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4 STRATEGIC PERFORMANCE

PLANNING & CONTROL

TEACHING NOTE

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4 Strategic Performance Planning and Control

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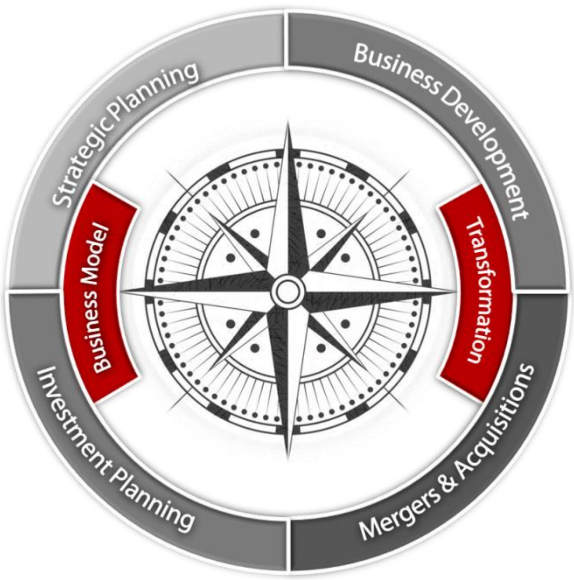
4.1 Introduction and Learning Objectives

What do we have to consider and do now in order to still grow and be profitable in 5, 10 and 15 years? This is probably the fundamental question in strategic performance management. The business world in the 21st century continues to be increasingly dynamic. Capitalism was famously described by Schumpeter almost a century ago as the process of creative destruction. Some even refer to the business environment as a war zone which is probably why strategy, the art of winning wars, has become important and necessary for the long-term success of companies. I define strategic performance management as follows: thinking and acting ahead of the market by continuously transforming the business model in line with anticipated and monitored changes in the business environment.

Strategic performance management means managing the strategic performance loop of companies. Strategic analysis, strategic planning, transformation and strategic control are stages of the strategic performance loop that do not directly interfere with the operational performance cycle (except for the crisis mode) of a company's business model. It is a mixture of extending the business value of today and innovatively creating new business values with creative business models. Strategy has despite its belligerent origin a soft and stratospheric connotation: the future is uncertain and hypothesizing about the future and changing the course of a business model based on assumptions is a risky process. However, this is the core of a company's entrepreneurial drive. If the assumptions turn out fine and the execution of the strategic transformation proceeds well, there is a real chance of creating value. There is no algorithm to create future business value and strategic performance management follows heuristic processes.



Strategic performance management is not an isolated process. It goes to the very heart of the entrepreneurial activities within the company. The core is the transformation of the business model to stay competitive in a changing world. Various processes are or should be interconnected: Strategic planning, business development, investment planning and M&A. Strategic Planning is on the one hand an analytical and on the other hand a creative activity, all of which is based on the current business. However, it is mostly an intellectual process. This chapter focuses on analyzing the business model and developing a strategic plan. The business development, on the other hand, tries to actually change the business and investment planning and mergers & acquisitions form part of this transformation. Since investment planning and M&As are very special topics, they will be dealt with in other chapters.

4.2 Strategic Performance Management as a Process

Books on strategy are able to fill entire libraries. Unfortunately, if the authors of these books knew how to make money on implementing business strategies, they probably would have spent their time making money instead of writing books. The exception might be consultants who want to convince potential clients about their ability to structure their strategy process. This chapter offers the heuristic of understanding strategic performance management as a process with six elements. This might help the reader to comprehend the nature of this complex endeavor. The elements are: Strategic Radar, Strategic Analysis, Strategic Plan, Strategic Initiatives, Transformation and Strategic Control.

Strategic Radar

Although the operational business cycle consumes a lot of management attention, top management should always establish a radar to track the weak and sharp signals in the business environment and to detect a looming strategy crisis or opening business opportunities. The annual revision of business performance against the budget and the competitors in terms of sales and profit is a good start to assess the opportunities and threats to the business model. But overall, this is an ongoing process which involves a variety of information sources such as:

- Reading international newspapers for political, social, economic, technological and legal developments
- Attending trade fairs to see new competitors and new developments
- Connecting with customers to learn about their needs and developments
- Connecting with suppliers to learn about new technologies
- Monitoring competitors to learn about their performance and strategies
- Talking to advisors about new tendencies or trends in the business
- Connecting with employees on all levels in various locations
- Monitoring the market for innovative start-up ideas

Strategic Analysis

The strategic analysis is a systematic approach to holistically analyze the current business model or various business models for strengths, weaknesses, opportunities and threats. The analysis should lead to the identification of strategic issues. These issues could be opportunities or threats that need to be addressed to make the current business model fit for the future.

Example of strategic issues could be the demographic change, lack of financial resources or a new technology like 3D printing which might open new sales opportunities. A special section will elaborate further on techniques for strategic analysis.

Strategic Plan

The strategic plan connects the dots of the strategic analysis and envisions the future of the company for the next five or ten years. This will clearly involve numbers for sales revenues and profitability: For various reasons companies and investors aim for profitable growth. A strategic plan that does not offer a serious road map for its implementation will probably result in the strategic skills of the management team being brought into question. The strategic plan offers assumptions about the evolution of future market developments in regards to various parts of the business; this should include the results of new strategic initiatives.

Strategic Initiatives

Strategic initiatives are the levers for transforming the business over the next years. They could be manifold. They might include R&D projects, major investments or even dis-investments, M&A activities or organizational restructuring-efforts with the aim to boost profitability. These initiatives usually come with a price tag and need funding and shareholder support.

Transformation

Strategic initiatives need to be executed and monitored closely. They represent the ongoing change within the business models. One could compare this to open heart surgery. The execution of M&A projects, the implementation of investments or putting business process optimization programs into practice consumes resources including management attention and partly disturbs the operational business. It also includes delicate processes of cultural change and surmounting of skepticism and resistance. The mindset which was fundamental for the business success of the past (e.g. highly aligned and execution oriented) might not be adequate for the business challenges of the future, which might require a higher degree of decentralized entrepreneurial thinking and organizational agility. Transforming the business, however, is the only way for survival and growth.

Strategic Control

The monitoring and controlling of the progress of initiatives is important. Aligning the organization around a single strategy and focusing all efforts on value generation needs adapted communication and control mechanisms.

However, even more important is whether or not the assumptions at the foundation of the strategic plan are still valid. In the end, the business performance has to show the effectiveness of the strategy. Agility means to be able to change and adapt the strategic plan to meet new circumstances. It is counterproductive to implement a plan, if the plan is no longer in harmony with a changing business environment.

4.3 Business Model Check

The business model check analyses seven high relevance areas of our business model and works to identify strategic issues, opportunities or threats to be dealt with in our strategic plan and initiatives. Asking critical questions might evoke creative solutions for transforming our business model in order to achieve profitable growth. Bigger companies are most likely to pursue a variety of business models at the same time. This might involve partly unrelated customers and value propositions. In this case it is more meaningful to analyze each business model and then perform a meta-analysis. A simplified example of a coffee store will illustrate the framework.

Figure 4-1: Business Model Check

4.3.1 Customers

Marketing has done a great job to focus business attention on the customer: thinking everything from the customer's perspective can help us to identify growth opportunities and spot imminent threats.

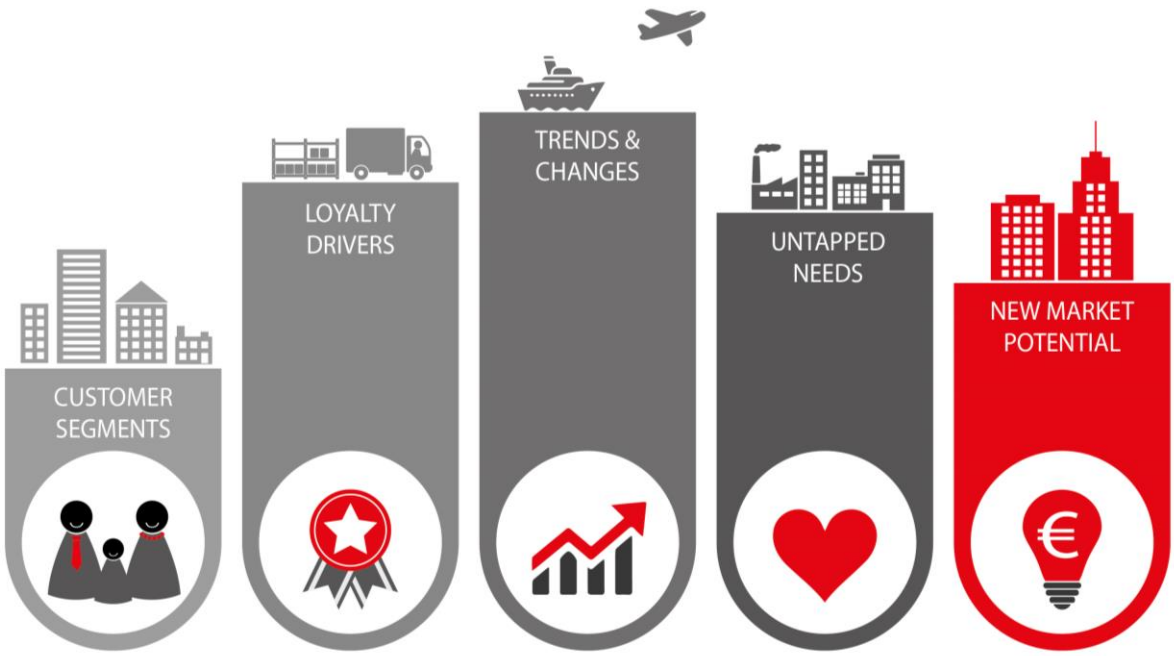


Figure 4-2: Customer focus

Customer segments

Who is our customer? Can we separate our customers into meaningful segments by categories like industry, geography, wealth, age, education, etc.? Can we identify the customer segments which provide the highest/lowest value (in terms of revenue, profit, prestige, etc.) for us?

Loyalty Drivers

What do our customers expect from us and what makes them loyal and repeat customers? What kind of service and what kind of product quality does each customer segment expect? What does each customer segment value? What are the touch-points with the customers? How do we use it to foster trust and customer loyalty? Do we have a brand value? What is attached to it?

Trends & Changes

Our customers are subject to cultural changes. They follow demographics trends which state that the European population is getting older and adapting new technologies like smartphones and tablets. Economic depressions will likely reduce the propensity of the average customer to spend. Cultural changes might also include fashion, design and social or environmental consciousness and values. Generation Y is a social cohort with special needs and expectations.

Untapped Needs

Usually out of these new trends develop new needs which have yet to be tapped. Tapping such a need ahead of the competition might build a competitive advantage. In many cases customers might even not be aware of their desires and could need special instruction to learn about the products which can serve them. In some cases, customers proactively ask us if we could provide additional products or services. Here, one might eventually co-create and jointly develop new products. Since social needs and the needs for self-actualization are almost limitless, it should be possible to cater to the needs that the customers did not even know they have. This is less possible with business customers, but still possible.

New Market Potential

What can we do to earn more money with the same customers? Would they be open to buy a wider range of products or services from us?

What are the customer segments that we do not serve right now, but might be very interesting in the future? Eventually, market expansion from a regional market penetration into national or even selected growing international markets might be promising. Would it be fine to use sales agents or is it time to establish an independent sales office?

The market potential for reach should also be quantified in order to create a basis for revenue and profit projections.

4.3.2 Value Proposition

The value proposition is the promise that our products and services will create value for the customer by solving their problems. Performance, innovativeness, design, friendliness, reliability, trust or security might be attributes of our brand and our products, but the question is whether we create value for money.

Customer Value

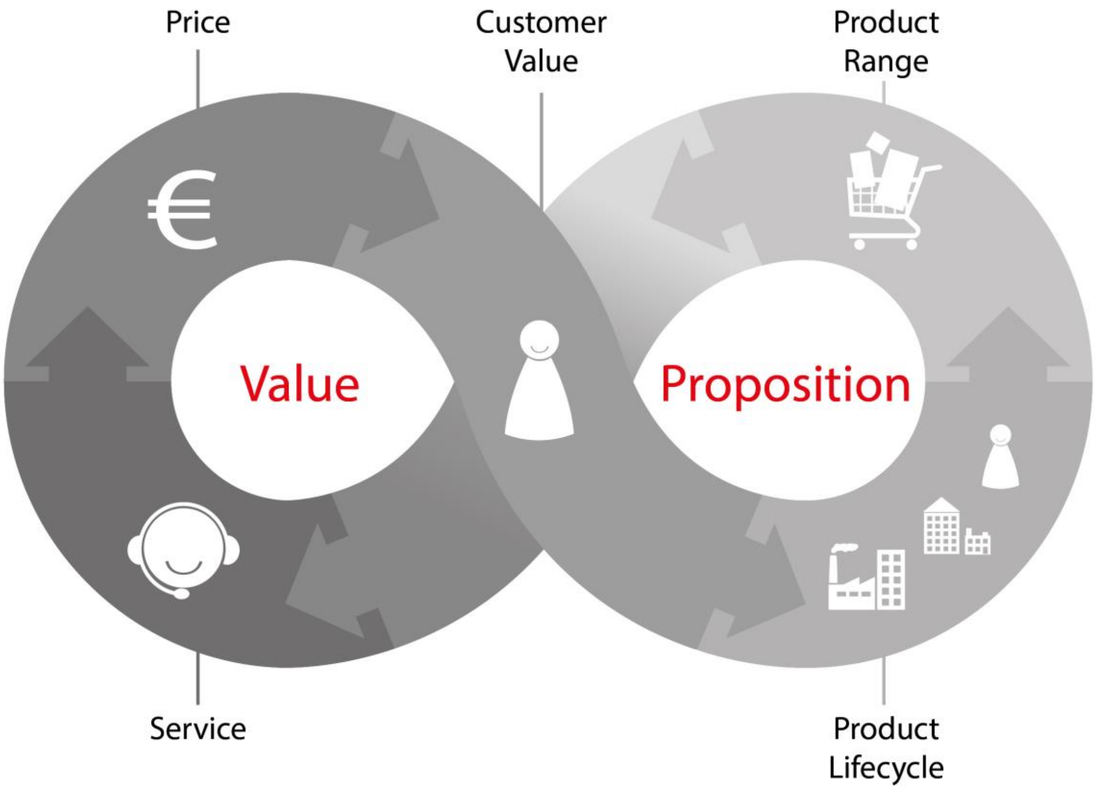


Figure 4-3: Value Proposition

If our customers are other companies they use our products and services to earn money for themselves by serving their customers. They might look for the total cost of ownership of the product or service, all the explicit and implicit costs during the product life-cycle, which includes spare parts, idle time or management attention, and the assessment of whether they can still earn money with it. Similarly, the final customer value or customer surplus is generated by providing product or service qualities at a lower price than the customer would have been willing to pay. In order to create value, we have to ask ourselves the question what problems do our customers have and how can we help solving them? If we analyze our product and service portfolio, we should first look for the ability to solve our customers' problems. Understanding our customers and their needs will open up opportunities for new products or services. However, we should keep in mind that we need to generate money from solving our customers' problems. In some cases we might have to make investments to develop them, in other cases we just have to be creative and re-package things into a value-bundle, or offer additional services to increase the cross-selling value they bring to the company.

Product lifecycle

If we analyze our product portfolio we see that some products are rather old and some are relatively new. The life-cycle of our services usually is limited. In the area of smartphones, every nine months, a new generation of a smartphone is presented. If our product portfolio is outdated and we have no full development pipeline, we might enter into a corporate crisis.

Product range

Another question concerning the value proposition deals with the product range. The product range can be complementary, offering different kind of products for different market segments. Volkswagen offers the whole spectrum of cars with under different brands like VW, Audi and Skoda. A large product range using similar components can lead to tremendous economies of scale and scope. However, there is a risk of cannibalism, should customers perceive the different brands as similar and simply opt for the best price-value ratio. Cross selling additional products like financing, insurance or service packages can further enhance the value proposition to the customer and generate additional income for the company.

Service

What is the range of our services? The diversity of services includes automated online services, dedicated personal assistance as well as offering co-creation platforms like Facebook or Xing. The question is what do our customers need and for which service are they willing to pay? The service in a fast-food restaurant in a suburb is different from that found in an ambitious Michelin-starred restaurant in a fancy location within a metropolis. The difference is that the customers are willing to pay for the exclusive experience.

Price

The price has to match the logic of the cost-performance ratio. The payment could come in the form of personalized advertisement like Google or other optional buy-ins. This means the background costumer is paying for the access to the data or attention of the user customer. Very popular is the so-called freemium model: The customer gets a certain service level for free but has to option to acquire additional value if he buys special items or premium membership privileges. This is true for network platforms like LinkedIn or Xing, but also very popular in computer games.

4.3.3 Value Processes

The business process of a company should serve the customer by enabling the value proposition, providing goods and services. Depending on the business model, the elements to focus on might differ. The following areas (sales, supply, logistics, production, service, management, R&D and partnerships) are worth looking into for value enhancement, meaning increasing the value creation and or reducing costs.

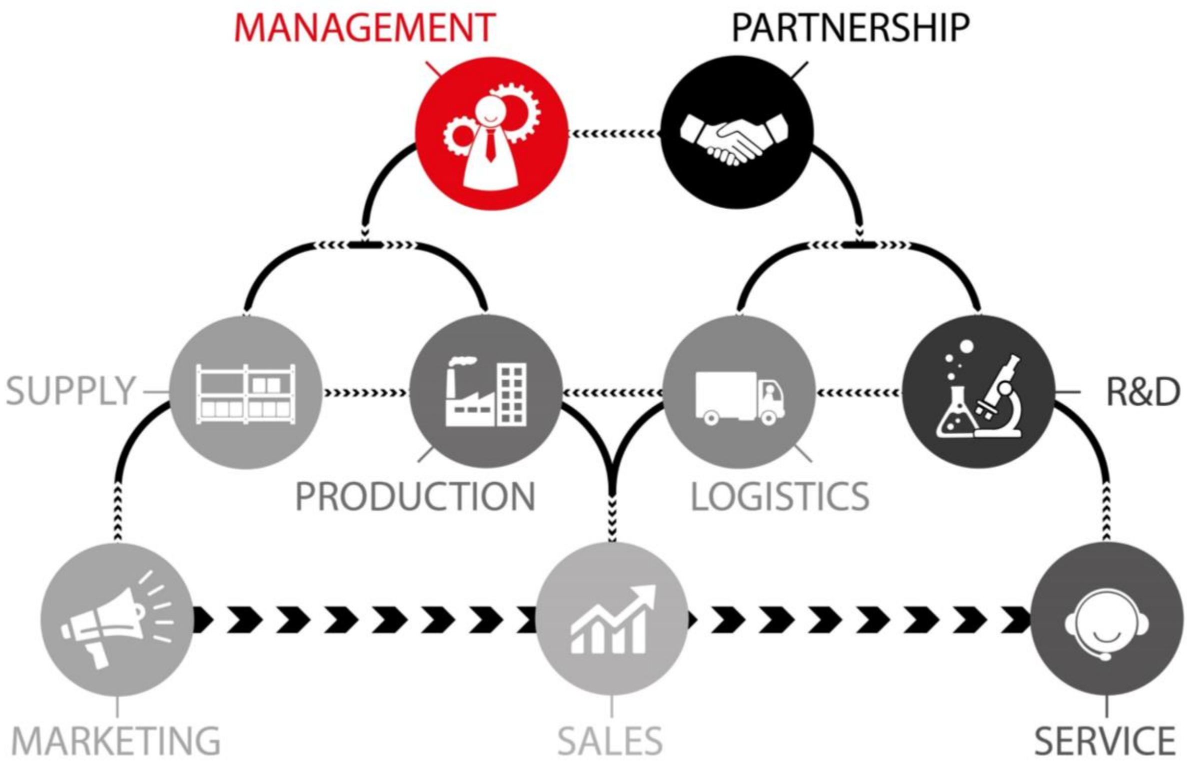


Figure 4-4: Value processes

Sales

How do we reach our customers? What are the value enhancing activities in this area? Are we using the right sales channels online and offline? Do we successfully explain our value proposition? Are the sales conditions adequate? Are we effectively measuring the right success indicators?

Supply

Our suppliers help us to create value for our customers. Managing the value chain is crucial in terms of quality, cost, time and reliability. Are we using the right suppliers? Are we getting all the value we should get from them?

Logistics

If our customers decided that they want our product or service, do we have the right processes in place to provide fast service? This includes the handling the orders, the physical transportation of supplies and the final delivery to the customer. If we provide a network solution, our key value proposition is mastering and providing logistics.

Production

It might sound old fashioned, but in the case of selling physical assets, we will probably have to do part of the production ourselves, even if it is only the final assembly. Outsourcing of production looks like a good solution, but we might lose our innovative edge and become dependent on our suppliers. Are we producing in the right place and at competitive costs?

Service

How can our customers reach us, if they need service? Do we differentiate the service level per customer segment? Some might be happy with self-service, some require automated service, some might even expect, like in private wealth management, dedicated personal assistance including dining and wining. The question remains whether the service level is adequate and is adding value to the customers and the company. Service can be a good way to increase sales but reducing service could be a good way to reduce costs.

Management

Does Management add value to the company? Although this question sounds aggressive, this is exactly the pressure every management has to work under. Shareholders fire top managers quickly if they do not see proof for this. Successfully managing the performance management cascade and creating long-term profitable growth are the necessary indicators for shareholders to be satisfied with management.

The market process of creative destruction demands creativity and business acumen of management to constantly look for efficient and profitable operations and development of a roadmap for strategic profitable growth.

Research & Development

Developing new products and new solutions is essential for the business success of tomorrow. An in house R&D can be very prestigious, but also very costly. Does our R&D add to our value proposition or just to our overhead costs? What is our research output in terms of sales generated from newly developed products?

Partnerships

No company is an island. We have a lot of potential partners at our reach to help us with different parts of our value creation process. These partners could help us with selling such as marketing agencies, sales agents or a sales network (e.g. Walmart, Aldi, specialized dealers, etc.), supply crucial components, on which the performance of our product depend, run our logistics, produce our products (like Foxconn produces Apple products) and even provide the service for our customers (e.g. external customer hotline, or dealers). As far as the management is concerned, business consultants could help us to develop our strategic plan or help with the optimization of our operations. R&D is classical area where we might even share the development costs with a competitor or outsource the research altogether. Clinical studies are today mostly run by special research agencies and not by pharmaceutical companies. Partnering could also include teaming up with our customers to jointly develop a new solution.

The value propositions in today's world are the result of a complex interplay of different players and processes. New combinations and fresh ideas can imply strategic potential.

4.3.4 Resources

In order to offer a value proposition to the customers, the company has to provide resources. These resources can be money, physical assets, people or intellectual property.

Money

Even though one might argue that companies are money making machines, their fuel is money itself which buys other resources. The money that companies have could be equity or loans from banks or suppliers. The definition of bankruptcy is that a company is no longer able to service its debt. Money is therefore the key resource of companies. Money can buy people, physical assets and intellectual capital.

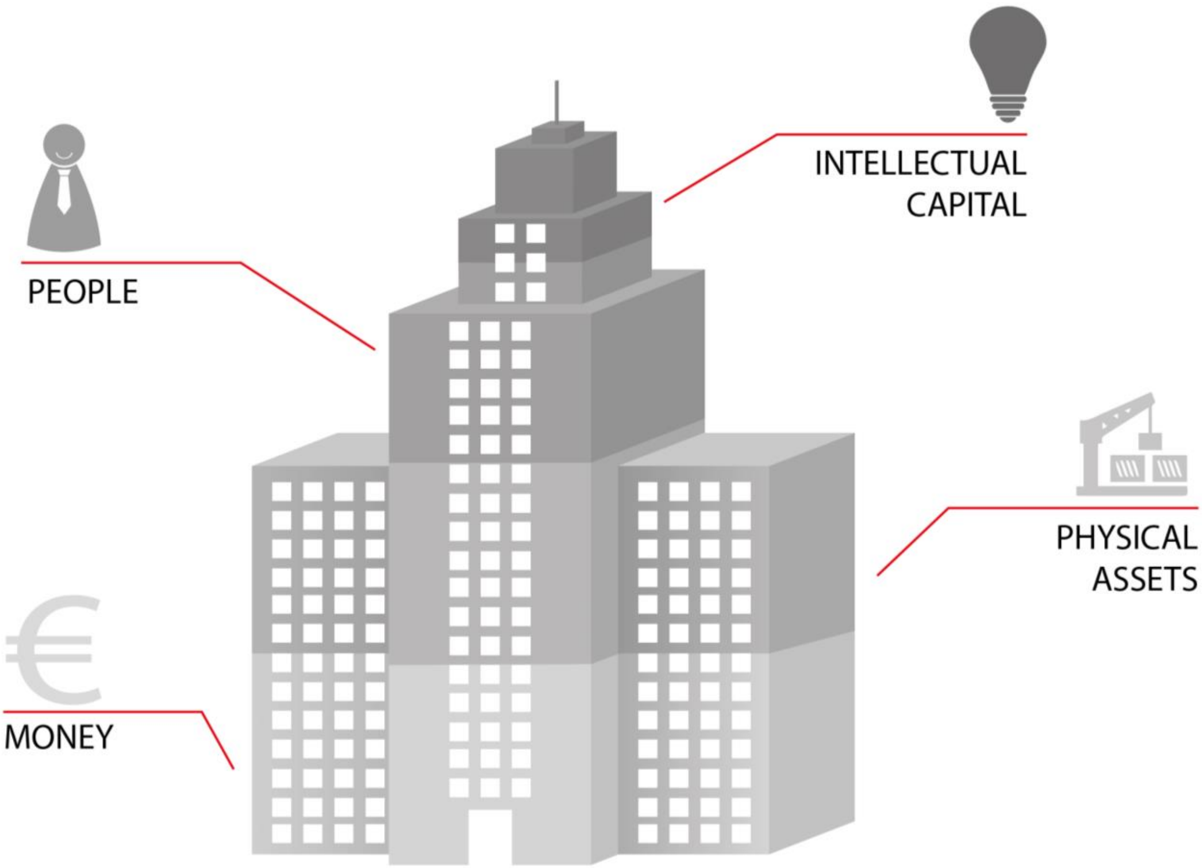


Figure 5: Resources

Money is needed to build up and transform a company. The strategic options of a company are limited by its financial resources. That does not mean that people, assets and intellectual capital do not count. On the contrary, they are absolutely necessary for the success of any strategy. However, every investment in people, physical assets and intellectual capital touches money and has to bear financial fruits.

Physical Assets

Building a new plant, buying new trucks, establishing new stores or logistic centers, investing in new server capacities or other long-term assets is the realm of investment planning. But there are other strategic considerations: maybe an important input factor for production is threatened to be limited (rare earths were in the debate over the last years). It might also be interesting to strategically buy most of the available and future assets of a particular kind in order to make it difficult for competitors to copy a new production strategy. Graphene is currently discussed to be one of these materials of the future. Buying a graphene maker or getting into a special partnership which might include cross-over shareholdings would be a strategic move for a company that plans to exploit the possibilities of graphene in the coming years.

People

Most of the business models depend on the dedicated work of employees in the value processes of the company. People are therefore a strategic resource. Growth implies more employees. Attracting, retaining and motivating talented employees has become a challenge against a backdrop of shrinking populations in the mature markets. Engagement and loyalty cannot be taken for granted any more, and the classical incentives (bonus payments, company cars) have lost their luster.

The culture and the performance of employees are strategic success factors. The readjustment of the corporate culture towards the changing exigencies of the markets by leadership, trainings, and management controls systems is the basis for a profitable growth strategy.

Even in a growing business, some areas might require some “right-sizing” which involves restructuring and a reduction in the workforce. Money is needed for the growth and nurturing of the workforce, the transformation and the reduction. Cynically, some companies wait until insolvency protection (like chapter eleven in the US) to get rid of their workforce, because they can get away without providing severance packages or other compensations.

Intellectual capital

The intellectual capital of a company is at least twofold. On the one hand it describes the intellectual property in the form of patents or brand value and on the other hand, it stands for the creative potential of its employees. On top of this, the trust the employees and the organization instills in others is a valuable asset. The following questions might be raised: How innovative are we currently and how innovative have we been in the past? What kind of intellectual capital do we need to address the challenges of the future? How should we develop this area? Should we internally invest into R&D or buy companies with the necessary knowledge and the related patents? Do we need to hire specialists to help our current R&D force?

Some of our markets might also have developed in a direction, where the products have become commodities, and our own R&D department is no longer adding real value to the business. In this way, reducing or outsourcing the intellectual capital might be a strategic option. Does our management team have the trust of the shareholders and stakeholders? Do they believe they can make credible promises and deliver? Trust can be easily lost and is difficult to rebuild.

4.3.5 Competition

Analyzing the competition should become an ongoing routine for every company. Since many competitors are publicly listed, it is easy to get access to a lot of relevant data via the internet. Competition might from a macro-economic perspective look like a marvelous generator of innovation and progress. New business models make others obsolete and drive out established market players. Unfortunately, competition, especially head-on competition with similar products for the same customers, leads to a dilemma situation. Prices will go down to unsustainable levels, until some competitors go bankrupt. In other words, competition is like a poison for company profits and should be avoided as far as possible.

Figure 6: Competition Avoidance Tactics

Direct price cartels of competitors are illegal in most legislations and market dominance of individual companies like Google Inc. is scrutinized by official European market watchdogs for abusing its market powers.

However, there are many legal ways of avoiding competition. Let us elucidate a few in the following lines.

Create superior products

If you create a wonderful and even revolutionary product that act like a game changer in an industry, you will leave the competition breathless for a while. When the Apple iPods revolutionized the market for MP3-players, this was the effect. The same was repeated with the iPhone and the iPad. Superior products (in the perception of the customers who are willing to pay a large premium for them) unfortunately do not keep the competition away for long. And it is very difficult to keep ahead of the market for a very long time, just as it is to be able to revolutionize market after market with extraordinary products.

Make use of patents

The regulators of the world have protected intellectual property to an extent that it might create a real monopoly situation. This can happen in the pharmaceutical or any other sector. A clever patent strategy could make it impossible for the competition to work its way around it. They will either have to pay royalties to use some of the protected technology or cannot compete. It might even be rational to buy a patent which might threaten one's own business model. So if there was a technology which would instantly make all gasoline consumption radically more efficient, the oil industry would have an interest to buy the technology and keep it locked up. If one has patents or trademarks, one has to rigorously monitor and fight patent violation of competitors.

Create closed eco systems

A closed ecological system is a term from biology meaning a system that does not rely on an exchange with any part outside the system. In other words, it is the idea to create a protected world that keeps the customers completely free from interferences from competitors – or in other words trapped. Of course, the business examples are not fully closed ecological systems: but you may have noticed that you can buy a cheap jet printer but need to use the expensive original ink of the same brand to make it work. As soon as you buy an Apple product you are drawn into a world where you can consume, play, buy, pay and work, and you can easily extend the apple world by buying additional products and features. Being a member of the club offers you the feeling of being part of a very special world, to which Microsoft or Android users have no access. The best business models seem to have a touch of a religious sect quality, where customer loyalty becomes a spiritual decision. The financial and social costs of leaving are also immense.

Buy competitors

Market concentration helps to stabilize prices and margins in an industry. Therefore, lateral or horizontal mergers are an interesting option to reduce the competition and increase market power. As this is a very dynamic and interesting topic, it will be dealt with in more detail later within this book.

Monopolize Resources

Although it might not be allowed to buy competitors, it certainly is to monopolize resources in terms of people or critical resources for production. F you hire EVERYONE who can run server farm, you will soon be the sole provider left. Or if you buy a year of annual production of a critical resource in advance (for example for SSD) you are in a position which cannot be rivalled for a while.

Influence regulations

Influencing governments to regulate markets usually only has the effect of decrease market competitiveness. Tariffs or difficult technical regulations might create hurdles for international competitors. Lobbying for legislation might lead to the establishment of protected new business models. Since lobbying is being done anyhow, one might as well invest to steer the pendulum in the preferred direction.

Attract the best professionals

As already said within the part about resources, people are also a crucial factor to the success of any business. Therefore, creating an environment where the brightest minds of your industry are striving to work for can make them move away from your competitors and put their potential to work for you. This in turn is then a two-fold benefit for you. On the one hand you become more innovative and can strengthen your market position, and on the other hand your competitors might experience shortfalls in their development pipelines making lowering their market position.

Create a competitive cost base

Whatever we do to protect our business model, we will probably sooner or later see the commoditization of our products and thus the fight for the lowest price. Therefore cost discipline is needed, even when the differentiation potential seems huge and the market power overwhelming. A competitive cost base that will survive the final price wars of the specific market will be a valuable asset for creating cash flow for investments in other markets. This includes making use of all economies of scale and scope.

Follow a niche strategy

If the market is full of competition, there might still be tiny niches where a competitor might live a quiet but prosperous life. A niche could be an interesting minority group, like specializing on smartphones for blind people. Providing features that appeal especially to this customer group probably will not attract too much attention from other competitors. Interestingly enough, the smartphone for the blind is already an explored niche market. The use of apps has made it possible to easily cater to the needs of the visually impaired. It could be also possible to cater to the demands of the German speaking minority in Rome, or providing special medicines for a rare disease. Offering a German bakery in Hanoi falls into this category.[1] New technologies might threaten the business model of a niche strategy.

4.3.6 Revenue & Profit Potentials

The objective of the strategic planning exercise is to substantiate a prognosis and plan for the sales and EBIT for five to ten years from now. It should take into account the development of the existing business, organic growth and the external growth options to be pursued.

Existing business

Based on our analysis and certain explicit assumptions about determinant variables leading to market growth in the markets where we are already active: What will be a realistic scenario for our sales / revenue development? A comprehensive market model shows a solid understanding of the market forces. This should also include a clear statement about the development of the profitability of our business in terms of EBIT as a % of sales. What kind of projects are planned to maintain or increase the profitability in the existing business and what will be the total free cash flow expected to serve investment projects and shareholders?

Organic Growth

Based on our R&D pipeline of new products and services and our plans to expand into new markets, what is the expected sales development for sales with new products or in new markets (with old or new products)? The plans for organic growth are communicated towards shareholders and for publicly traded companies. This means that public interest is surprisingly explicit. Here, a company should try to convey the story behind the organic growth path.

External Growth

Part of the strategic plan is also to give hints regarding M&A options which would help achieve a profitable growth strategy. Are they oriented towards market consolidation or more into selectively buying new products or access routes into new markets? The early discussion of external growth plans with shareholders and other stakeholders like

[1] http://donkeybakery.com

banks is relevant, because they will have to provide the funding and need to be confident about the rationale the company is following as it searches for potential candidates or weighs M&A opportunities.

Visualization

The total plans could also be visualized as follows the challenge is to convey not a lofty plan for the next year, but a convincing story based on a thorough analysis of the business model and the market forces.

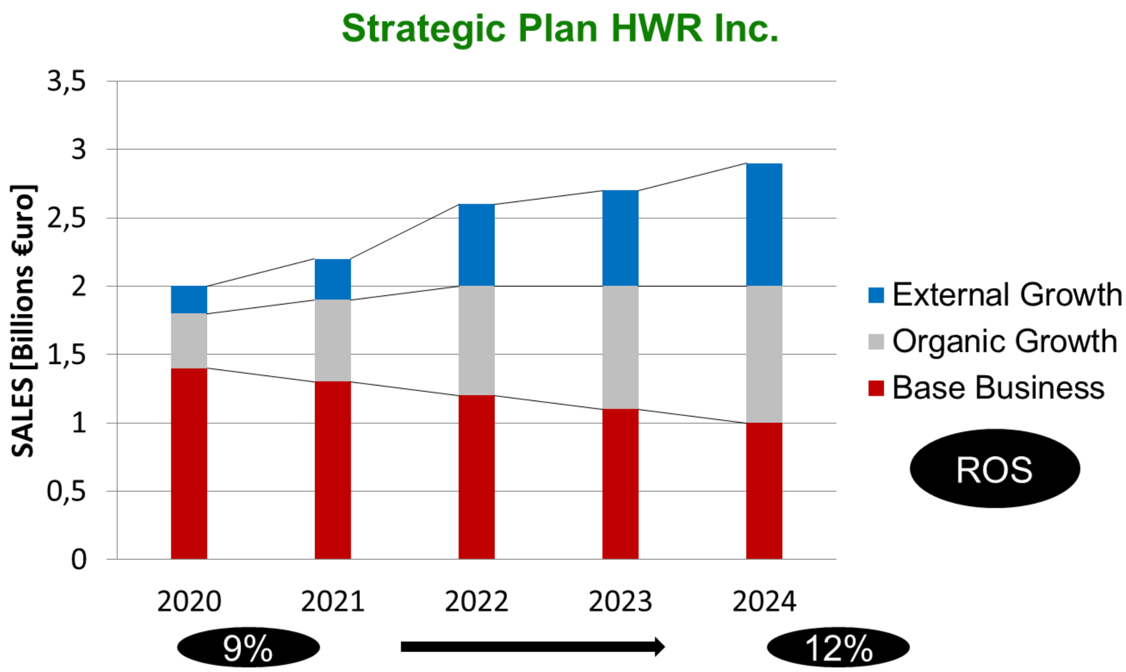


Figure 4-7: Strategic Plan Sales

A well prepared CFO is able to drill down on every project and explain the underlying logic for its expected development.

4.3.7 Risk Profile

Risk management is an important aspect of business and cannot be explained in full detail in this chapter. However, most of the risks a company is confronted with are induced by the business model and its strategic choices. Therefore, strategic planning should include a systematic analysis of the risks coming along the way.

Strategic risk map

A strategic risk map maps the biggest risk and assesses their probability or likelihood as well as the potential impact of certain events.

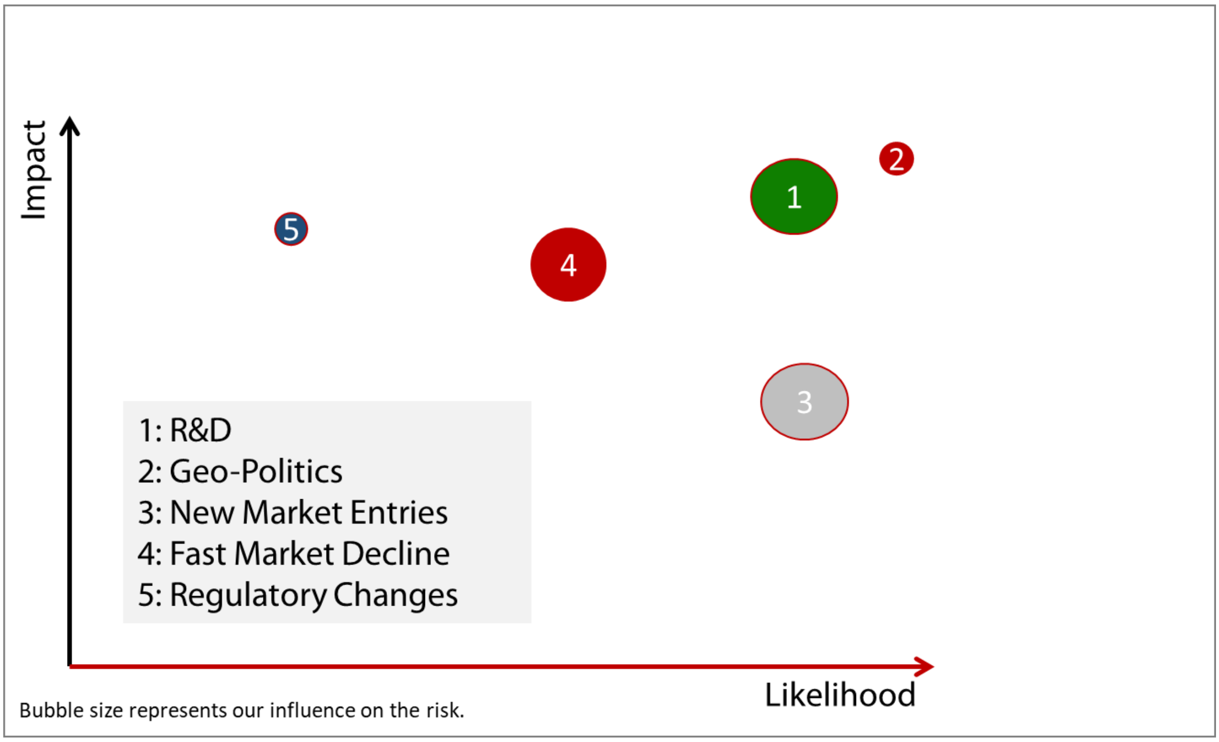


Figure 4-8: Strategic plan risk map

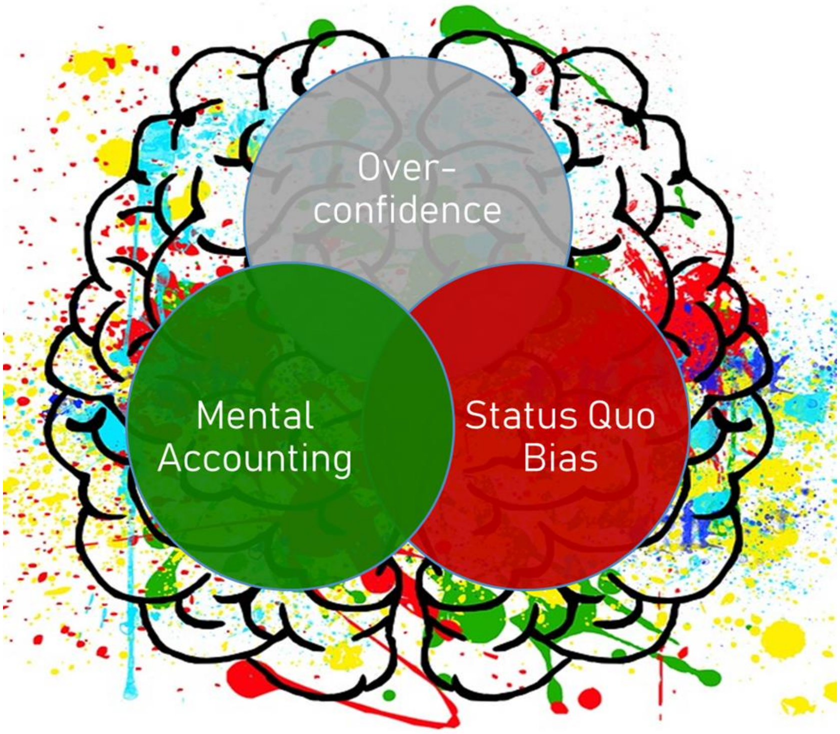
In the example above the company has identified the 5 major risks for the strategic plan. Number 1 is R&D. This means that the fulfillment depends largely on the on-time development of new products depending partly on new technology. This includes a high risk. The size of the bubble indicates how much influence of managing the identified risk the company has. In the case of R&D the company has a lot of management possibilities. Risks number 2 consists of geopolitical risks. The company assesses the geopolitical risks surrounding the Middle East and Russia and anticipated a substantial impact for its strategic plan as far as sales are concerned. There is little the company can do about these risks. Risk 3 deals with new market entries: In the case of competitors or new companies entering the specific markets, especially in India and Brazil, the sales and profit levels might suffer. The company believes itself to have a certain level of influence on how this happens, since they can establish premium customer relationships and prepare the market for new entrants. Risk number 4 would be a faster home market decline than anticipated. This would substantially erode the cash flow generation over the next years and would imperil parts of new investments. Last, regulatory changes might threaten parts of our business model. In this case the use of a key substance in our products might be banned, because it might be considered to be too toxic and carcinogen.

Although a risk map will not reflect all possible risks, it might reveal flaws and biases.

4.4 Cognitive Biases and KPIs

4.4.1 Cognitive Biases in Strategic Planning

Strategic planning is not a science. One might say that the strategic plan is a hypothesis for the development of the company within its business environment. We do not know the future, but are striving to create it. Nonetheless, systematically, decision makers fall into the following perception traps: overconfidence, mental accounting and the status quo bias. These traps are psychologically well explained and occur regularly in projecting long-term scenarios. Under-standing the biases is the first step for de-biasing and getting to better strategic plans.



Overconfidence

Strategic planners have the tendency to be overly-optimistic and thus overestimate revenue potentials and underestimate related risks and costs. Against the cloud of an unknown future this seems a natural reaction and the entrepreneurial driver per excellence. Many projects would not have started if one had known all the details beforehand.

However, in the case of strategic plans, the strategic planners should critically assess whether their assumptions are adequate. Institutionalized pessimism might be a good antidote: Discounting the base scenario by 30% or even more is a typical way of bringing in this antidote. The devil's advocate could be played by the CFO or the controller.

Mental accounting

Mental accounting boils down to the perception where a Euro does not equal a Euro any more. It comes in at least two varieties, the positive attribution and the negative one. Let us assume that a company has decided to push for India following the assumptions that India would be outgrowing even its future estimates and that an early participation in the India boom would set the game for the decades ahead. This could lead to interesting case that better projects will be disregarded because it does not mean investments into India but the US. It might even be that the US location is mentally discounted because they have for ten years not lived up to the entrepreneurial expectations. Therefore, the decision to expand production to India vs. US is biased from the start.

Outside help in form of critical board members might be needed to mitigate these biases.

Status quo bias

The most dangerous of all biases is probably the status quo bias. It assumes that everything will more or less stay the same and that the current business model does not need a constant questioning and transformation. Ignoring signs of cracking in our value proposition and underestimating market forces could well lead into a strategic crisis. Constantly self-cannibalizing one's own business model is a good way of keeping away from this bias. If we do not change our business model ourselves, the competition will do. Non action is threatening the future in an ever changing business environment.

4.4.2 Strategic KPIs and Risk Indicators

Strategic planning can use a plethora of key performance indicators as guiding lights for analyzing the performance of a company or finding early warning indicators for the business development. The following list might serve as a source for inspiration:

- Sales and sales growth per customer segment, average sales volume per sale
- Market share per segment
- Profitability per customer (requires activity based costing)
- Population growth per relevant segment / region
- GDP or industrial output growth per relevant region
- Customer satisfaction index
- Percentage of repeat-customers
- Customer request for currently unavailable additional products or services
- Sales per employee
- EBIT per employee
- Patent registrations per year
- Average tenure of all employees
- Cycle time as a % of the cycle time of a major competitor
- Investment set aside per future EUR of sales
- Investments as % of depreciations & amortizations
- Sales of products released within 12 months as % of total sales
- Number of trainings per employee (increase knowledge of them)
- % of value added by each division of the company (e.g. when having different business models)
- % of R&D expenses of Sales

4.5 Example CLOSE

Let us assume the following case: a student coffee shop CLOSE with limited restaurant and bar service has established itself close to the entrance of a University.

Customers

The customers are mostly students, university staff including professors and a few guests from the neighborhood. Although the biggest customer group consists of students, they tend not to spend a lot of money. Instead, they just buy a coffee to go, prefer the cheap university mensa for lunch and eventually have a beer after class for socializing. They offer a special smokers' room and have tables outside during summer, where smoking is permitted. Challenging are the university holidays which total up to almost five months in the year with almost no students around. The average bill per customer is around 3.50 Euros. The customer base is planned to stay the same for the years to come.

Value Proposition

The value proposition as of now consists of offering a low-budget coffee shop atmosphere and offering convenient food and alcohol at aggressive price levels at the doorstep of a University with 5000 students. The value proposition is already enriched by newspapers and journals and WiFi for customers. However, the spectrum of services is mostly addressing students. The counter is used for serving the very price sensitive to-go customers and the tables are served.

The management of CLOSE is weighing the options to add a party catering service to their portfolio to serve university events and student parties. Another option is to organize special student parties.

The product range and the menu have not changed for several years, serving rather cheap traditional food like pasta and salads, which are prepared in the kitchen of CLOSE. All options are discussed to increase the offering to the customers. The most profitable part of the business is selling drinks or coffee at the tables. The selling of a coffee to go at a price of 1.50 Euros leaves roughly 70 cent of operating profit, without taking into considerations overhead costs like rent.

Value Processes

Offering a good atmosphere at the coffee shop, organizing food and drinks supply, running a kitchen, serving customers at the counter and at the tables are the direct value processes. This includes regular renovations of the interior and managing a handful of service personnel.

The management team discusses to stop running an underutilized kitchen and catering in some convenient food. Another option is to start an in-house ice cream production or a bagel shop with hot bagels. Starting discussions with a brewery to gain extra money for an up-scaling of the interior is an old but unrealized idea.

Resources

Money has been tight throughout the existence of CLOSE. Some insiders laughed about the name and dubbed it "CLOSE to bankruptcy". Every month the company has to pay rent and utilities adding up to 1,500 Euros. Although the cash-flow generated allowed for the survival of the business and a subsistence of the owner, the interior and exterior looks reflect the permanent lack of money. A new coffee machine will be needed within the next two years. This looming investment reduces the investment power substantially. The CLOSE service team enjoys the work but is badly paid and not very enthusiastic about the working conditions. Any strategic plan would require bringing in new investors or a cheap credit.

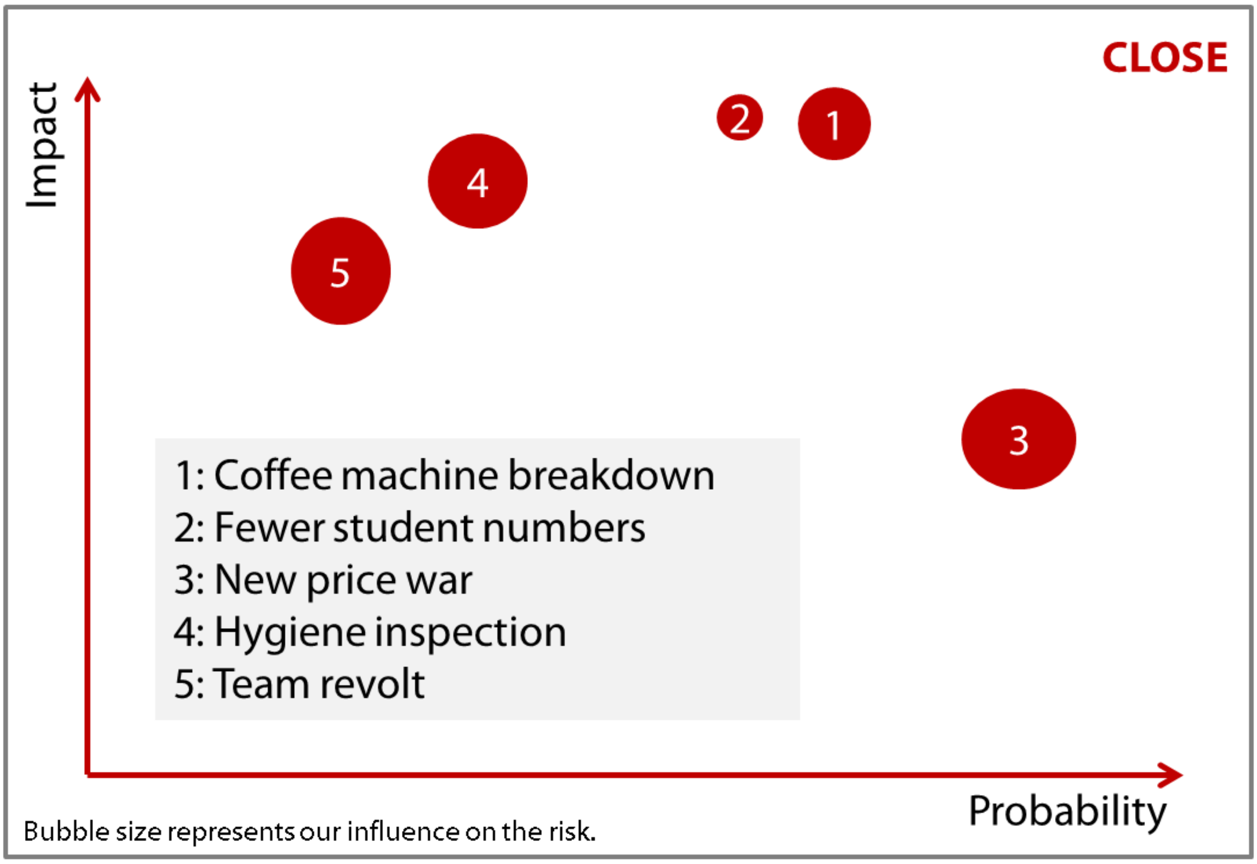
Competition

With walking distance, there is the subsidized student restaurant run by the University, a newly established pizza store and another coffee store. Since all of the competitors struggle to survive, prices are low and competition is fierce. CLOSE might have the best micro-location with many students passing by on their way to university, but there is a clear reason to differentiate itself in its offering from its competitors. In the mid-term at least one competitor is going to go bust. Muddling through in the hope to survive the imminent round of market consolidation is the current hope of CLOSE.

Revenue & Profit Potential

The revenue for the next years is looking to stagnate with the current offerings and with the prices low, the low profitability with an ROS of 5% will be difficult to maintain. The cash can pay for the operational costs two month ahead including rent. The idea of running a coffee shop without a kitchen would help the bottom line, but some fear that without food the profitable drinks business might suffer. The conversion of the kitchen into a bagel shop cum ice cream parlor would involve investments of at least 50,000 Euros. The same amount would be needed to upscale the interior. Although the investment might pay back within three years and substantially increase the long-term profitable growth outlook of CLOSE, the 100,000 Euros needed make this investment unrealistic out of the cash flow of the running business.

Risk Profile



CLOSE faces various risks. The imminent risk would be a sudden break-up of the coffee machine. This would lead to a short-term liquidity crisis and the sudden need for new capital. The team treats the machine with love and care, but anything is possible.

In the mid-term declining student numbers might become an issue, due to demographic changes and changes in the high school system, which might provoke a year without new students.

Since the competition is fierce, the current players might again reduce prices on coffee to go to up to 1.20 Euro per cup, like a year ago. The effect would be chilling, but not disastrous.

A failed hygiene inspection of the kitchen, however, might have a very bad effect on the business. The kitchen is not profitable, but a forced closure would further erode the trust in the business model and the CLOSE brand. The kitchen tools are old and need an investment: maintaining the needed hygiene level is a challenge.

Last but not least the company sees a team revolt as a possible risk. Loosing experienced staff is one aspect, but the real risk is a disgruntled employee who might even sabotage the coffee machine.

Questions and Cases

Questions

1. What is strategic performance management?
2. What is fundamental objective of performance management?
3. Name two reasons why as a strategic performance manager it is important to plan for the future?
4. What is strategic radar? Provide 2 examples of how to develop it.
5. Name the 6 components of the strategic management process.
6. Which component of the strategic management process is concerned with assuring that the business plan/ model is up to date with current circumstances?
7. Provide an example of how a company could address an untapped need.
8. Name the elements that constitute value proposition.
9. What element of value proposition addresses cannibalization?
10. What is a cost performance ratio and where is it implemented with regards to value proposition?
11. Explain intellectual capital.
12. How can a company combat competition?
13. Under which competition avoidance strategy would M&As fall?
14. Differentiate organic from external growth.
15. What can a company do to combat geopolitical risks?
16. Name another type of risk a company might face and provide a real world example.

Multiple Choice questions:

1. Annual business planning with a time horizon of 2 years can be regarded as an effective way to prepare for the future?
   a) Yes
   b) No

2. Strategic Performance Management aims at diversifying the risks of a company?
   a) Yes
   b) No

3. The difference between Business Development and Strategic Planning is:
   a) They are synonyms
   b) Strategic planning questions the status quo business model and Business Development translates this into action
   c) Business development is an operational task, whereas Strategic Planning is an intellectual one

4. What could be tools to increase the reliability of a strategic road map?
   a) KPIs / Ratios
   b) Risk analysis
   c) Goals
   d) All of the above

5. During an M&A integration management should solely focus on their operational work and leave the integration to experts.
   a) Correct
   b) Incorrect

6. When performing a business model check we should only focus on the customers that currently contribute most revenue to the business?
   a) No
   b) Yes

7. What are possible ways to tackle a corporate crisis in the product lifecycle area?
   a) Increase cross-selling
   b) Diversifying product portfolio
   c) Increase R&D expenditures
   d) All of the above
   e) a&b
   f) b&c
   g) c&a

8. What best describes the resources of a company?
   a) It is a mixture of Money and tangible assets.
   b) It consists of people, intellectual capital, physical assets, and money.
   c) Money is the most important resource for a company.
   d) Resources can be used to actively lower a competitor’s ability to acquire resources.

9. Strategic performance management is about:
   a) Letting go of the status quo if necessary
   b) Always updating the current business models
   c) Making the company more agile
   d) Creating a measurement system for evaluating C-level managers

10. Organic growth is about:
    a) % of Sales caused by internally generated innovations
    b) % of Sales due to new markets
    c) % of Sales due to existing markets
    d) A mixture of a & c
    e) A mixture of b & a

11. It is especially important to have a consistent Revenue & Profit potential story line because (please name all applicable):
    a) Shareholders & Stakeholders have to agree to the projects
    b) It increases the CFOs reputation
    c) It helps to identify bottlenecks
    d) Competitors can be intimidated

12. When translating a strategic risk map only the factors we can influence should be taken care of:
    a) True
    b) Untrue

13. When using KPIs for strategic management one should:
    a) Include internal performance measures only
    b) Include economic output measures
    c) Use a many measures as possible to be able to measure everything deeply
    d) Use internal and external measures and weigh them for decision making

Answer sheet:

Question	Correct Answer
1	B
2	A
3	B
4	D
5	B
6	A
7	F
8	B
9	A
10	A
11	All
12	B
13	D

Exercises

Analyze a company of your choice following the steps of the business model check. Identify and elaborate chances and threats to the business model. Elicit ideas how to develop the business model and present a risk map for the business. Identify important KPIs and risk indicators.

Transfer

Business models can also be transferred to personal planning. Apply (and adapt) the business model check to your own career planning. Develop your strategic profile and develop your own strategic career plan.

Case Albert's nursery

Background

After 20 years in the business, Albert Leitz is now experiencing severe problems in running his nursery business that he loves so much. This makes him especially sad as he likes to advise his shop visitors on plants that are suitable for their needs. Unfortunately, those customers are now rarely coming into his shop since the opening of a big DIY market down the road. Still, Albert is taking pride of his independence from the corporate world and that he is able to employ people who really need it. However, now that Albert turned 58 he is looking into an uncertain future and is questioning his current business model.

The type and history of the business

After graduating from college as an engineer in the 70s, Albert found himself in different corporate positions where he did not see his wishes fully satisfied. As a passionate gardener and beekeeper he always wanted to be outside and see his plants grow. Therefore, he founded Leitz's nursery in the 1980s, which is still located near Baumschulenweg in an outskirt of Berlin, Germany. Here, Albert has been running his business for 30 years now serving customers from the city centre, as well as people living in Köpenick. However, in the last 3 years Albert has experienced some serious decrease in business, which has also forced him to let go of 4 employees that he previously had for 15 years. Nowadays, Albert enjoys taking care of his bees as it helps him distract from the problems he experiences with his business.

At the customers' discretion, Albert offers high quality trees, which he also displays on his land for customers to get inspired by them. Moreover, as an experienced and passionate gardener he is also happy when visitors ask him for advice on which plants they should choose and offers this consulting for free to them. Moreover, Albert sells the typical tools one needs to plant a tree in his own garden. However, due to an increase in urbanization people put less and less emphasize on having their own garden or space to plant their own trees.

Nevertheless, besides this retail business Albert's nursery also offers consulting services for local authorities and companies on equipping their offices with plants. However, local authorities have withdrawn almost all of their contracts with Albert due to his inability to fulfil their needs for biweekly full-service treatments for the plants in their offices.

Products and Services offered

Albert's nursery provides retail plants to local consumers and wholesale plants and services to businesses. Of especial importance to Albert are the fruit plants as he not only likes to look at them but also eat their fruits. Nevertheless, Albert also offers all other kinds of trees like oaks, maples or conifers. During office times from 10 – 17hrs Tuesday – Saturday, either Albert himself or one of his employees provide free advice to walk-in customers on gardening design and the different plants available. In case a customer is interested in having a plant installed in his garden, one of Albert's experts will take care of this and in case more landscaping is requested, Albert collaborates with an old friend of him who is working as a landscaper. By doing so, they mutually benefit from attracting business for each other. Additionally, Albert offers the basic tools a gardener might need like shovels, plant containers, garden hand tools or irrigation equipment.

Moreover, Albert's nursery provides plants for rental for bars and restaurant at the Spree that do not want to take care of them also winter times. Nevertheless, this kind of professional business requires the most work from Albert's team as they will have to drive out and check weekly if the plants are still beautiful or might need some treatment.

Further, Albert has also leased out a part (approx. 2 acres) of his land to a local boat shop to store their stuff. However, this lease contract is going to run out next year and because of the increasing attractiveness of the land, Albert has already been approach by several companies that would like to make use of it. Therefore, he has the following options to choose from on what to do with the idle land:

- Sell it to a real estate company
- Rent it out so that solar panels can be installed there
- Use it for his own purposes

The last option is especially interesting to him because as his oldest son, a banker, told him the interest rates are at an historically low point.

Employees

Albert is married and has 2 sons which both recently graduated from university. Both sons are more interested in pursuing careers in baking / consulting instead of taking over the family business as they do not like to get their hands dirty themselves. Albert’s wife, Martina, works at a local dentist where she focuses on administrative tasks like bookkeeping, and assistant activities to the doctors.

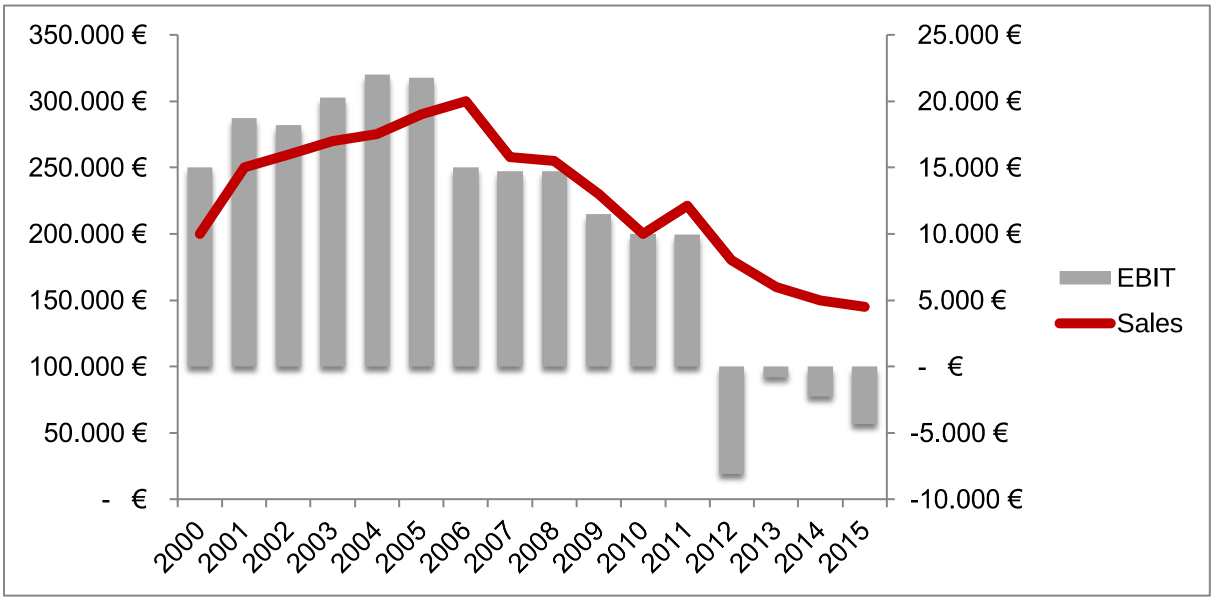
Albert is currently relying heavily on 2 supervisors, which have been with him for 5-8 years already and which he fully trusts. Albert is really proud of his ability to have been able to keep these supervisor for this time already, as all other ones had either to be let off due to the recession or where attracted by the better conditions at local DIY markets. The supervisors are mostly responsible for checking the plants rented by bars / restaurants and making sure they are in perfect conditions. Next to this, they also use their expert knowledge to advise visiting customers.

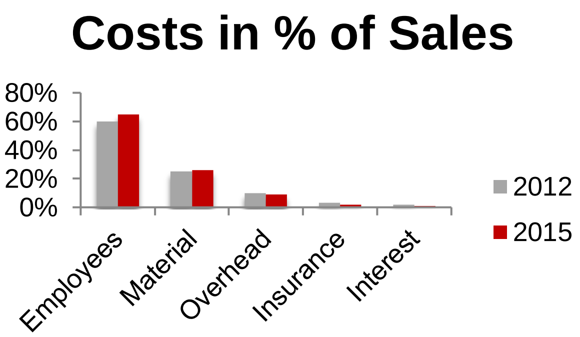
Next to these, the nursery also employees two further full-time workers that are mostly responsible for the heavy work that comes along with the installation of the plants. Furthermore, there is another female assistant to Albert that takes care of the bookkeeping and purchasing activities of the nursery.

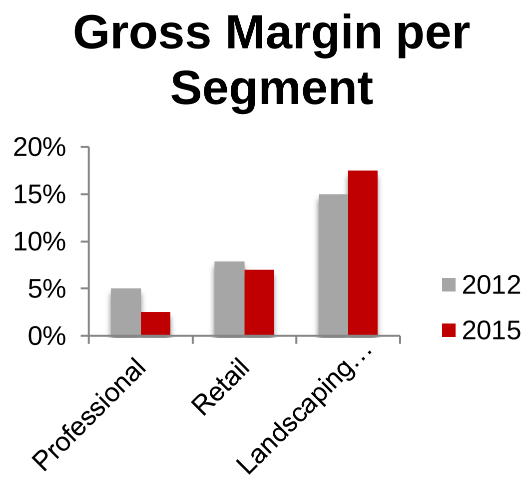
Financials

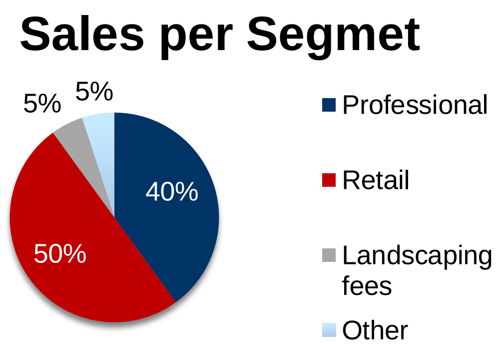
Because Albert was able to enjoy an engineering education, his sons are more familiar with the use of KPIs than he is. Therefore, his youngest son was so kind to set up a dashboard for Albert on which he has a look every couple of years. Below is the current one that Albert quickly gathered using estimations where he was not sure about the figure (e.g. Insurance payments).

Nevertheless, Albert does not make use of this tool very often and relies more on his gut feeling.









Further, despite of the difficult situation that Albert's business is currently facing he was able to pay back a loan in total in 2013 using his private savings. Albert did this because he anticipated that the interest rates will be lower in the future and that he would be able to finance his business cheaper in case he would need to do so.

Competition

The nursery does not exclusively compete with other nursery and landscaping businesses, but also with national retail chains that market also secondary gardening equipment. Unfortunately for Albert, he mainly has to compete with national chains that do have a lot more purchasing volume and therefore have a better bargaining power with their suppliers. Nevertheless, because of an increasing price sensitivity of customers when buying at these chains, there quality is below the one that Albert is able to offer. Moreover, they are not cooperating with professional landscapers but rather provide printed advice and online tools to their customers on how to do it on their own. Further, especially the biggest competitors of Albert's are also pursuing an aggressive external growth strategy trying to eliminate competition by buying them and using their land for speculation purposes.

However, advantages that Albert thinks he has over them are his knowledge and his ability to also provide tips for his customers on how they should take care of their plants. Further, he sees his unwillingness to sell his company to his competitors, which he also informs his customers about, as a strength as well.

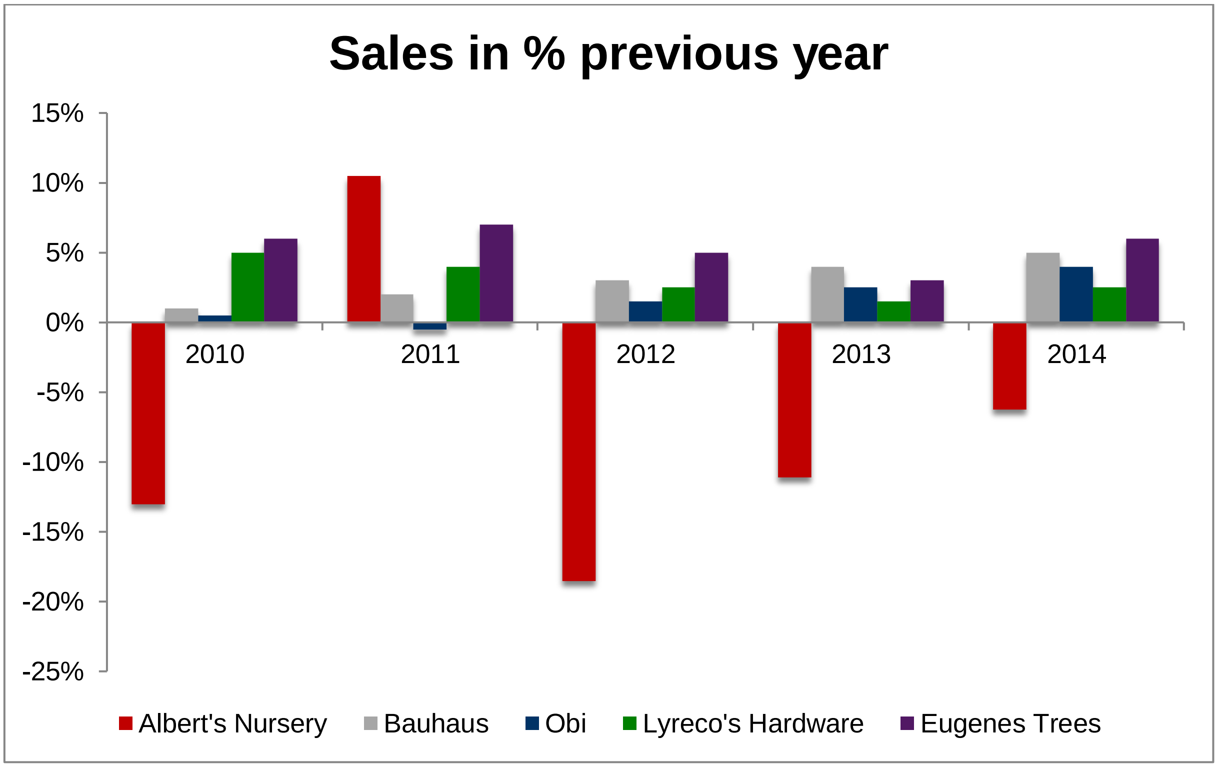
The following table provided an overview of the products and services offered by the competitors as identified by Albert himself:

Store	Plants	Gardening tools	Rent of Gardening tools	Repair of gardening equipment	Landscape design	Rent of plants	Installation of trees	Employees	Revenues in KEUR	EBIT in 000 EUR
Albert's Nursery	Y	Y	N	N	N	Y	Y	4	145	-4
Phaedra's Gardening Center	Y	Y	Y	N	N	N	Y	10	581	76
Bauhaus	Y	Y	N	N	N	N	N	187	3234	854
Obi	Y	Y	Y	N	N	N	N	173	2105	628
Lyreco's Hardware	Y	Y	Y	Y	N	N	N	120	1800	532
Eugenes Trees	Y	N	N	N	Y	N	Y	35	586	48
Adrian's Tools & More	N	Y	Y	Y	Y	N	N	12	500	53
Marion's Nursery	Y	Y	Y	Y	Y	N	Y	2	98	-6
Falk's Store	Y	N	N	N	Y	Y	Y	3	148	-15

SCHÖNBOHM

Moreover, as his oldest son works in a bank, he provided his father with some sales data, which he was able to gather from the banks databases as well as online sources. However, he was only able to get a complete time-line for the 4 biggest competitors as the other ones did not publish their Profit & Loss online.

The expressed numbers are in given in % to make them comparable despite of the different sizes of companies:



Customers

Customers are currently the biggest concern for Albert as he experiences a severe downturn in the numbers of visitors to his retail store. Previously, his customers used to be people from Berlin and the Brandenburg area who had either rented a garden, or had their own houses with a garden attached. However, due to more and more people moving into the city and therefore the need for more living space, this kind of target group is constantly decreasing.

Next to this, also the ability to attract local authorities and companies that need help to take care of their offices plants is also limited. This is on the one hand due to the need for the entities to cut costs, and on the other one on Albert's poor past performance in servicing these professional customers. However, this was due to poor motivation of past employees that disliked having to go into other people's offices and to service them.

Nevertheless, when Albert talks to the few visiting customers they are all really thankful for getting a high quality advice on what they should buy and are all very satisfied with Albert's service. They value especially his ability to deliver the plants to their doors, install them quickly and the time Albert and his team take to evaluate the needs of customers.

The future

During the birthday party of his youngest son, Albert begins to socialize with a colleague of him who also is a consultant He then tells Albert about the current megatrend in business: Mobility, Urbanization, Digitalization and Resource Awareness.

Albert is very interested in this topic, but soon he realizes that he would not be able to pay the consultancy fees if he would like to work together with this consultant.

Instead he turns to an old friend of his. This friend is now a Professor for Business at a Berlin based University, which promises to help Albert with the use of his brilliant students.

The task: Imagine you are a business consultant:

- Conduct a Business Model Check of Albert's nursery
- Come up with further KPIs that Albert can use to be better aware of future trends (and also indicate which additional information he would need to have)
- Prepare a 3 min pitch to Albert explaining:
  - What changes are necessary
  - Steps he should follow
  - How he can benefit from it

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https://www.youtube.com/watch?v=sfdnBOtA_dY

Others:

List of management consulting firms:

http://en.wikipedia.org/wiki/List_of_management_consulting_firms

A visualization tool for analysing a Business Model & Value Proposition Channels can be found:

http://www.businessmodelgeneration.com