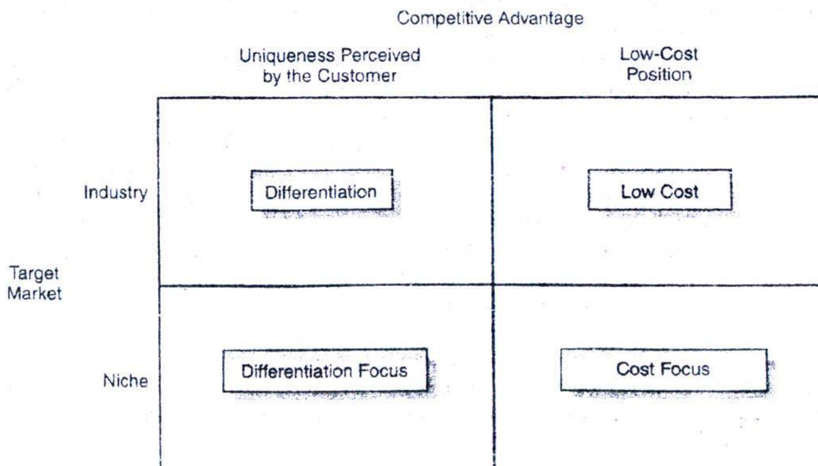


FIGURE 3.2 Three Strategic Options

A Company Example

American Champion Aircraft, a maker of small, lightweight, single-propeller airplanes that once was in bankruptcy, also has a significant cost advantage over its rivals, enabling it to sell its planes for as much as $100,000 less than comparable planes from competitors. In 1988, Jerry and Charlene Mehlhaff bought the company for its salvage value of just $400,000 and began rebuilding the company. They invested $1.7 million to modernize the production process, hired a crew of nonunion workers, and began making airplanes in 1991, earning a profit that first year. Because American Champion's nonunion workforce molds and manufactures 90 percent of its aircrafts' parts, the Mehlhaffs estimate that they save in costs at least $30,000 per plane! The primary components the company purchases from suppliers are the Textron Lycoming four-cylinder engine and propeller. Each aircraft is custom-made, and options such as sophisticated navigation electronics and vacuum-pump fuel systems can add as much as 50 percent to the base prices of $71,000 to $111,000, depending on the model. Still, an American Champion top-of-the-line airplane goes for about $150,000, which is $100,000 less than many comparable single-propeller aircraft sell for.[44]

Of course, there are dangers in following a cost leadership strategy. Sometimes a company focuses exclusively on lowering manufacturing costs, without considering the impact of purchasing, distribution, or overhead costs. Another danger is misunderstanding the firm's true cost drivers. For instance, one food processing plant drastically underestimated its overhead costs and, as a result, was selling its products at a loss. Finally, a firm may pursue a low-cost leadership strategy so zealously that it essentially locks itself out of other strategic choices.

Under the right conditions, a cost-leadership strategy executed properly can be an incredibly powerful strategic weapon. Small discount retailers that live in the shadows of Wal-Mart and thrive even when the economy slows succeed by relentlessly pursuing low-cost strategies. Small chains such as Fred's, Dollar General, Family Dollar, and 99 Cents Only cater to low- and middle-income customers who live in inner cities or rural areas. They offer inexpensive products such as food, health and beauty products, cleaning supplies, clothing, and seasonal merchandise, and many of the items they stock are closeout buys (purchases made as low as 10 cents on the dollar) on brand-name merchandise. These companies also strive to keep their overhead costs as low as possible. For instance, 99 Cents Only, whose name describes its merchandising strategy, is housed in a no-frills warehouse in an older section of City of Commerce, California.[45] The success of these stores proves that companies pursuing a cost leadership strategy must emphasize cost containment in *every* decision, from where to locate the company headquarters to which items to stock.

differentiation strategy—*a strategy in which a company seeks to build customer loyalty by positioning its goods or services in a unique or different fashion.*

DIFFERENTIATION. A company following a **differentiation strategy** seeks to build customer loyalty by positioning its goods or services in a unique or different fashion. That, in turn, enables the business to command a higher price for its products or services than competitors. There are many ways to create a differentiation strategy, but the key is to be special at something that is important to the customer. In other words, a business strives to be better than its competitors at something customers value.

A Company Example

*Although it sells a wide variety of clothing, **It's A Wrap! Production Wardrobe Sales** is not the typical clothing store. The Burbank, California-based company sells wardrobe in volume from the sets of film, television shows, commercials, and the fashion runway. Jan Hallman Dion, a former movie studio employee, came up with her business idea in 1981 after she coordinated an auction to sell wardrobe, props, and equipment from several of the studio's recent movies. She opened a small store in Studio City that sold movie clothes to eager customers who wanted to wear what the stars had worn! It's A Wrap! has experienced significant growth over the years and has expanded into larger quarters twice, now occupying a location with 10,000 square feet of showroom space. The company's location is perfect for implementing Dion's differentiation strategy because Burbank is home to dozens of movie and television studios. It's A Wrap! is literally in the backyards of its suppliers! Dion's company makes the studios' job of disposing of thousands of items much easier, providing valuable services such as instant pickup, computerized inventory control, and private sales. The store's inventory changes daily, depending on which items television or movie studios are selling. Garments come from every kind of show or movie imaginable—from sitcoms and soap operas to war movies and westerns—and every one comes with a certificate of authenticity verifying its origin. It's A Wrap! has been featured in several magazines and on many television shows, including* The Oprah Winfrey Show *and CNN's* Financial Report.[46]

If a small company can improve a product's (or service's) performance, reduce the customer's cost and risk of purchasing it, or both, it has the potential to differentiate. To be successful, a business must make its product or service truly different, at least in the eyes of its customers.

A Company Example

Entrepreneur Yngve Bergqvist has no trouble setting his hotel in Jukkasjärvi, Sweden, apart from others. Located 125 miles above the Arctic Circle, the aptly named **Ice Hotel** *offers travelers a unique experience. Everything in the hotel—walls, beds, night tables, chairs, cinema, bars—is made from 30,000 tons of snow and 10,000 tons of crystal-clear ice harvested from the Torne River! Each of the 60 rooms is unique, designed by a different artist from around the world. Guests sleep in insulated sleeping bags on ice beds covered with thin mattresses and plenty of reindeer blankets. Because temperatures inside the hotel typically hover at 5 degrees below zero (centigrade), guests cannot take their luggage to their ice rooms; it will freeze! Amenities include an ice bar, an ice chapel, an ice cinema, and an ice art exhibition. The 30,000-square-foot Ice Hotel is open from December through April (it melts in the spring), but during its brief existence, it will accommodate some 5,000 guests at rates ranging from $200 to $500 per night. Countless rock groups, including Van Halen, have shot music videos at the Ice Hotel. It's not about comfort," says co-owner Arne Bergh. "It's a journey, an adventure."*[47]

Although few businesses are innately as unique as the Ice Hotel, the goal for a company pursuing a differentiation strategy is to create that kind of uniqueness in the minds of its customers. The key to a successful differentiation strategy is to build it on core competencies, those a small company is uniquely good at doing in comparison to its competitors. Common bases for differentiation include superior customer service, special product features, complete product lines, instantaneous parts availability, absolute product reliability, supreme product quality, and extensive product knowledge. To be successful, a differentiation strategy must create the perception of value in the customer's eyes. No customer will purchase a good or service that fails to produce its perceived value, no matter how real that value may be. One business consultant advises, "Make sure you tell your customers and prospects what it is about your business that makes you different. Make sure that difference is in the form of a true benefit to the customer."[48]

There are risks in pursuing a differentiation strategy. One danger is trying to differentiate a product or service on the basis of something that does not boost its performance or lower its cost to customers. Business owners also must consider how long they can sustain a product's or service's differentiation; changing customer tastes make the basis for differentiation temporary at best. Imitations and "knockoffs" from competitors also pose a threat to a successful differentiation

Guests at the Ice Hotel pay up to $500 a night to bundle up and sleep in an ice bed covered with reindeer blankets.

Courtesy of AP/Wide World Photos.

strategy. For instance, entrepreneurs have built an ice hotel in Finland to compete with the original ice hotel in Sweden. Designers of high-priced original clothing see much cheaper knockoff products on the market shortly after their designs hit the market. Another pitfall is overdifferentiating and charging so much that the company prices its products out of the market. The final risk is focusing only on the physical characteristics of a product or service and ignoring important psychological factors such as status, prestige, and image, which can be powerful sources of differentiation.

focus strategy—*a strategy in which a company selects one or more market segments, identifies customers' special needs, wants, and interests, and approaches them with a good or service designed to excel in meeting those needs, wants, and interests.*

FOCUS. A **focus strategy** recognizes that not all markets are homogeneous. In fact, in any given market, there are many different customer segments, each having different needs, wants, and characteristics. The principal idea of this strategy is to select one (or more) segment(s), identify customers' special needs, wants, and interests, and approach them with a good or service designed to excel in meeting these needs, wants, and interests. Focus strategies build on *differences* among market segments.

A successful focus strategy depends on a small company's ability to identify the changing needs of its targeted customer group and to develop the skills required to serve them. That means an entrepreneur and everyone in the organization must have a clear understanding of how to add value to the product or service for the customer. How does the product or service meet the customer's needs at each stage—from raw material to final sale?

Rather than attempting to serve the total market, the focusing firm specializes in serving a specific target segment or niche. A focus strategy is ideally suited to many small businesses, which often lack the resources to reach the overall market. Their goal is to serve their narrow target markets more effectively and efficiently than do competitors that pound away at the broad market. Common bases for building a focus strategy include zeroing in on a small geographic area, targeting a group of customers with similar needs or interests (e.g., left-handed people), specializing in a specific product or service (e.g., Batteries Plus, a store that sells and services every kind of battery imaginable), or selling specialized knowledge (e.g., restoring valuable and priceless works of art).

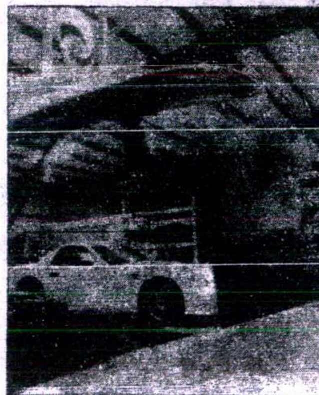
A Company Example

*After taking over the painting business his father had started in 1947, Paul Thomarios had transformed the company into the dominant force in the Akron, Ohio, market. Thomarios discovered the foundation of a profitable niche strategy in 1996 when he landed a contract to restore and paint a Saturn V rocket from the Apollo Space Program for the National Aeronautic Space Agency's (NASA) John F. Kennedy Space Center. Today, the **Apostolos Group** generates 25 percent of its $15 million in sales by restoring and repainting "the tons of old rockets out there," says Thomarios. In addition to NASA, the company's customers include the Detroit Science Center and the U.S. Space and Rocket Center in Huntsville, Alabama.*[47]

The most successful focusers build a competitive edge by concentrating on specific market niches and serving them better than any other competitor can. Essentially, this strategy depends on creating value for the customer either by being the lowest-cost producer or by differentiating the product or service in a unique fashion but doing it in a narrow target segment. To be worth targeting, a niche must be large enough to be profitable, reasonably reachable through advertising media, and capable of sustaining a business over time (i.e., not a passing fad).

A Company Example

*Dan Panoz, founder of **Panoz Auto Development**, is implementing a focus strategy in an industry dominated by global giants where many entrepreneurs before him have flamed out: the auto industry. Like Preston Tucker (whose company lasted from 1946 to 1948), Henry Kaizer (1946–1958), and John DeLorean (1981–1983), Panoz is building his business in a niche: hand-built sports cars. The challenges are formidable, and the capital requirements are high, even for a niche player. At the world's least automated auto assembly line, each Panoz Esperante requires 200 hours to assemble, about 10 times longer than it takes Toyota to build a Camry. Panoz has done a masterful job of taking stock components (mostly from the Ford SVT Mustang Cobra) and transforming them into a high-performance car that one auto magazine called "the world's best engineered, best-built, low-volume car." Priced at $80,000, Panoz is aiming the Esperante directly at men in their forties and fifties who earn annual incomes of more than $150,000 and are auto enthusiasts. The typical*



Dan Panoz, whose company relies on a focus strategy, inspect a high-performance Panoz Esperante.

Courtesy of AP/Wide World Photos.

customer owns two or three other cars, and many travel to the factory near Atlanta to pick out special leather and wood trim and to watch their cars being built. Panoz is shooting for a target of producing 30 cars a month, and his calculations show that once he sells 200 cars, he can begin to earn a profit. Once he works the kinks out of the assembly process, Panoz plans to introduce model variations, such as a hardtop Esperante, to reach his ultimate goal of selling 1,000 cars a year.[50]

As Panoz's venture suggests, pursuing a focus strategy is not without risks. Companies sometimes must struggle to capture a large enough share of a small market to be profitable. If a small company is successful in a niche, there is also the danger of larger competitors entering the market and eroding it. Panoz's constant struggle to keep costs down is typical; the small volume of business that some niches support can raise production costs, making a company vulnerable to lower-cost competitors as their prices spiral upward. Sometimes a company with a successful niche strategy gets distracted by its success and tries to branch out into other areas. As it drifts farther away from its core strategy, it loses its competitive edge and runs the risk of confusing or alienating its customers.

A Company Example

Victoria's Secret, the mail-order company once known for its niche in lingerie, runs the risk of losing its appeal to its traditional customers as the business has strayed from its roots. In addition to its wide selection of lingerie, Victoria's Secret sells wedding gowns, jeans and casual wear, shoes, and career clothing. Muddying its image with customers puts a company in danger of losing its identity.

An effective strategic plan identifies a complete set of success factors—financial, operating, and marketing—that, taken together, produce a competitive advantage for a small company. The resulting action plan distinguishes a business from its competitors by exploiting its competitive advantage. The focal point of this entire strategic plan is the customer. The customer is the nucleus of the business, and a competitive strategy will succeed only if it is aimed at serving target customers better than the competition does. An effective strategy draws out the competitive advantage in a small company by building on its strengths and by making the customer its focus. It also designates methods for overcoming a firm's weaknesses, and it identifies opportunities and threats that demand action.

STRATEGY IN ACTION. The strategies a small business selects depend on its competitive advantages in the market segments in which it competes. In some cases, the business will implement multiple strategies across several segments. When a business has a well-defined strategic advantage, it may pursue highly aggressive growth strategies in an attempt to increase its market share. This is especially true when a business achieves a "first-mover" advantage in a market with little direct competition. By being the first in the market, it establishes name recognition and a loyal customer base. Starbucks Coffee continues to reap the benefits of being the first company to establish a chain of upscale retail coffeehouses in major markets after Howard Shultz traveled to Milan, Italy, and noticed the tremendous popularity of espresso bars. A year later, in 1984, Schultz launched his coffee bar concept as a test in Seattle, Washington. Today, the chain has nearly 6,000 locations around the globe! Aggressive strategies sometimes can backfire if larger competitors decide to fight back. In many cases, the old adage of being the "big frog in a small pond" allows a small business to earn a handsome profit in a market niche without attracting the attention of larger competitors.

Small companies must develop strategies that exploit all of the competitive advantages of their size by:

- Responding quickly to customers' needs.
- Remaining flexible and willing to change.
- Constantly searching for new, emerging market segments.
- Building and defending market niches.
- Erecting "switching costs," the costs a customer incurs by switching to a competitor's product or service, through personal service and loyalty.
- Remaining entrepreneurial and willing to take risks and act with lightning speed.
- Constantly innovating.

Step 8. Translate Strategic Plans into Action Plans

No strategic plan is complete until it is put into action. Entrepreneurs must convert strategic plans into operating plans that guide their companies on a daily basis and become a visible, active part of the business. No small business can benefit from a strategic plan sitting on a shelf collecting dust.

YOU Be the Consultant . . .

One-of-a-Kind Chip Maker

Mark and Stacy Andrus, cofounders of Stacy's Pita Chip Company, have become experts at keeping costs low in their small Randolph, Massachusetts–based company that makes crispy, low-fat chips from pita bread. Housed in an old brick warehouse, the only exterior "sign" identifying the company is a sheet of paper taped to the door. The interior is spotless but contains no frills; the approach is strictly utilitarian. The Andruses' office is decorated in the style of late college or perhaps early yard sale. Stacy's office chair is a castoff from her aunt's old dining room set. The company's location speaks volumes about its founders' philosophy: Make every penny count. Even their salaries are "scavenger-level," says Stacy. "*Everything* goes into the business."

Leaving behind their careers as a psychologist (Mark) and a social worker (Stacy), the couple decided to get into the pita chip–making business. Both self-confessed "foodies," the Andruses worked in restaurants during their college years in California. There they learned that they loved the food business but that they did not want to work for someone else. When they returned to New England, they developed a plan to open a bistro offering the fresh California-style food they knew and enjoyed. Debt from college, however, altered their plans. They started with a pushcart from which they sold hot dogs, sausages, and chili at local festivals and events. Soon they took their cart to Boston's financial district and changed their menu to "Stacy's D'Lites," handmade pita-wrapped sandwiches. Their cart-based menu was perfect for their target customers; during the two-hour lunch rush, the Andruses typically sold 200 wraps, and the line of waiting customers would stretch to 30 or 40 people! "Invariably," says Mark, "the last people in line would trickle away, so we wanted to do something to get them to wait."

What they did was recycle each day's leftover pita bread. Every night, Mark would take the leftover bread, coat it with cinnamon, sugar, or garlic and Parmesan, cut it into wedges, and bake it. Customers loved the chips! In 1996, the Andruses made a decision to stop making sandwiches and focus instead on making pita chips. Their goal was to mass-produce them and sell them nationwide. In keeping with their low-cost philosophy, the Andruses took a low-budget approach, renting space at the Boston Pretzel Bakery and using the bakery's equipment in the off-hours. They cut, bagged, and labeled their chips by hand! The one thing they refused to scrimp on, however, were the ingredients. Because their maximum production rate was just seven cases of chips per 10-hour day, the Andrus's first-year sales were just $25,000. As sales grew steadily, they began investing in automated equipment and moved into the space the company occupies today. They cleaned, stripped, repaired, and painted the entire 10,000-square-foot facility themselves. (David built his "cubicle" from plywood salvaged from a shipping crate from a packaging machine!) The second year of operation produced sales of $450,000.

The Andruses needed capital to expand, but without an extensive track record, they knew they had to prepare a stellar business plan. With Stacy as the majority owner, Stacy's Pita Chip Company qualified for a special Small Business Administration guaranteed loan to assist women entrepreneurs through BankBoston, where many of their former sandwich-cart customers worked. They qualified for $360,000 in loans. "I had a good, solid business plan," says Stacy, "and we had the demand." Her plan included a letter from an airline executive stating that his company would purchase 1 million bags of Stacy's pita chips if the company could turn them out.

As sales continued to climb, the Andruses began looking for more automated equipment to help them increase their production levels. They could not find the automated slicer they needed, and having one custom-built would cost them at least $100,000, which they could not afford. After searching for a year, they finally found a used carrot-cutting machine that the Campbell Soup Company had used for 40 years! The price was a much more affordable $18,000. Mark modified the antique, and it is still in use today. When the Andruses needed an oven with a conveyor belt and adjustable temperature, velocity, and airflow controls, they could not find a used one, nor could they afford the $160,000 a new one would cost. Their solution: They struck a deal with an oven company to build two ovens for $80,000; they purchased one, and the oven maker kept the other to use as a prototype to boost its sales. As sales climbed, they bought a second oven from a bankrupt baker for just $13,000, charging the purchase to a credit card because no bank would lend them the money! "Now we can do 700 cases a day," says Mark.

The Andruses spend very little on advertising, instead relying on the methods they used when they sold food from a pushcart. They make personal appearances at trade shows, cooking demonstrations, public appearances, and grocery stores across the nation, giving out free samples to passersby.

Despite the intense workload they face and the constant challenges of running a business, the Andruses know they made the right choice when they started Stacy's Pita Chip Company. "When we talked about starting our own business, we thought, if we don't do it now, we're going to someday look back and think, "we wish we had," says Mark. "The only regrets you have are for the things you don't try," adds Stacy.

1. Which of the three basic strategies described in this chapter are Mark and Stacy Andrus using? Explain. How effective is it?

2. When it comes to implementing their strategy, how do the Andruses use their size to their advantage? How would you rate the level of creativity they exhibit in managing their business?

3. What suggestions would you offer the Andruses to improve the company's future?

Sources: Anne Stuart, "The Pita Principle," *Inc.*, August 2001, pp. 58–64; Stacy's Pita Chip Company, www.pitachips.com.

IMPLEMENT THE STRATEGY. To make the plan workable, the business owner should divide the plan into projects, carefully defining each one by the following:

Purpose. What is the project designed to accomplish?

Scope. Which areas of the company will be involved in the project?

Contribution. How does the project relate to other projects and to the overall strategic plan?

Resource requirements. What human and financial resources are needed to complete the project successfully?

Timing. Which schedules and deadlines will ensure project completion?

Once entrepreneurs assign priorities to projects, they can begin to implement the strategic plan. Involving employees and delegating adequate authority to them is essential since these projects affect them most directly. If an organization's people have been involved in the strategic management process to this point, they will have a better grasp of the steps they must take to achieve the organization's goals as well as their own professional goals. Early involvement of the workforce in the strategic management process is a luxury that larger businesses cannot achieve. Commitment to reaching the company's objectives is a powerful force, but involvement is a prerequisite for achieving total employee commitment. Without a team of committed, dedicated employees, a company's strategy usually fails.

Step 9. Establish Accurate Controls.

5. Understand the importance of controls such as the balanced scorecard in the planning process.

So far, the planning process has created company objectives and has developed a strategy for reaching them, but rarely, if ever, will the company's actual performance match stated objectives. Entrepreneurs quickly realize the need to control actual results that deviate from plans.

CONTROLLING THE STRATEGY. Planning without control has little operational value; therefore, a sound planning program requires a practical control process. The plans created in the strategic planning process become the standards against which actual performance is measured. It is important for everyone in the organization to understand—and to be involved in—the planning and controlling process.

Controlling projects and keeping them on schedule means that an entrepreneur must identify and track key performance indicators. The source of these indicators is the operating data from the company's normal business activity; they are the guideposts for detecting deviations from established standards. Accounting, production, sales, inventory, quality, customer service and satisfaction, and other operating records are primary sources of data that managers can use to control activities. For example, on a customer service project, performance indicators might include the number of customer complaints, the number of orders returned, the percentage of on-time shipments, and a measure of order accuracy.

To judge the effectiveness of their strategies, many companies are developing **balanced scorecards**, a set of measurements unique to a company that includes both financial and operational measures and gives managers a quick yet comprehensive picture of the company's overall performance. One writer says that a balanced scorecard:

balanced scorecard—*a set of measurements unique to a company that includes both financial and operational measures and gives a quick yet comprehensive picture of the company's overall performance.*

> is a sophisticated business model that helps a company understand what's really driving its success. It acts a bit like the control panel on a spaceship—the business equivalent of a flight speedometer, odometer, and temperature gauge all rolled into one. It keeps track of many things, including financial progress and softer measurements—everything from customer satisfaction to return on investment—that need to be managed to reach the final destination: profitable growth.[51]

Rather than sticking solely to the traditional financial measures of a company's performance, the balanced scorecard gives managers a comprehensive view from *both* a financial and an operational perspective. The premise behind such a scorecard is that relying on any single measure of company performance is dangerous. Just as a pilot in command of a jet cannot fly safely by focusing on a single instrument, an entrepreneur cannot manage a company by concentrating on a single measurement. The complexity of managing a business demands that an entrepreneur be able to see performance measures in several areas simultaneously. "Knowing whether an enterprise is viable or not doesn't mean looking at just the bottom line," says one manager.[52] Scorecards that

combine relevant results from all aspects of the operation allow everyone in the organization to see how their job performance connects to a company's mission, goals, and objectives.

When creating a balanced scorecard for their companies, entrepreneurs should establish goals for each critical indicator of company performance and then create meaningful measures for each one.

A Company Example

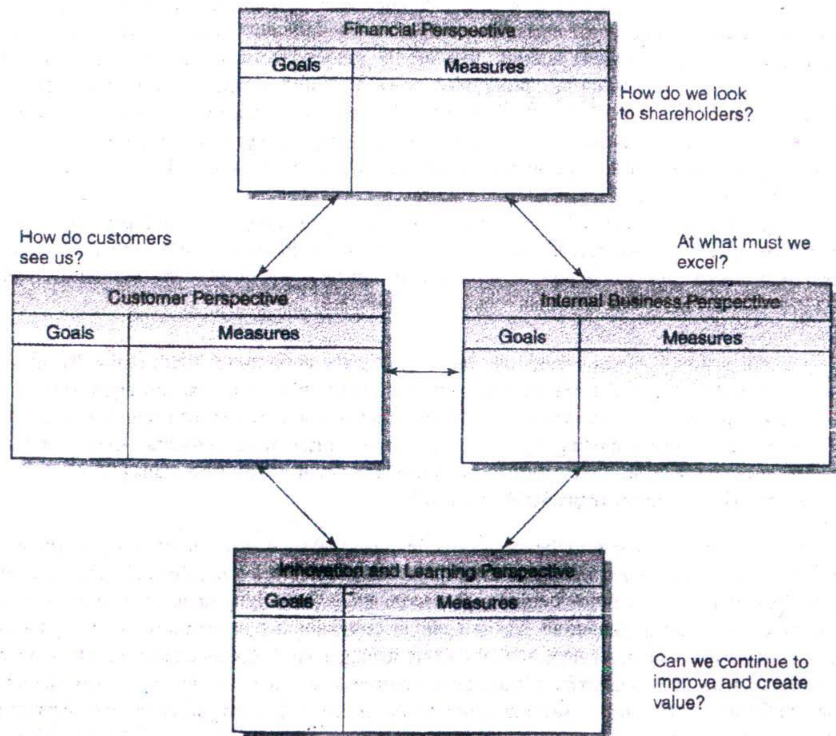
For example, Court Coursey, founder of ***Certifiedmail.com****, a company that delivers certified mail electronically, has developed a scorecard that encompasses measures on everything from financial performance to employee satisfaction. Every quarter, Coursey presents Certifiedmail.com's one-page scorecard to his 10 employees for review. "It's a good way to get a grasp of the company and how it's performing," he says. The scorecard gives Coursey important feedback that allows him to adjust his management style and the company's direction when necessary. The scorecard already has improved Certifiedmail.com's performance. One of Coursey's top priorities is cost control, and the scorecard recently pointed out a wasteful practice that he halted. "[The scorecard] showed me a way to save money," he says. "And it was something I may not have seen without this feedback."*[53]

Ideally, a balanced scorecard looks at a business from four important perspectives (see Figure 3.3):[54]

Customer Perspective: How do customers see us? Customers judge companies by at least four standards: time (how long it takes the company to deliver a good or service), quality (how well a company's product or service performs in terms of reliability, durability, and accuracy), performance (the extent to which a good or service performs as expected), and service (how well a company meets or exceeds customers' expectations of value). Because customer-related goals are external, managers must translate them into measures of what the company must do to meet customers' expectations.

Internal Business Perspective: At what must we excel? The internal factors that managers should focus on are those that have the greatest impact on customer satisfaction and retention and on company effectiveness and efficiency. Developing goals and measures for factors such as quality, cycle time, productivity, costs, and others that employees directly influence is essential.

FIGURE 3.3 The Balanced Scorecard Links Performance Measures



Innovation and Learning Perspective: Can we continue to improve and create value? This view of a company recognizes that the targets required for success are never static; they are constantly changing. If a company wants to continue its pattern of success, it cannot stand still; it must continuously improve. A company's ability to innovate, learn, and improve determines its future. These goals and measures emphasize the importance of continuous improvement in customer satisfaction and internal business operations.

Financial Perspective: How do we look to shareholders? As the most traditional performance measures, financial standards tell how much the company's overall strategy and its execution are contributing to its bottom line. These measures focus on such factors as profitability, growth, and shareholder value. On balanced scorecards, companies often break their financial goals into three categories: survival, success, and growth.

Although the balanced scorecard is a vital tool that helps managers keep their companies on track, it is also an important tool for changing behavior in an organization and for keeping everyone focused on what really matters. As conditions change, managers must make corrections in performances, policies, strategies, and objectives to get performance back on track. A practical control system is also economical to operate Most small businesses have no need for a sophisticated, expensive control system. The system should be so practical that it becomes a natural part of the management process.

CONCLUSION

The strategic planning process does *not* end with the nine steps outlined here; it is an ongoing procedure that entrepreneurs must repeat. With each round, managers and employees gain experience, and the steps become much easier. The planning process outlined here is designed to be as simple as possible. No small business should be burdened with an elaborate, detailed formal planning process that it cannot easily use. Such processes require excessive amounts of time to operate, and they generate a sea of paperwork. Entrepreneurs need neither.

What does this strategic planning process lead to? It teaches business owners a degree of discipline that is important to business survival. It helps them learn about their businesses, their core competencies, their competitors, and, most important, their customers. Although strategic planning cannot guarantee success, it does dramatically increase a small firm's chances of survival in a hostile business environment.

CHAPTER SUMMARY

1. Understand the importance of strategic management to a small business.

Because they are affected by the forces of a rapidly changing competitive environment, small businesses need the guidance that strategic management can provide. Strategic management enables a company to set itself apart from the competition.

2. Explain why and how a small business must create a competitive advantage in the market.

The goal of developing a strategic plan is to create for the small company a unique image in the minds of its potential customers. A company builds a competitive edge on its core competencies, which are a unique set of capabilities that a company develops in key operational areas, such as quality, service, innovation, team building, flexibility, responsiveness, and others that allow it to vault past competitors. They are what the company does best and are the focal point of the strategy. This step must identify target market segments and determine how to position the firm in those markets. Entrepreneurs must identify some way to differentiate their companies from competitors.

3. Develop a strategic plan for a business using the nine steps in the strategic planning process.

Small businesses need a strategic planning process designed to suit their particular needs.

Step 1. Develop a clear vision and translate it into a meaningful mission statement.

Step 2. Assess the company's strengths and weaknesses. Strengths are positive internal factors; weaknesses are negative internal factors.

Step 3. Scan the environment for significant opportunities and threats facing the business. Opportunities are positive external options; threats are negative external forces.

Step 4. Identify the key factors for success in the business. In every business, key factors determine the success of the firms in it, and so they must be an integral part of a company's strategy. Key success factors are relationships between a controllable variable and a critical factor influencing the firm's ability to compete in the market.

Step 5. Analyze the competition. Business owners should know their competitors almost as well as they know their own business. A competitive profile matrix is a helpful tool for analyzing competitors' strengths and weaknesses.

Step 6. Create company goals and objectives. Goals are the broad, long-range attributes that the firm seeks to accomplish. Objectives are quantifiable and more precise; they should be specific, measurable, assignable, realistic, timely, and written down. The process works best when managers and employees are actively involved.

Step 7. Formulate strategic options and select the appropriate strategies. A strategy is the game plan the firm plans to use to achieve its objectives and mission. It must center on establishing for the firm the key success factors identified earlier.

Step 8. Translate strategic plans into action plans. No strategic plan is complete until the owner puts it into action.

Step 9. Establish accurate controls. Actual performance rarely, if ever, matches plans exactly. Operating data from the business assembled into a comprehensive scorecard serve as an important guidepost for determining how effective a company's strategy is. This information is especially helpful when plotting future strategies.

The strategic planning process does not end with these nine steps; rather, it is an ongoing process that an entrepreneur will repeat.

4. Discuss the characteristics of low-cost, differentiation, and focus strategies and know when to employ them.

Three basic strategic options are cost leadership, differentiation, and focus. A company pursuing a cost leadership strategy strives to be the lowest-cost producer relative to its competitors in the industry. A company following a differentiation strategy seeks to build customer loyalty by positioning its goods or services in a unique or different fashion. In other words, the firm strives to be better than its competitors at something that customers value. A focus strategy recognizes that not all markets are homogeneous. The principal idea of this strategy is to select one (or more) segment(s), identify customers' special needs, wants, and interests, and approach them with a good or service designed to excel in meeting these needs, wants, and interests. Focus strategies build on *differences* among market segments.

5. Understand the importance of controls such as the balanced scorecard in the planning process.

Just as a pilot in command of a jet cannot fly safely by focusing on a single instrument, an entrepreneur cannot manage a company by concentrating on a single measurement. A balanced scorecard is a set of measures unique to a company that includes both financial and operational measures and gives managers a quick yet comprehensive picture of the company's total performance.

DISCUSSION QUESTIONS

1. Why is strategic planning important to a small company?
2. What is a competitive advantage? Why is it important for a small business to establish one?
3. What are the steps in the strategic management process?
4. "Our customers don't just like our ice cream," write Ben Cohen and Jerry Greenfield, cofounders of Ben and Jerry's Homemade, Inc. "They like what our company stands for. They like how doing business with us makes them feel." What do they mean?
5. What are strengths, weaknesses, opportunities, and threats? Give an example of each.
6. Explain the characteristics of effective objectives. Why is setting objectives important?
7. What are business strategies?
8. Describe the three basic strategies available to small companies. Under what conditions is each most successful?
9. Explain how a company can gain a competitive advantage using each of the three strategies described in this chapter: cost leadership, differentiation, and focus. Give an example of a company that is using each strategy.
10. How is the controlling process related to the planning process?
11. What is a balanced scorecard? What value does it offer entrepreneurs who are evaluating the success of their current strategies?

THE BUSINESS DISC

Launch *The Business Disc*. From the menu across the top of your screen, select the "Reference" option and then click on "General Information." Here you will find several reference guides that offer useful information to entrepreneurs. Click on "Strategic Planning for the Growing Business" and review the concepts in this reference guide and in Chapter 2. Write down your company's mission statement. Next, identify the primary strengths and weaknesses your business can rely on. Develop a list of the top two or three opportunities and threats your start-up business faces. Now, establish meaningful goals and objectives for your business start-up. (Be sure to select a reasonable time frame; six months to one year is probably best.) Finally, describe the strategy you plan to use to develop a competitive edge for your business. How will you set your company apart while attracting and retaining customers?

BUSINESS PLAN PRO

Business PlanPro

As you study the concepts of organizational objectives, mission, and the key success factor for a business, go to the "Concept Kick-Off" section of *Business Plan Pro* and begin work on each sub-section.

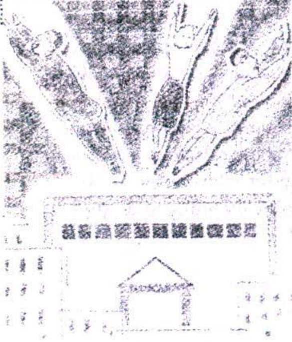
Objectives Drawing upon the criteria in Chapter 3 which defines objectives, list the three or four most critical objectives your business must achieve to be viable.

Mission In this section enter the mission statement for your business. In most cases it will take a half-dozen re-writes of the mission statement before it states exactly what you want it to say. Our suggestion is to then ask four or five acquaintances to read the mission statement and tell you what they think you have said.

Keys to Success In step four of the strategic planning process you were asked to identify the key success factor(s) for a business. Applying that material to your proposed venture, enter your key success factor(s).

Other key aspects about your business that relate to this chapter can be inserted in sub-sections such as "Company Summary" and "What You Are Selling." This material will not complete the sections but will allow you to capture your thoughts while they are fresh in your mind.

BEYOND THE CLASSROOM . . .



1. Contact the owner of a small business that competes directly with an industry giant (such as Home Depot, Wal-Mart, Barnes & Noble, or others). What does the owner see as his or her competitive advantage? How does the business communicate this advantage to its customers? What competitive strategy is the owner using? How successful is it? What changes would you suggest the owner make?

2. In his book, *The HP Way*, Dave Packard, cofounder of Hewlett-Packard, describes the seven commitments of the HP Way:

   - Profit—the ultimate source of corporate strength.
   - Customers—constant improvement in the value of the products and services the company offers them.
   - Field of interest—seeking new opportunities but limiting them to complementary products and services based on company core competences.
   - Growth—a measure of strength and a requirement for survival.
   - Employees—provide opportunities for advancement, share in their success, and offer job security based on performance.
   - Organization—foster individual motivation, initiative, and creativity by giving employees the freedom to work toward established goals and objectives.
   - Citizenship—contribute in a positive way toward the community and society at large.

   In what ways do these values help HP define its vision? Its competitive edge? How important is it for entrepreneurs to define a system of values to guide their companies?

3. Contact a local entrepreneur and help him or her devise a balanced scorecard for his or her company. What goals did you and the owner establish in each of the four perspectives? What measures did you use to judge progress toward those goals?

4. Use the strategic tools provided in this chapter to help a local small business owner discover his or her firm's strengths, weaknesses, opportunities, and threats; identify the relevant key success factors; and analyze its competitors. Help the owner devise a strategy for success for his or her business.

5. Choose an entrepreneur in your community and interview him or her. Does the company have a strategic plan? A mission statement? Why or why not? What does the owner consider the company's strengths and weaknesses to be? What opportunities and threats does the owner perceive? What image is the owner trying to create for the business? Has the effort been successful? (Do you agree?) Which of the generic competitive strategies is the company following? Who are the company's primary competitors? How does the owner rate his or her chances for success in the future (use a low (1) to high (10) scale). When you have completed the interview, use the following evaluation questionnaire to rate the company's strategic orientation. Compare your evaluation with other classmates. What, if any, generalizations can you draw from the interview?

Is the Owner Managing the Business Strategically?

Rate your present managerial actions on each of the following questions:

1. In the past two years have you written or reviewed your firm's mission statement?

   Yes (10 pts.)

   No (0 pts.) Q.1. ______

2. Are you confident that your employees are aware of the key underlying values that drive the business?

Absolutely (10 pts.)

Generally (7 pts.)

Not sure (3 pts.)

I have never shared with them my values (0 pts.) Q.2. _____

3. Does each manager have a clear set of performance objectives for his area of responsibility?

Yes (10 pts.)

Some do (5 pts.)

No (0 pts.) Q.3. _____

4. Do you regularly meet with your key managers and employees to discuss the behaviors of your competitors?

Regularly and often (10 pts.)

Informally, but not a scheduled event (5 pts.)

Never have done so (0 pts.) Q.4. _____

5. Would your employees be able to accurately describe the strategies your firm is attempting to employ?

Definitely (10 pts.)

Most of them (5 pts.)

The firm's strategies have never been explained to them (0 pts.) Q.5. _____

6. Do all employees understand that through the achievement of success for the organization they enhance the opportunity for achieving their own personal goals?

Definitely (10 pts.)

Most do (7 pts.)

A few do (4 pts.)

It has never been explained to them (0 pts.) Q.6. _____

7. Do you annually conduct an environmental scanning exercise with your managers in an attempt to identify future opportunities for the firm?

Yes (10 pts.)

Informally (5 pts.)

No (0 pts.) Q.7. _____

8. Can all of your managers explain the impact of their performance, and that of their staff, on the performance of the total organization?

Absolutely (10 pts.)

Generally (7 pts.)

Not sure (3 pts.)

No (0 pts.) Q.8. _____

9. Has your business been moving in a clear and positive direction over the past three years?

   Definitely (10 pts.)

   Generally (7 pts.)

   Not sure (3 pts.)

   No (0 pts.) Q.9. _____

10. Do you and your key managers think and behave strategically?

    Always (10 pts.)

    Generally (7 pts.)

    Not sure (3 pts.)

    Seldom (0 pts.) Q.10. _____

    Total points _____

    Maximum Score 100

    Minimum Score 0

    Grading Your Firm:

    A+ 95–100 pts.

    A 90–94 pts.

    B+ 85–89 pts.

    B 80–84 pts.

    C+ 75–79 pts.

    C 70–74 pts.

    D+ 65–69 pts.

    D 60–64 pts.

    F below 60 pts.

Your recommendations: