BOH4M
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Lesson Note: Strategy

This lesson note will talk about
1. What is Strategy
2. The Importance of Planning
3. Levels of Planning
4. Planning Tools
5. Strategic Analysis Models

What is Strategy?

Strategy is a buzzword in business. Customer strategy, technology strategy, HR strategy, this strategy, that strategy. What is strategy anyway?

Very simply, **strategy** is all about where you want to go and how you plan to get there. Put another way, strategy is your goals plus action plan. The goals are the WHAT and the action plan is the HOW.

Companies also need to have a WHY. The WHAT and the HOW need to align with the WHY. Why does this company exist? And no, making a profit is not why the company exists. That's just a by-product of the company existing. The WHY is about the company's core values. For example, Microsoft exists to make humanity more productive. That's their WHY. WHAT they do is make productivity software. HOW they do it is making software that is easy-to-use with lots of functions.

A **strategic plan** identifies your goals, how you're going to get there, and how you will track your progress.

On a personal level, you probably have goals. For example, let's say you are overweight, and you want to lose 30 pounds in the next 6 months. A goal without an action plan is just a wish. So you go make an action plan. You write down, "*I want to lose 30 pounds in the next six months. I'm going to do eat less junk food and exercise for 30 minutes every day.*" But wait, how will you track your progress? "*I'll check my weight on the scale every day.*" Now you have your goal, your actions, and your metrics. That's a simple strategic plan.

The Importance of Planning

From the personality class, you learned that some people like planning (judging types) while others prefer to go with the flow (prospecting types). For an organization though, planning is a must for two reasons:
1. An organization has limited resources. It has limited dollars, people, and time. So it must decide how to use its resources. That happens during planning.
2. An organization has multiple leaders, and they may not agree on the goals of the organization. The planning process is where those leaders come together to discuss and reach an agreement.

Having many people with disagreeing perspectives is actually very useful for creativity and idea generation. If they have strong teamwork skills and conflict resolution skills, all that conflict will result in a better solution at the end. If there is not a lot of difference in thinking, or if people are afraid of disagreeing with others, then the group can fall prey to **groupthink**, which is when people just agree with the group even though on the inside they disagree. In order to prevent groupthink, it's important to have a diverse group of people and to encourage disagreement and debate for the purpose of getting the best solution (not for the purpose of proving anybody wrong).

After making their strategic plan, the organization has to execute it. Of course, unexpected things will happen, and so leaders who can adapt to changes (prospecting types) will be highly valuable for those situations.

Organizations typically have a **strategic planning month** at the beginning of each year. This is when they review their results from last year to set new goals for this year. Throughout the year, organizations typically check up on their success metrics set out in the action plan every 3 months (quarterly). This way, they can make adjustments to stay on track towards their goals.

Levels of Planning

Just as there are three levels of management, there are also three levels of planning. Only the top-level sets goals. The lower levels make an action plan to meet the goals.

Top-level management does strategic planning for the entire organization. They set the goals and action plan for the organization, and then give it to the middle-level management (the department heads). The department heads then focus on just their role in the organization's action plan. Then they make their own, more-detailed action plan about what their specific department needs to do. The middle-managers then communicate with the low-level managers, and the low-level managers make their own action plan for their team.

Planning Tools

What tools do organizations use to determine what goals they should set? We'll look at two common tools: Benchmarking and Scenario Analysis.

Tool 1: Benchmarking

A **benchmark** is basically a standard in the industry for some sort of metric.

For example, let's say you own a restaurant, and there are 2 other restaurants on your street. Last year, you made $100,000 in revenue. The other two restaurants made $80,000 and $150,000. What is the benchmark revenue? The industry average is (100 + 80 + 150)/3 = 110K. So how are you doing compared to the benchmark? Oh you're below the average. So maybe a goal should be to increase revenues.

But wait, is revenue the most important thing in a business? No, profit is more important. Let's say you made $50,000 in profit, while the other two restaurants made $30,000 and $40,000 in profit. What's the benchmark profit? (30 + 40 + 50)/3 = 40k. So your restaurant is doing better than the other two.

From this example, we can see that ***it's very important to choose the metric carefully***, and then compare that metric to the benchmark.

You might be wondering, where do I get this benchmark information though? Typically, industries will have research organizations that have researchers tracking metrics for the industry. Big companies in the industry will pay these research organizations money to access their research so that they can use it for their strategic planning.

Tool 2: Scenario Analysis

When an organization sets a goal, there are usually many ways to achieve that goal. Let's say a restaurant wants to increase profit. They may have many ideas, such as offering new menu items, advertising to new customers, changing suppliers to lower cost, etc. How does the restaurant decide from all these options? That's where scenario analysis comes into play. The restaurant can try to predict the results for each option using qualitative and quantitative analysis.

Qualitative analysis does not involve numbers. The restaurant manager might notice that recently, customers want cheaper and simpler meals, and many competitors are offering lower-priced menu items. That's a qualitative observation.

Quantitative analysis involves numbers. The restaurant manager might look for some other suppliers. Maybe her current supplier sells her vegetables for $2/lb, and she found some other suppliers that sell for $1.5/lb. That's a quantitative observation. However, maybe the cheaper supplier is also lower quality, and so she can't store those vegetables as long. That's a qualitative point.

In **scenario analysis**, you think of many options, then you pick the best 2 or 3 options, and then you analyze those options both qualitatively and quantitatively. Using your analysis, you predict how well you will do. In the restaurant example, the manager could use industry reports to access financial data to predict how much more profit she might make from each of her ideas. Then she picks the best one to invest her time and resources in.

Strategic Analysis Models

There are many strategic analysis models out there. The two most basic ones are SWOT and PEST, which we can combine and call SW PEST. Another important one is the Customer-Product Fit analysis. Finally, we'll look at Porter's Generic Strategies.

Model 1: SW PEST

SWOT stands for Strengths, Weaknesses, Opportunities, Threats. You look at your company's strengths and weaknesses (internal analysis) first. Then you look at opportunities and threats (external analysis).

Let's continue with the restaurant example. Maybe the manager finds that her restaurant is particularly good at making high quality meals. Her kitchen is small so her weakness is output; she can't make that many meals at once. Therefore, she should sell expensive meals on her menu, and she should market to customers who are willing to pay a higher price.

But then she looks at opportunities and threats. Recently, more and more customers are buying low-priced meals. There's an opportunity to sell more if she can make low-priced meals. There are also many other restaurants selling low-priced meals, and no one else is trying to sell high-priced meals. That means if she tries to sell low-priced meals, firstly it's a weakness and secondly she won't be able to beat her competitors at it. The conclusion from this SWOT analysis is that she should continue focusing on high-priced meals.

PEST stands for political, economical, social, and technological. You use it as part of the Opportunities and Threats analysis in SWOT. Instead of thinking of SWOT and PEST as two separate models, you can just think of it as SWPEST.

Let's continue the restaurant example. With Covid-19, the government has prevented customers from eating in restaurants.

- **Political**: Maybe the government later increases the minimum wage, and you pay many of your employees minimum wage. Those are both political factors.
- **Economical:** The economy is in a recession, meaning people eat out at restaurants less. That's an economic factor.
- **Social:** In Toronto, there are many diverse cultures, so there are opportunities more many ethnic restaurants. In a small town like Barrie, there is little diversity, so there's less opportunities for ethnic restaurants. Or maybe one city has lots of young people who like to order delivery, while another city has mostly older people who like to go in to the restaurant to eat. Those are social factors.
- **Technological:** In the past, there were no delivery apps. After delivery apps became popular, restaurants had to improve their delivery operations. In the past, there was no Alipay or WeChat pay. Now, restaurants have to pay a fee to Alipay and WeChat pay.

Model 2: Customer-Product Fit

A **Customer-Product Fit** analysis is about analyzing the customer and seeing if the company's product meets the customer's demands. We always *start with customer analysis* before SWOT because whether or not something is a strength or weakness depends on what the customers want. For example, if a restaurant is good at making high quality meals, is that a strength or weakness? If their target customers want high quality meals, then it's a strength. If their target customers don't care about quality that much and instead want lower price, then it becomes a weakness.

Here are some questions to think about when analyzing the customer:

1. How many customer groups do we have?
2. What does each customer group want from us?
3. What price is each group willing to pay?
4. How big is each customer group?

For the restaurant, let's say they have two customer groups. The first group (Group A) cares about high quality meals and they are willing to pay $20 a meal. The second group (Group B) cares about low price and they don't care about quality of food. They are willing to pay $10 a meal. The first group makes up 80% of our customers right now, but they only make up 30% of the entire industry.

Now let's analyze our products. The restaurant right now does a great job selling high quality food. The customers gave us good reviews. We don't have many low-priced items. So we are already meeting the needs of the Group A, and we are not meeting the needs of Group B.

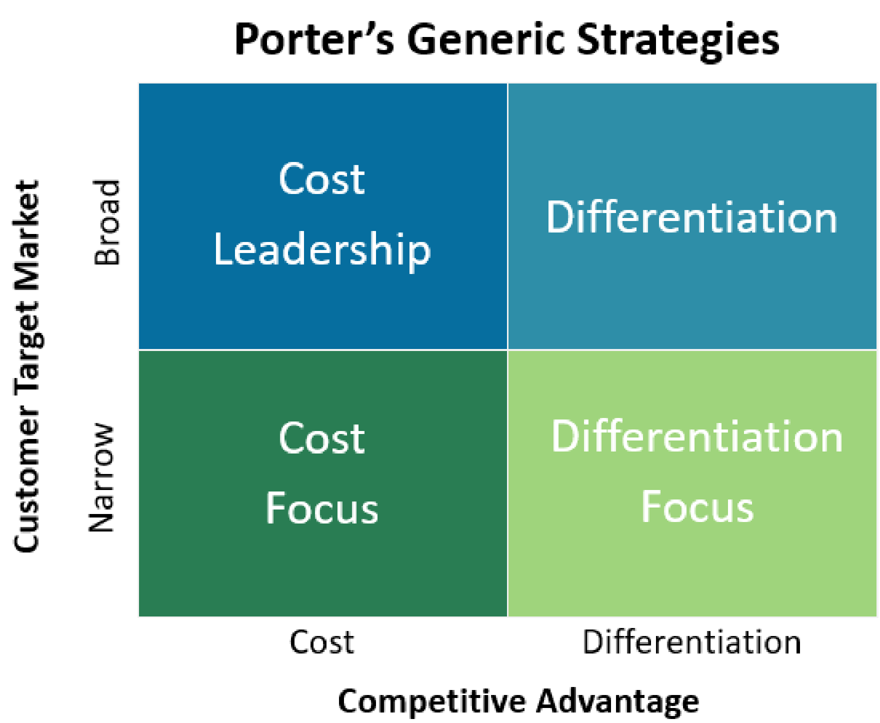
The Customer-Product analysis is very useful for finding opportunities to serve customers better and earn a profit while doing so.

Model 3: Porter's Generic Strategies

Michael Porter is a famous business professor from Harvard, and he states that there are four common strategies used by businesses. You get these four strategies by looking at a business's competitive advantage and target market.

Your **competitive advantage** is what makes you different from competitors in a good way, in a way that the customer cares about. Typically, there are two forms of competitive advantage: **lower cost**, or **differentiated (different) product**. Lower cost means you can make your product at a lower cost, which means you can either price lower or price the same as competitors but have a higher profit. Differentiated product means your product has special features that competitors don't have. Customers are willing to pay more for these special features.

Your **target market** is the group of customers your business targets. Some businesses target the masses, while other businesses target a very small, niche group of customers.



Cost Leadership
These businesses target the masses, and they focus on low cost. A good example is Walmart. They sell almost everything, and they focus on being cheaper than competitors.

Cost Focus
These businesses also focus on low cost, but they target a small group of customers only. A good example is Dollarama, a dollar store in Canada. They only target customers who don't care about quality. Customers who go to Walmart can still trust that the quality will be decent. A small group of customers don't care about quality and want an even lower price, so they go to Dollarama.

Differentiation
These businesses focus on making their product different and great. As a result, they can command a higher price, but they still appeal to the masses. A good example is Apple.

Differentiation Focus
These businesses also focus on making their product different and great, but they target a small, niche customer group. For example, Tesla makes luxury electric cars. Most people won't be interested in buying a Tesla, but for the small group of customers who are interested, they are extremely passionate and loyal to Tesla.

Check Your Understanding Questions

1. What is strategic planning and why is it important?
2. What is groupthink and how can you prevent it?
3. What are two planning tools used by organizations?
4. What are common benchmarks that companies look at?
5. What is the SWOT and PEST analysis and how it is useful?
6. What is the Customer-Product Fit analysis and how is it useful?
7. What are the 4 generic strategies? Give an example for each.