White Paper

Strategic planning: 5 essential considerations for SME owners

Many small & mid-sized businesses in BC are missing the advantages of strategic planning.

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hathway management consulting

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Introduction

Most people wouldn't purchase a house without making a detailed assessment of the neighbourhood and the general economic situation. They would get independent structural and valuation assessments and investigate several home financing options. Buyers take their time because it's likely the most important future investment decision they will make.

Faced with much greater levels of uncertainty and risk capital, many small and mid-sized enterprises (SMEs) don't adequately plan for their future through strategic thinking and planning. Despite the fact that business survival rates for start-ups are a depressing 50% within the first 5 years, many business owners believe that strategic planning is either unnecessary or too hard to implement.

Several studies have shown that SMEs who formulate strategies outperform their peers. This white paper looks at some of the reasons behind the lack of strategic planning and what a business owner should consider to get started.

#1. SMEs are critical to the economy

Small and medium businesses are the life blood of most economies. In BC, they provide over half the employment and a significant proportion of income. They generate new ideas and sometimes grow to become multi-national enterprises.

Their size is both an advantage and disadvantage: quick thinking, innovation and local expertise propel them forward whereas higher unit costs, weaker branding and fewer resources hold them back.

The definitions of small and mid-sized vary but an SME generally has between 1 and 500 employees. The point at which a business is seen as mid-sized varies between 100 and 200 employees.

BC Stats [1] published data in 2011 showing;

- 47% of BC's 370,000 companies had between 2 and 199 employees
- 53% were sole proprietorships
- Less than 1% had 200 or more employees
- The SME sector contributed 1 million jobs (around 45% of the total)
- SMEs were prevalent in the service sector and dominate health, education, finance and construction

Statistics Canada showed that firms across Canada with fewer than 500 employees contributed over 54% to the GDP.[2]

1 http://www.bcstats.gov.bc.ca/StatisticsBySubject/BusinessIndustry/BusinessCountsEmploymentByIndustry.aspx

2 http://www.statcan.gc.ca/pub/11f0027m/11f0027m2011069-eng.pdf

The sector is dynamic but tough

Given the potent mix of innovation activity, start-up rates and failures, the SME sector has the highest job gain and job loss rates.

Statistics Canada published data in 2008 showing that 5 year survival rates of SMEs were 50%, and 3 year survival rates were 70% [3]. A 2012 TD economics study [4] of Canadian SMEs confirmed the 5 year 50% survival rate and highlighted capital, talent attraction and retention as key issues.

SMEs generally fail due to [5];

- Bad management (especially at the early stage)
- Owner/manager motivation
- Apathy
- Bad decisions or investments
- Economic or competitive shocks

Looking at data from Forbes [6] and the Economist Intelligence Unit [7], client capture, cash flow, profitability (including client profiling) and risk reduction were seen as the major issues, aside from general economy.

Both data suggest that market development, innovation, operations and customer service are the key to better results.

We believe that small businesses in relatively protected environments cannot be complacent. Consider the rise of franchising in the service sector in Canada, where for instance independent retailers and service providers are facing competitors who have clear strategies, hungry franchise owners and deep pockets.

A recent survey [8] showed that in Canada, half of the owners of small and medium enterprises would retire within 10 years. The upshot is a $3.7 Trillion value transition, affecting 15% of Canadian GDP. Of concern, the survey continued was that 6 out of 10 owners between 55 and 64 do not have exit plans.

Our internet-based research shows that most businesses take 9 to 18 months to sell.

Clearly, SME owners need to manage growth, survival and succession along-side everyday issues facing their firms.

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[3] http://www.ic.gc.ca/eic/site/061.nsf/eng/02717.html
[4] http://www.td.com/document/PDF/economics/special/sg1012_small_business.pdf
[5] http://www.strategie-aims.com/events/conferences/2/communications/139/download
[6] Small and medium-sized enterprises: Rebuilding a foundation for post-recovery growth (Forbes insights 2010)
[7] Understanding growth priorities at small and medium-sized businesses (Economist Intelligence Unit 2009)
[8] http://research.cibcwm.com/economic_public/download/if-20121113.pdf

Rarity and challenges in the mid-sized sector

A 2012 BDC survey[9] showed that although only 1% of Canada's firms have 100-500 employees, they generate 12% of GDP and 17% of exports. Of concern was the reduction in the total number of firms of this size by 17% from 2006 to 2010.

The main observations were that manufacturing was hit hard, the CAD had become uncompetitive and the general financial crisis. Some 14% shrunk to less than 100 employees or closed altogether. Only a small percent grew to become large corporations.

The main barriers to growth were finance availability, talent acquisition and retention and hyper competition. Mid-sized firms average revenues average $30M but the range is broad. When asked about past 3 years sales growth, the mean annual rate was 3.8%. The outlook consensus for the next 3 years was stable or cautious growth. Their average number of years in business was 39.

The BDC study was consistent with earlier BC Stats data showing that mid-sized firms are prevalent in manufacturing, retail, business services, accommodation and food, and construction.

[9] What's happened to Canada's mid-sized firms? Business Development Bank o f Canada 2013

#2. The reasons many SMEs don't do strategic planning

Through published third party research and our own observations, we have identified four broad reasons why many SME firms do not plan strategically.

No desire: comfort zone of the owner

Some owners are happy to be "lifestyle" owners, and are clear about the relative importance of the business to their personal objectives. They have little concern or desire to bring performance to the next level having found the ideal balance of income and leisure time.

No need: perception of irrelevance

Some small businesses operate in clear markets with straightforward operations and little variation. Strategic planning may be seen as too grandiose say, for the neighbourhood store with a history of stability, or the manufacturer whose formula of success has delivered over the years with minor tweaks.

Alternatively, a new firm will be headed by an entrepreneur with a clear vision and unwritten strategy which is communicated frequently to the start-up team. Strategic planning may be seen as cumbersome and time-consuming and unnecessary in the first phase.

During economic down-turns, tactical cost-cutting is sometimes seen as a natural choice at the expense of more strategic activity.

No certainty: fear of change

Any change can create fear of the unknown or uncertain pay-off. It may be that the firm has tried to implement planning in the past and it failed to be implemented, or did not bring the results it desired. This could have been due to poor communication, lack of understanding about the goals or insufficient consideration to the time required.

Certain departments and individuals may feel that sharing and cooperating with other areas of the business in strategic planning may reduce their power base or make them vulnerable during change.

No catalyst: starting barriers

There are firms whose markets are highly competitive or whose supply chain is becoming complex. They recognize that strategic planning is needed but are unsure where to start. Either the current team has not had prior experience or they are too busy with revenue-generating projects. This is a common situation and the decision to start strategic planning is often compelled by crisis.

Prevalence

A study in Australasia[10] in 2003 showed that 58% of SMEs had a strategic plan, but the tools used were often limited to SWOT, PEST and budgeting, which had an internal or limited scope.

A review in 2005[11] looked at a large study made a few years early of nearly 3000 SMEs. Only 16% of firms were found to be regular planners.

Our own experience within SMEs shows an inconsistent or incomplete approach to strategy planning in the SME sector.

[10] The use of strategic tools by small and medium sized enterprises: an Australasian study (Strategic Change 12:49-62 2003)

[11] Longitudinal Analysis of Relationships Between Planning and Performance in Small Firms (Small Business Economics [2005] 25: 207-222)

#3. Benefits of Strategic Planning for SMEs

Practically all large companies rely on detailed, planned strategies because they have complex operations, multiple-market presence, and statutes to shareholders. We look at the potential benefits for SMEs.

Immediate benefits

The introduction of strategic planning will immediately spark focus on organizational goals by careful analysis of the internal and external environment.

This awareness often drives better decision making and creates a more realistic set of things to measure against.

Near-term benefits (within 6 -18 months)

Strategic planning guides effective strategy-making through coordination and shared purpose. Implementing strategies will have a number of effects. Resource efficiency should improve, and internal communication will become more frequent and more spontaneous.

The strategies will require greater problem solving skills, but this will be addressed by a greater sense of togetherness and clarity amongst your team.

Your customers will begin to value your renewed vision and focus. All of your strategies will ultimately deliver superior customer value through better need awareness and innovative thinking.

Long-term benefits (after 18 months)

The holy grail of strategy is achieving long-term competitive advantage. This takes time because it demands superiority at supply-side and demand-side.

The journey to gaining competitive advantage will be noticed by the wider market and you will be more attractive to larger companies who value strategic insight and capability in their partners.

The culture of the company will change and be more cohesive and able to shape the future.

Evidence of benefits

Several studies in the SME sector have shown better performance outcomes for those who plan strategically [12]. Ogunmokun and Tang [13] remark that theirs and 16 other studies show the value of strategic market planning for SMEs.

A review in 2005 by Gibson and Cassar [14] found that better performers were more likely to use business planning, though better performance was not guaranteed by formal planning.

[12] Explaining the lack of strategic planning in SMEs: The importance of owner motivation. (International Journal of Organisational Behaviour, 12 (1), 1-16)
[13] The Effect of Strategic Marketing Planning Behaviour on the Performance of Small- to Medium-Sized Firms. (International Journal of Management, 2012)

A study published in 2006[15] showed that the effects of planning on small firms were greater than large firms, because larger firms tended to be refining their processes and procedures whereas smaller firms were gaining all the benefits of adoption.

Leitner and Guldenberg [16] found in 2010 that SMEs benefited from strategies which had combinations focus, differentiation or low-cost.

An extensive survey of 800 business owners in 6 English speaking countries published in 2013[17] looked at the effects of strategy making in SMEs. Amongst many other findings, they found evidence that firms who combined visioning with market planning strategies enjoyed 25% incremental growth rates.

The franchise model: a case study in SME strategic thinking

Being a franchisee can be a compelling way to participate in a successful business formula with predictable costs and a small business budget. There are the flexibilities of being small, and the big-business benefits in the supply chain and marketing levels. Of course, the trade-off is that the ongoing benefits must be paid for, the limitations of territory agreed to, and franchisee must follow the formula to a greater degree, reducing independence.

According to a recent study by the Canadian Franchise Association, 40% of Canadian retail sales are franchise. Of all the franchises opened in Canada within the last 5 years, 86% are under the same ownership and 97% are still in business.

Longevity of the franchise and the quality of the formula explains a lot of this success but we believe that this is driven in large part, by superior strategic planning.

14 Longitudinal Analysis of Relationships Between Planning and Performance in Small Firms. (Small Business Economics 2005 25: 207-222)

15 Thirty-five years of strategic planning and firm performance research: a meta-analysis. (Academy of Management Proceedings, 2006)

16 Generic Strategies & Firm Performance in SMEs: A Longitudinal Study of Austrian SMEs. (Small Business Economics: An Entrepreneurship Journal, 35(2), 169-189)

17 Planning to Grow? Exploring the Effect of Business Planning on the Growth of Small and Medium Enterprises. (Entrepreneurial Practice Review 2:4 Winter 2013)

#4. Preparing your company for strategic planning

This section defines some strategic terms and poses questions to the SME owner considering strategic planning.

Defining strategy and related terms

Strategy is about preparing for a successful future, and for most firms that means competing to win. Ideally then, a strategy will have the following characteristics;

- Intent: product/service/market (what, where, which level)
- Timing (when)
- Methods (how to achieve)
- Economics and business case (how much to invest and expect in return)
- Differentiation (how to win, benefit your customers, disadvantage your competitors)

The best strategies are simple enough to be understood, smart enough to make a difference and realistic enough to be implemented.

Strategic planning is the process that guides us through strategy making and strategy deployment. It should be consistent, measurable, and flexible enough to adapt and learn from mistakes and triumphs.

Company Mission & Values. Our strategies need to be guided by our mission (what we do and why we do it), and our values (how we do things true to our beliefs). At times, it's necessary to review the company mission in light of internal and external changes, and modify values over time. Such changes require long term strategic thinking.

Emergent strategy is what firms adapt to or devise in quick response to current opportunities or events. This type of strategy often begins in the front-line of the organization and is common in competitive, dynamic markets.

A **business plan** is not a strategy in itself but is required for new strategic initiatives. Typically, it will contain the opportunity context, commercial and market plans, operational plans and a business case. Often it will guide the approving team with decision criteria.

Best practice is simply a way of doing something which has been shown to achieve the best results and is seen as the benchmark. It is not a strategy in itself, but a firm wishing to compete in a certain markets may have to achieve best practice in an area where it has traditionally been weak.

Competitive advantage is the package of things a company does (or will do) well that the market will value and its competitors, for now, cannot copy. It's complex, unique and temporary. We may follow best practice in many of our functional areas but so may our competitors. We may even redefine best practice in our pursuit of competitive advantage. It's very hard to achieve on a consistent basis and it relies on strategic innovation and agility.

A **business model** is an articulation of how value is created. It can be as simple as a diagram or a detailed strategic document. Several templates became popular during the Internet boom of the 90s to contrast the physical location "bricks" and online "clicks" ways of doing business. A strategy will either contain explicit business models, or provide the value creation logic in other formats such as a value chain.

Questions to ask yourself and your organization

Sometimes, it's worth taking a step back from immediate opportunities and problems to assess how your organization thinks strategically.

What's your strategic orientation?

These four metaphors, adapted from Images of Strategy[18] may be a useful starting point.

Stalwart: You act with purpose, yet infrequently see things coming

Many organizations fit this description. They stick to formula that has provided success in the past, at the expense of learning about or anticipating the future. After all, the maxim "if it ain't broke, don't fix it" is seductive, but dangerous.

Your strategy should harness your operational skills with new abilities to create value from existing or new markets, products and services.

Field Marshall: You are considered one of the leaders in your market sector by anticipating the future and acting with purpose. Don't let complacency take over and consider that even the best companies periodically struggle, and perhaps reflection could be a worthwhile activity.

Academic: You can sense what is coming, but are not able to capitalize on it

As a thinking organization, your ideas and foresight are well developed, but internal blocks, whether intentional or not, hold you back. Your strategy must unlock the creativity, channel and motivate your team to help you achieve success. One way to achieve this is by creating and communicating a clear vision and purpose and involving a broad cross section of your firm in the process.

Drifter: You struggle to foresee events and do not act purposefully.

During market turbulence, the cautious company will either cut costs or sit back and wait for positive change before committing resources. Being reactive in a structured way (for instance taking a second-mover position) can be a very productive strategy, but endless drifting will erode the confidence of your customers and staff. The use of a range of options rather than big strategic bets can promote future growth and get your organization into the habit of strategic thinking.

[18] Images of Strategy, Cummings & Wilson, Wiley 2003

Which stage of maturity are you?

Larry Greiner [19] identified 6 phases of growth of a typical organization, typified by a period of stability followed by a crisis. The crises defined how the organization stalled or moved forward. Later studies tended to agree with the idea of phased growth but also showed that firms do not necessarily follow the sequence arbitrarily. The phases are;

- The creative growth phase is about getting new products and services out into the market, usually driven by a small team held together by a vision and informality. Further growth requires professional management which often sets off a **leadership crisis**.
- This describes further growth promoted by the use of formal communications and planning tools. The added complexity means there is potential of a **crisis of autonomy**, which needs formal structure and hierarchy in the organization.
- The third phase is where firms have clear mid management and senior management structures but the original managers find themselves in strategic roles but unable or unwilling to let go of the operational tasks they had responsibility for. This is known as the **crisis of control**, and many firms plateau at this stage.
- Phase four indicates that previous challenges of control and coordination have been overcome but there is a danger of a **red tape crisis**, in that some of the creativity and purpose may be dampened to suboptimal levels.
- Phase five is about collaboration in response to the red-tape crisis. The organization takes a more project-centered approach and this sparks further productivity and growth. The potential problem is a **crisis of internal growth** – a point of discovery that the firm cannot do everything itself.
- The final phase is about external partnerships and covers the relationships the firm will want to participate in for learning, growth and survival.

Each stage has two clear strategic imperatives: achieve the transition to the next stage, and anticipate the crisis.

What's your market position

As competitive companies, we should be aware of both the perception and reality of the position(s) we hold in the market. It's not always easy, especially in dynamic and crowded markets.

There are many ways to consider market position but the most important thing is to work out what your target-customers value, how you compete right now, and how your competitors are positioned.

Most small businesses focus on one or two niches where they are either innovative, have the lowest costs or both.

Medium sized businesses may compete in more niches, or serve a broader market segment as an innovator or low cost provider.

[19] Evolution and revolution as organizations grow. (Harvard Business Review, [1998] 76, 3, 55-68)

Some strategists contend that a company can define a new market space with no competition through innovation and strategic thinking. This is the holy grail of strategy but is very difficult to achieve.

Knowing your current position, its attractiveness and where you want to be is a powerful starting point on the journey to creating a coherent strategy for the whole of the organization. Having some facility to keep up-to-date with the market is also an important part of your strategic process. Your customers and suppliers have a role to play along with more formal research.

How are you set-up internally?

To compete successfully in your chosen markets, you need to create value for your customers through competitive advantage.

As an SME, you have to allocate investments for product/service development, internal development and market development.

Your staff, facilities, research capacity and IT infrastructure require constant investment to keep you competitive and provide the differentiation customers value.

A strategic review will look at your different functions and resources to see how they support or hold you back from your overall strategic objectives.

This is one of the most challenging areas of strategy because the constraints are real and the need for innovation and best practice essential.

Preparation Work

Let's assume that your company either has ad-hoc strategy planning or has tried to implement it in the past and did not succeed.

Strategic planning can only work if the owner has growth orientation and has the will to introduce discipline into the process, and is clear of the expected benefits and potential risks.

There are many things that the organization should do to prepare for introducing strategic planning (the process) and strategy making (the content of the strategy itself).

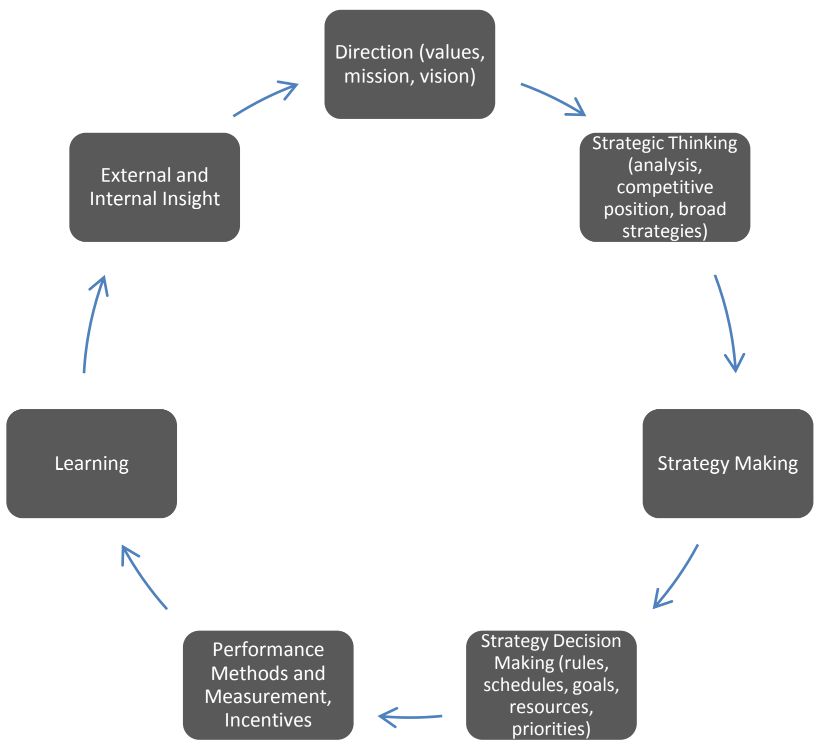
This list outlines some of the broad-brush areas to consider;

- Identification of key people in your organization who are active decision makers, who could make time to get involved and would be considered cooperative.
- Creation of a budget for putting the planning initiative together. This would include consultant costs and the time required of the key people
- Putting together a list of objectives for strategic planning. These could cover expected benefits, concerns, implementation considerations, costs etc. This should have more emphasis on the process of strategy planning rather than the content.
- Outlining an ideal timeframe for start and finish

- For the strategy making, you can either use the consultant to facilitate initial discussions or prepare some work in advance by creating a dossier on your products/services, customer surveys or feedback, perceived market positions, market data, organization structure, selected financial data etc.

Strategic Planning

Once the ground work has been done, a strategic framework will be put in place. There are several models to choose from, but most share similar characteristics. This is a variation of the McGee[20] model;



One of the first things to determine will be the extent to which your existing strategic thought can be integrated into the planning model.

The main objective in strategic planning is to create and articulate the strategy, and make resource allocation decisions to guide the whole company during the strategy cycle. Secondary objectives include setting goals, managing learning and feedback, and measuring and rewarding results. The length of the cycle will depend on your business, but you will want to measure progress weekly or monthly.

In terms of the strategy making itself, there are many routes to take and methods to consider. The objective is always the same: to improve the performance of your organization.

[20] Strategy Analysis and Practice. McGee, Thomas and Wilson, McGraw Hill 2005

Length of Strategy Cycle

For established businesses in relatively calm markets, a planning horizon of 12 months may be appropriate with a complete strategic review every 3-5 years. For start-ups or firms in unpredictable markets, traditional yearly cycles will not be appropriate. The start-up will need a shortened and adapted process to fit with the reality of fast innovation and frequent, low-cost market testing. Strategy is about competing, regardless of size and planning can be agile not constraining.

Strategy Making

Examples of things your new strategy might influence;

- Product or service attributes, including function, quality, choice and availability
- Pricing
- Who you team up with to promote growth or productivity
- How you innovate
- Your team, their skills and motivation
- How you look after your customers
- How you interact with your environment and society
- Your market choices
- Your brand and market perception
- Your culture and how you get things done

Your new strategy will link all areas of the organization coherently, have articulated means and outcomes and for the most part, show your customers and the wider market your intent.

The consultant will guide the process of making the strategy with you, and provide expertise for various parts of the strategy. Where specialist knowledge is needed, members of your team and outside knowledge will be required. Your consultant will have advised you in advance of their domain of expertise.

Strategy requires choices about investments. Most strategic investment decisions use discounted cash flow analysis to judge potential project value and merit. An SME may have two or three alternative projects to consider, and some of those projects would require several investment decision points along the duration. Real options analysis determines the commercial implication of investing in a project now and continuing that investment if the project succeeds. It also models the timing of when the project starts or if it is abandoned. For the SME, where cash is limited, this strategic analysis resolves some of the uncertainty of investment by understanding the value of investing now, waiting and learning or abandoning projects. It also puts a value on the option itself, to guide the investment decision and gives strategic flexibility to firm.

A good strategy should have the following characteristics;

- Significance: material improvement to your organization
- Realism: achievable and consistent with the existing organization resources and goals
- Measureable: comparable against the expected benefits, to manage and learn
- Clarity: little or no ambiguity for all the organization about the “what” and “why” of the strategy
- Inclusiveness: to aid implementation and avoid alienation of certain groups

There are a number of factors that can get in the way;

- Poor communication and goal comprehension
- Unrealistic expectations during implementation (timing or scope oversight)
- Employee capabilities and motivations (time, ability, fear, uncertainty, loyalty etc)
- Implementation coordination (unclear management structure, disjointed command)
- A set of external factors or crisis halted implementation

The sponsor of the strategy must balance all the 10 factors above when devising the strategy. The expected benefits of implementing the strategy must be weighed against the risks of suboptimal execution or incorrect assumptions.

The best ways to improve return on strategy are to start modestly and gain confidence in the process. If the process needs adjustment, then add simplicity or nuance as needed. For the inevitable shocks and events which interrupt the flow, treat them as strategic opportunities or threats and take a step back to see how they can be dealt with using the process. It may be prudent to budget for emergent strategies but with strict preconditions.

#5. Who should you engage with for strategic planning

It is useful to consider the four different advisory types to see which one would better serve your interests.

Counsellors motivate you to get started and identify your options so you can make the initial choices. Typically, their scope is personal development before or at the start of a new business. The arrangement is often regular and short-term but can be longer. Their key added value is providing personal clarity.

Coaches provide you with tools for thinking and provide ongoing guidance. They are focused on business best practices and less on implementation. The arrangement is often frequent contact and medium term, as the relationship ends when the entrepreneur has learned the additional skills needed for the business. Their key added value is helping the entrepreneur grow.

Mentors lead by examples of personal success and provide advice that you can act on. Typically, it's a non-commercial arrangement and they will not get involved in the implementation specifics. Mentors also motivate you and can help broaden your network. The relationship is less frequent than the other advisory forms, but it is seldom short term. Their key added value is inspiration and leadership.

Management consultants solve specific strategic problems and opportunities. They work to agreed scopes, timelines and deliverables. The engagement is intense, and typically not long term. Their key added value is solution delivery "walking the talk" and imparting their knowledge.

Making the choice

In reality, the distinction between some of the forms is not exact and some advisors will offer hybrid services. Other professionals such as lawyers and accountants provide specific advice and services for a fee. They can also be a useful source of strategic advice within their practice area.

Strategic planning is the domain of the consultant, but can be performed by specialist coaches willing to get involved within your company or suitably qualified mentors if their time permitted.

If you do your research and are clear about what you want to achieve, it will be much easier to select the right form of advice, and the right person to work with you.

Introducing strategic planning for a smaller organization is not a trivial task and will require time, effort and determination. It may take some time to become part of the normal routine of the organization and for results to occur.

Given the evidence, the effort may well be worth it.

About hathway management consulting

We are a boutique management consultancy specializing in SME strategy, with a focus on firms in British Columbia. Please feel free to contact us with any comments about this paper or other enquiries.

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