Practical strategy development: a wise investment for middle market businesses

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Times are tough for middle market businesses (MMBs) – defined here as firms with revenues of $50 million to $1 billion. A perennial economic powerhouse, they inject as much as $3 trillion in revenues annually into the US economy, and employ 20 million workers[1]. But a host of forces are increasingly arrayed against them, hindering performance and their potential for strategic adaptation. Some are obvious macroeconomic and industry-specific environmental threats, but others are unique to middle-market firms, who find themselves struck in the middle: too big to be nimble and impulsive; too small to deploy sophisticated strategic management tools, or have the luxury of defying industry and market pressures.

A practical strategy development program can help MMBs understand their competitive position, chart a short and mid-term path, set priorities for allocating resources, and resolve critical implementation issues – but few invest in the process with any consistency, or efficacy. This article proposes a straightforward approach to strategy that has worked particularly well for MMBs, converting an uneven or nonexistent process into a powerful and galvanizing management weapon that can help propel them forward to growth and profitability.

Stuck in the middle

The average middle market firm today struggles for survival within a turbulent environment, characterized by a series of antagonistic, macro and MMB-specific dynamics.

Mature industry malaise

Most US industries are mature, and so most MMBs find themselves in an environment characterized by slower growth, increasing competition, more powerful customers, accelerating disintermediation, and other structural turbulence (like outsourcing). Global competition in most sectors – especially in traditional, lower-tech categories – has further turned up the heat on most MMBs. The margin for error has diminished dramatically, and in the rapid consolidation these conditions induce, many MMBs will not survive.

Rising customer expectations

At the same time, many customers have savored the fruits of increased competition, demanding ever more quality for the same price. This trend shows no signs of slowing down: most MMBs have every reason to expect that tomorrow their customers will demand even more quality for the same price, as the update of the classic value line in Figure 1 illustrates.

A recent survey of MMB leaders confirms the dramatic rise in customer expectations (see Figure 2), particularly in areas like product quality, turnaround time, customized (extra) services, and the catch-all, services that ''go beyond the standard relationship'' (Grant Thornton, 2004)[2].

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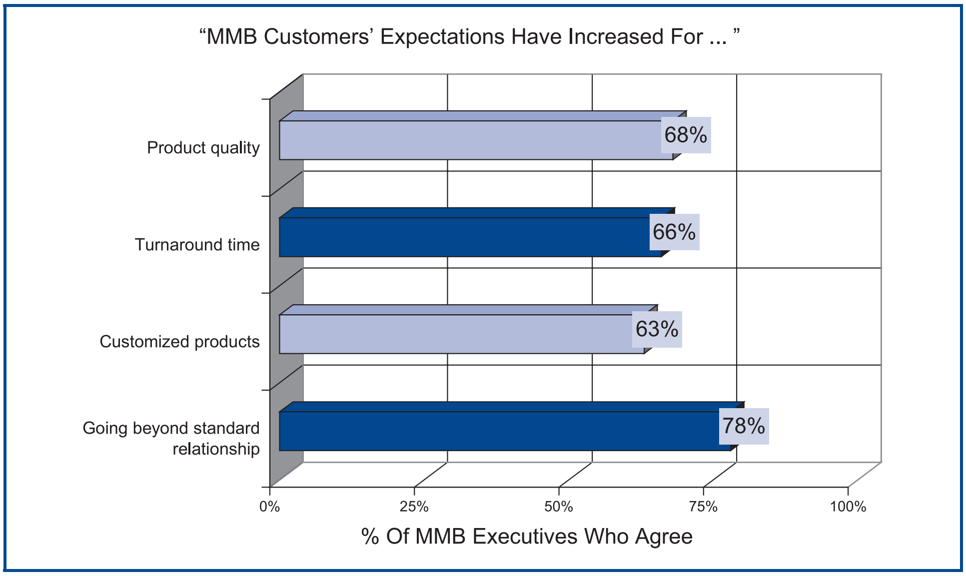
Figure 1 Pursuing the value line

Figure 2 MMB perspectives on customer expectations



Poor execution of strategic and performance improvement initiatives

In the midst of all these pressures, one might hope that managers developed better reflexes or processes to confront and surmount today's increasing business challenges. Unfortunately, another cross-industry survey finds that only 43 percent of executives rate their companies as having been ''successful'' or ''very successful'' at executing strategic initiatives over the past three years. Worse yet, just one in three executives (34 percent) rate their performance management systems and processes to be effective (Economist Intelligence Unit, 2004)[3].

These trends are walloping virtually all companies, regardless of size, but MMBs have it worse. They face a particularly daunting set of additional challenges that are unique to their size and class – most reflecting the onset of maturity and critical mass.

Entrenched/misaligned systems

The good news: you have survived to become a firm of $50 million + , with over 100 employees, a relatively stable infrastructure, and a consistent stream of revenue from established customers. The bad news: most of your operating and information systems are now entrenched, cobbled together, and unlikely to be fine-tuned to reflect the requirements of today's – or tomorrow's – competitive landscape. An industrial equipment leasing firm, for example, grew rapidly over a five-year period through acquisition to hold approximately 25 percent national market share. The firm succeeded in harmonizing invoicing procedures and contracts, and superimposed a new national brand on each regional facility. However, the financial reporting systems remained isolated by facility: each branch ran its own basic monthly reports, then forwarded them to the head office for ''processing and review''. Headquarters gathered aggregate financial performance for consolidated reporting purposes, but in a holdover from the pre-acquisition era, did not make available the key metrics that could influence more immediate decision making, such as branch profitability, branch cash flow, or branch return on investment (ROI). As a result, benchmarking between branches was non-existent, and best practices were shared only informally, offering regional managers little context for resource allocation decisions. Isolation bred inefficiency, and many opportunities for integrated strategic activity (in pricing, for example) remained untapped.

Clash of micro-cultures

MMBs are big enough to foster a multiplicity of micro-cultures: islands, silos, and fiefdoms characterized by different styles, rules, and vocabularies. In addition to the typical functional rivalries – sales versus manufacturing, quality control versus production – middle market firms also wrestle with the bitter fruits of mergers, acquisitions, and past expansion. So rifts naturally grow between headquarters and the satellite locations, between the old (original) guard of managers and the newer (acquired) management layers.

Internal process complexity

With maturity comes complexity. Managing the business today is considerably more complicated than it was when the firm served regional customers in a single market with a simpler product line. Internal information technology has proliferated, often without a pre-planned architecture, and much more effort is invested in translating the results of one system into terms that the next system (or audience) can understand. Multiple locations, operations, and product lines require multiple reporting systems, performance metrics, and modes of communication. In a recent survey of almost 1,000 senior executives, 74 percent of middle market respondents reported that ''excessive complexity is raising our costs and hindering our growth'' – a significantly higher rate than executives at small or large companies (Bain & Company, 2005).

Market and strategic complexity

At the same time, in most industries, customer fragmentation and intense competition has produced a painful set of strategic pressure points (see Figure 3). In the same survey, a full 84 percent of MMBs perceive that ''a growing percentage of their products and services behave like commodities,'' (Bain & Company, 2005) which implies the need for investing in innovation. However, while innovation is rated by 87 percent of them as ''more important than

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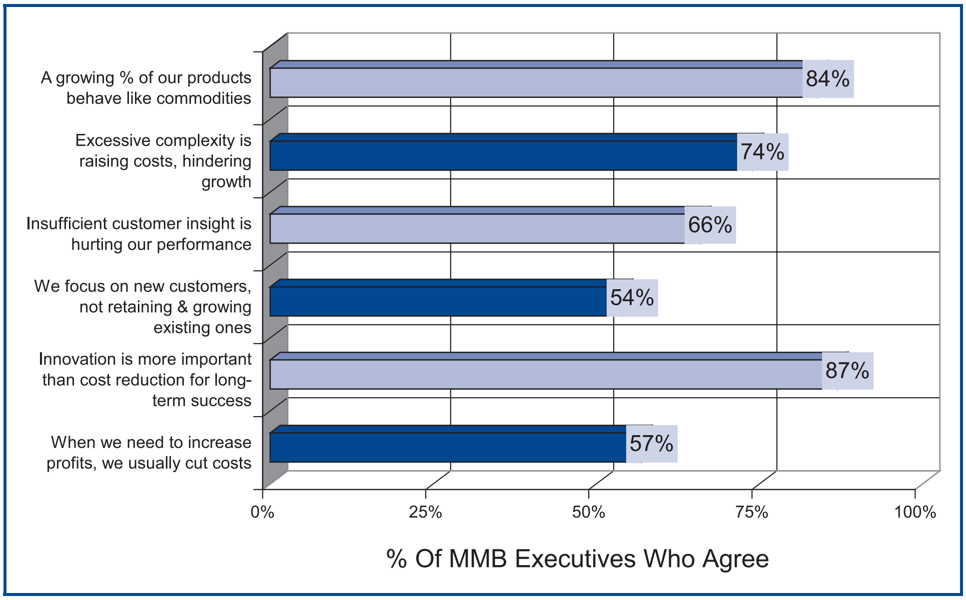
Figure 3 MMB perspectives on management trends



cost reduction for long-term success,'' more than half report that ''when we need to increase profits, we usually cut costs'' (Bain & Company, 2005). Old customers demand new services, and new customers demand services or product features the firm has never created before – often creating an acute tension between focusing on current or new customers. Whichever the choice, a broader customer and product portfolio is harder to manage, and is often a moving target, as product life cycles shorten. It is no surprise then that two out of three MMB executives report that ''insufficient customer insight is hurting'' their performance (Bain & Company, 2005).

On the business strategy plane, firms that once charged ahead with a relatively simple implicit strategy like ''seize market share'' or ''dominate the primary distributor channel'' are now confronted with more complicated and conflicted choices: should they pursue growth, or efficiency, for example? Growth demands an external, market-oriented focus, and efficiency an internal, cost-oriented focus. Both are imperative in today's environment, but few MMBs succeed in implementing both strategies concurrently. A focus on cost-reduction via enhanced efficiency at a $100 million automotive components manufacturer, for example, led to $900,000 in annual scrap reduction and a marked decrease in throughput time for several key product lines. However, so much of senior management's attention was directed to the internal programs and metrics that growth in new customer acquisition fell precipitously, fulfillment performance eroded, and a crucial technology diversification program stumbled dramatically: the senior team had a hard time implementing multiple strategies concurrently.

Worse yet, for most MMBs, the old approach – the strategies that got the firm where it is today – are quite likely no longer the right ones for the next chapter in the firm's evolution. For a $200 million European cosmetics firm with traditional channels of distribution (direct sales to pharmacies and perfumeries), an efficiency strategy succeeded only in squeezing out higher margins on flattening sales. It took a radically different strategy – direct sales in US markets to dermatologists, not retailers – to jumpstart the firm's growth and improve market share.

Leadership perspective transition

Many firms that ascend to the ranks of the middle market are still led by the founders, entrepreneurs, or the management team that launched the business. Yet few have the skill sets, expertise, or perspective required to manage a different phase in the life cycle. The entrepreneurial perspective is go-go, impulsive, and intuitive, for example; managers on the move often create a quick solution to a need, then get back to the race. Professional managers, by contrast, are trained to behave much more methodically; they manage, refine, change, or recreate systems based on data analysis, benchmarking, and best practices.

> **“A recent survey of middle-market business leaders confirms the dramatic rise in customer expectations, particularly in areas like product quality, turnaround time, customized (extra) services.”**

Many MMBs have yet to make the transition within the top-most ranks. CEOs are often the most culpable in this regard, as they confidently point to the legacy, and the management team, that they have created . . . it has worked so far, right? Unfortunately, the rate of change is ever-accelerating, and as performance plateaus, it becomes clear that the old rules apply less and less, and that the old sight lines may not encompass the new terrain.

Diverse and demanding stakeholders

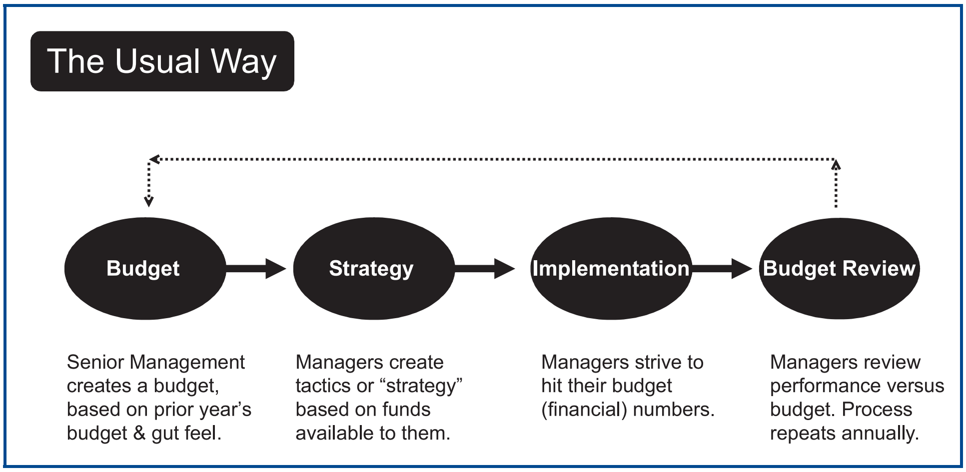
In smaller firms, stakeholder relations are more easily coordinated: the founder or senior management team personally knows the shareholders, the banker, the key customers, and the staff, and the board is stacked with family, friends, and close associates. It is rare to encounter too much divergence between the stakeholders' respective interests. By the time a firm has reached the middle market in scale, however, stakeholder relations become far more complex. The firm's leaders cannot possibly keep in personal contact with all the stakeholders, and new ones emerge to further distract them – lenders, outside directors, additional investor groups, an array of larger customers and suppliers, regulators, employee groups from different divisions or locations. And they demand more: tangible metrics, consistent proof of performance, justification for investments in capital equipment or product development, and often, explicit statements of business and market strategy. A new layer of middle management also needs a forum for understanding – if not contributing – to strategic direction. It is not much of a surprise that almost half of the senior executives of MMBs report that the ''job of CEO is far less attractive than it was ten years ago'' (Bain & Company, 2005)!

What strategy is not

In larger firms, the strategy process often works to thwart many of these antagonistic forces, providing the management team with the blueprint, building materials, and toolkit needed to build a ship capable of navigating the currents, weather and the waves. MMBs, however, do not often invest in a formal strategy program. While managers use the term ''strategy'' liberally, the process itself typically takes a wide range of distorted and ultimately unproductive forms, including:

- *The edict*. In this manifestation, ''strategy'' is handed down unilaterally from the CEO, who tells the management team exactly what they ought to be doing for the next 12-24 months. While this approach seemed to have worked fairly well in the Middle Ages, it suffers from limited market, competitive, and functional perspective, especially as the business (or multi-business corporation) grows more complex. Without operating manager and other stakeholder input, the edict risks impracticality: it may fail to address systemic obstacles (a mid-level management revolt or attrition, a new technology, a disruptive new competitor). It is also unlikely to be implemented well, as edicts rarely map out the incremental steps required to meet the goals set forth (think of the Ten Commandments). And, if implementation stumbles, managers have the luxury of shrugging off the mandate (after all, it was not their plan).
- *The budget*. In many MMBs, the budget actually is the plan. After the budget parameters are set for the year, the CEO tasks the managers with force-fitting ''strategies'' – more likely tactics or short-term actions – into what the company can ''afford.'' Next year's budget is often based purely on incremental adjustments to last year's budget, so it in effect compels the firm to repeat last year's strategy, irrespective of company, market or competitive dynamics. Figure 4 summarizes the ''usual way.''

Figure 4 The conventional strategy process



- *The data mine*. Yet another painful misinterpretation of ''strategy'' can be called the annual data-mining exercise. In this scenario, the senior management team is charged with an exhaustive review of their numbers – performance to plan, to forecast, to budget – and then compelled to present their wish list of new programs for funding. Managers prepare their sections of the program separately, typically organized along functional lines, rather than by strategy, with little or no input from their functional or divisional peers (or other stakeholders). The focus is inward, with little opportunity for external analysis, benchmarking, etc. – and critical operational or managerial systems issues are left unaddressed.
- *The goals and mission fest*. In this final common scenario, the CEO convenes his/her closest senior VPs and the team muscles its way through a two- or three-day process wherein they articulate the firm's new mission or vision, and a set (sometimes a really long set) of ''goals'' for the team to strive towards over the course of the year. This approach suffers from many of the same shortcomings cited above: the focus is internally, not externally, directed; the input is skewed to the senior management team, and leans towards prior year precedent; the outcome is usually a list of broad aspirations that are difficult to implement. Without delineating specific roles, responsibilities, schedules, and metrics, most of these aspirations (e.g. improve customer service, be the best in the industry, demonstrate world-class performance, expand into attractive new regions, achieve 20 percent EBITDA) are destined to sputter and lose steam after a few months.

What strategy can be (practical!)

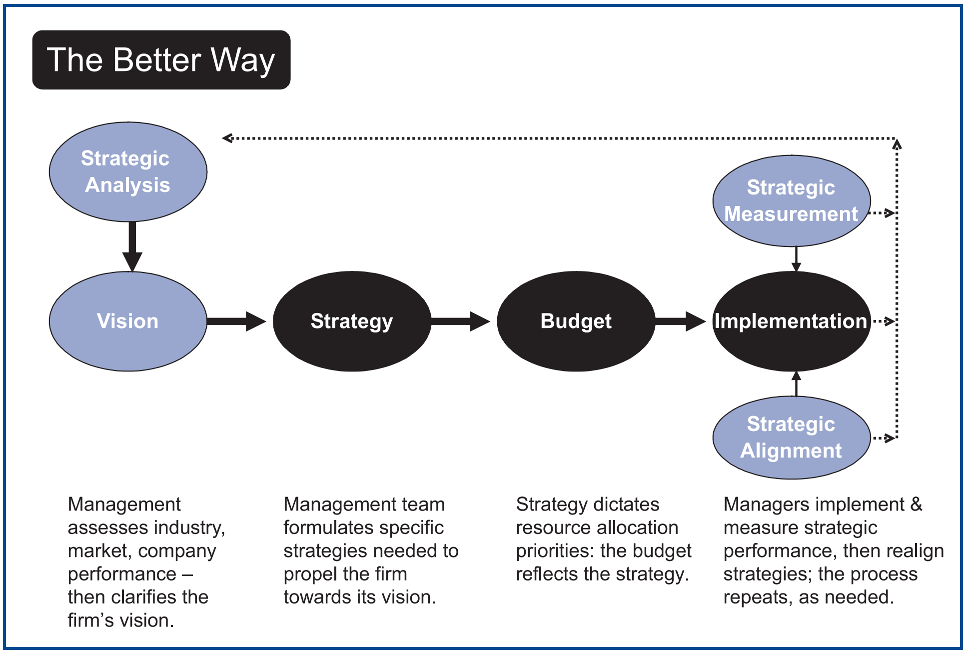
There is, fortunately, an alternative approach that enlightened MMBs can use to both frame the questions and get the answers they need to perform better. Strategy is ultimately a description of how the firm opts to allocate resources in order to achieve competitive advantage. Figure 5 summarizes a carefully structured and managed process that we argue is a better way to do it.

What characterizes this process? Successful programs feature five straightforward, but critical attributes.

Focused

Like a chronic infection, many strategy development programs endure for months on end, ever weakening (and depressing) the participants. The antidote is a rigorous and punctuated process that can move from analysis through strategy formulation and ratification in a crisp two months. The process features the development of a specific, streamlined databank, targeted input from a diverse range of sources, a formal, two- to three-day offsite workshop, and a final session with the entire management team and the

Figure 5 A better strategy process



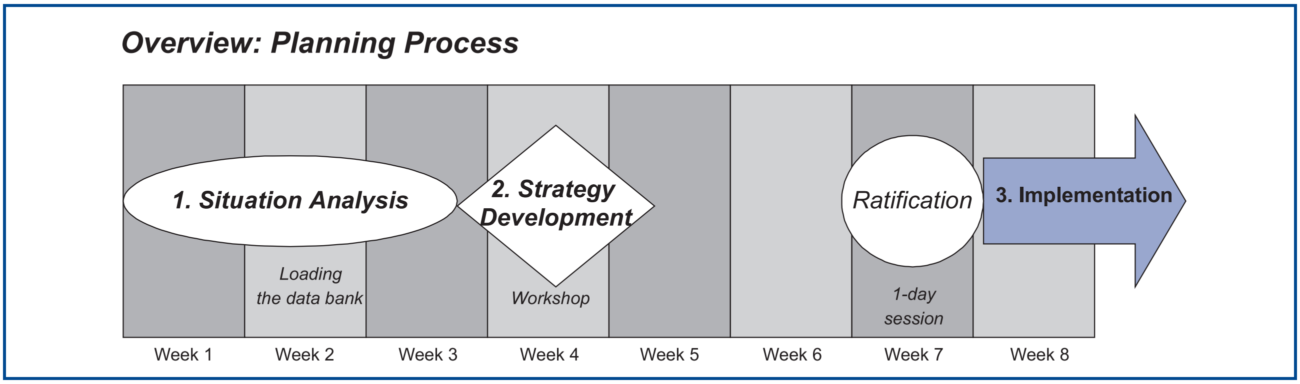
CEO/board to ratify the strategy, prior to triggering implementation. Figure 6 presents the compressed timeline.

Balanced and rational

The best soup is only as good as the ingredients used (and the cook!). Successful strategy programs feature balanced and rational input from what is typically a far broader set of stakeholders than most MMBs expect. The first step is to assemble a strategic data bank, one that offers the team a rational perspective of where the company is today, as a precursor to making decisions about where it should head tomorrow. Recognizing that perfect data are unattainable, and that time is precious, managers need to assemble and distill a mix of internal and external analyses, addressing:

- industry structure and market trends;
- competitor profiles, dynamics, and trends; external benchmarking data;
- customer profiles, dynamics, and trends;
- internal benchmarks, highlighting trends in financial and operational performance;

Figure 6 Strategy development timeline



- critical issues – input about what is important or threatening from a cross-section of stakeholders; and
- managerial systems issues – input about what is important from a cross-section of functions and levels within the organization.

Rigorous guidelines for presenting these data help immeasurably (see below). Managers offer distilled, comprehensive modules to the rest of the strategy team during the first part of the workshop, ensuring that everyone is working from a shared, common context before deciding how to allocate resources.

Participative

One of the classic complaints about formal strategy development is that it is a waste of time: either the decisions are ''already made,'' or the team approach is fruitless because no one (else) has a broad enough understanding of the business to make good decisions.

How do you make the process a constructive one?

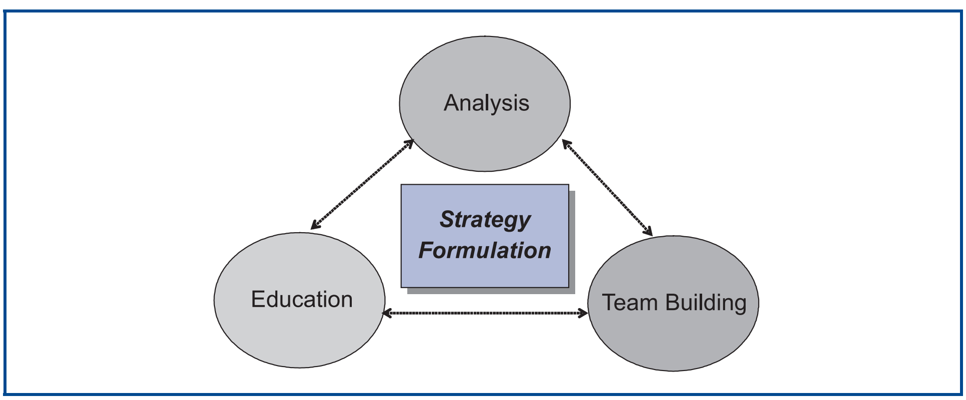
Our approach is combine strategy formulation with education, analysis, and teambuilding, as shown in Figure 7.

The logic is straightforward: the team reviews the strategic condition of the firm within the context of its markets and industry, and assesses its infrastructure. It then develops a clear vision for the future, and a small set of strategies that will help the firm enhance its competitive advantages, and its performance[4]. The process works best when managers learn a common ''strategic'' language, and have opportunities to collaborate with each other in solving problems on a common playing field. (In fact, we explicitly suspend hierarchies for the duration of the workshop, encouraging all managers to share opinions freely, in what one executive team dubbed ''The Zone of No Retribution''). Most critically, the strategy development phase must conclude with constructive action plans – delineating who is going to do what, when, to what effect. We typically assign ''strategy managers'' to each of the firm's new strategies, whose role is not to single-handedly implement, but rather to set the scope and manage the process of implementation. We explicitly invite them to recruit program managers from among the assembled group (and from within the organization) to help them manage individual programs/activities. The more the management team understands and participates in the process for implementing the strategies, the more likely they are to connect the dots, get traction, and succeed.

Energizing

A recent Conference Board survey found that one in four workers in America ''are just showing up to collect a paycheck,'' that only half say they're ''satisfied'' with their jobs, and that only 14 percent say they are ''very satisfied with their job'' (Conference Board (2005)[5]. In this light, it is no surprise that one of the greatest challenges a CEO or senior management team faces when approaching strategy is the anxiety that an exhausting, enervating process will conclude with business as usual. Or worse. Injecting enthusiasm and energy into the

Figure 7 Strategy workshop model



process is not easy – it is a serious, and often emotional challenge – but there are some practical guidelines (see also Figure 8):

- *Carefully structure the agenda*. Control the length and format of key presentations, ensuring they are succinct and value-adding.
- *Mix it up*. Interweave static modules with action-oriented problem-solving and team-building exercises, to help improve communication, teamwork, and blood flow.
- *Draw analogies*. Help the team gain insight into their current situation by coming at things from another angle, for example, using case histories to explore how other firms in different industries solved similar challenges[6].
- *Make decisions*. MMBs typically suffer from slow or opaque decision-making on new initiatives. The antidote can be to use the workshop process to make clear and immediate decisions on priorities or programs – tangibly demonstrating to the group that they have got traction, that their work matters.
- *Address the hard and soft stuff*. Honesty can be astoundingly energizing to a management team. We have seen countless times the benefits of directly confronting operational or cultural issues – clearing the air, and using the opportunity to map out appropriate corrective actions.

Practical

The ultimate test of a strategy process: do we emerge with practical solutions? The most daring or elegant strategies are not worth much if they never make it beyond the corner office. Firms do best when the outcome of the strategy workshop is a set of clear choices regarding future direction. That typically includes:

Figure 8 A strategy process checklist

	Yes	No
Strategy		
We have a written, up-to-date strategy document		
Key managers refer to the document regularly		
Our strategy includes specific, quantitative metrics		
Our performance goals/metrics are aligned with strategy		
Our strategy addresses external (market) and internal (firm) dynamics		
Our strategy helps us set clear priorities for allocating resources		
Our staff can articulate our strategy		
Our strategy addresses short, medium, and long term issues		
Strategy Process		
We articulate our strategy before preparing our annual budget		
We consistently analyze market & industry dynamics, and benchmark		
The strategy process simplifies managerial decisionmaking		
We have a process for translating broad goals into specific actions		
We communicate our strategy frequently, both inside & outside the firm		
Implementation		
We have a consistent, formal implementation process		
We've defined roles, responsibilities, schedule, and metrics		
We monitor implementation, adjusting course as necessary		
We have a regular forum for cross-functional input & discussion		
We've aligned managerial systems to support implementation		
We diagnose implementation failures, and celebrate successes		

> "In addition to the typical functional rivalries – sales versus manufacturing, quality control versus production – middle market firms also wrestle with the bitter fruits of mergers, acquisitions, and past expansion."

- A new vision statement, clarifying what the firm will look like in three to five years – spelling out approximate size, financial condition, markets served, and source of competitive advantage.
- A small set of strategies – usually three to five multiyear initiatives, each designed to propel the firm towards its targeted vision.
- Target performance metrics – a summary of expected performance for the firm in several key dimensions, such as revenue, market share, profitability, growth rate, cash flow, quality, and productivity.
- Preliminary implementation plans – at the least, a first pass at assigning roles, responsibilities, schedules, and metrics to the key strategies selected.

The term ''practical'' implies implementable: does the team have a simple methodology in place to set these strategies in motion, and track/monitor performance? Can the plans be communicated to stakeholders easily and succinctly?

Practical guidelines for MMB strategy development

Our work with MMBs from more than 50 industries suggests that while there are no cookie-cutter approaches to managing the process flawlessly, several additional guidelines can help you get the job done:

1. *Select the right team*. We have found that a team of 12-16 high-performing and high-potential cross-functional managers works best, for a number of reasons. The size of the group is surprisingly important: when there are too few participants, perspective is limited, and old habits and politics predominate; too many and the group discussions become fractious and unwieldy. At optimal size, the group benefits from a diversity of perspectives, and can be easily segmented into productive small groups. Some organizations need to dip down below the officer ranks to get the right group size, but this is almost always an excellent idea, for it expands the talent pool, elevates the perspective of the high-performing new participants, and plants the seeds for future development.
2. *Assemble a strategic data bank*. Good strategies reflect the input of a diverse set of stakeholders and encompass activities that address stakeholder needs. The strategic databank needs to capture and present candid information to the team on both hard (empirical) issues and soft (perceptual, or managerial systems-oriented) issues; it must incorporate perspective on what is happening outside the firm and within the firm. Structured, objective presentations do wonders to focus the group and reduce static; failure to do so significantly impedes the group's progress. It may sound trivial, but well-structured presentations catalyze group discussion, while sloppy ones quash critical thinking.
3. *Convene (and sequester) the leadership team*. To formulate strategy effectively, management teams need time and space to remove themselves from the day to day. The added cost and hassle of relocating off-site for an uninterrupted workshop is more than compensated for by the additional clarity and sense of purpose managers feel when they (finally) get to the conference. It also helps underscore the importance of the exercise: mapping out the company's future is an extraordinarily crucial investment. A final, practical point is that work sessions often lead deep into the night and start again early in the morning, as managers work elbow to elbow charting future direction.

4. *Assign clear responsibilities and schedule*. Most conventional strategy programs fail to delineate responsibilities and schedules, as we have discussed. When everyone's responsible, no one's responsible, and things often fall through the cracks. The workshop session must conclude with specific decisions regarding who does what, when.

5. *Ratify results with team and leadership*. During the two to three weeks following the workshop, strategy managers need to track down missing data, refine their projections, calculate the resources required to implement strategy, and resolve other critical issues. We recommend reconvening the entire team for a formal ratification meeting, where the final strategies, programs, performance expectations, and resource requirements can be presented, debated, and validated. Formal punctuation by the firm's decision-makers triggers the official start of implementation.

6. *Communicate to stakeholders*. One of the bigger misperceptions about strategy development is that it should be cloaked in secrecy. In fact, gathering input from a diverse set of stakeholders – inside and outside the firm – is not only important for the management team: it can also send a powerful, positive signal to ''outsiders'' that you are investing in a sincere and balanced process[7]. Senior management should take pains to carefully communicate the process to their staff during the workshop period, to manage expectations and preclude panic (e.g. ''they're selling the company!'' or, ''we're going under!''). After the strategies have been ratified, the CEO needs to recap the results formally, the rationale for the firm's (new) priorities, and the process moving forward, underscoring the importance of implementation. Consistently communicating progress or setbacks in implementation further galvanizes the process, and helps keep people motivated and pointed in the right direction.

7. *Implement, and make implementation count*. Shakespeare wrote that ''If to do were as easy as to know what were good to do, chapels had been churches and poor men's cottages princes' palaces''[8]. Implementation is hard. Some tried and true techniques for facilitating the process[9]:

   - broadcast the high-level strategic metrics and milestones, so everyone understands where the strategies are meant to propel the firm;
   - link incentive compensation/bonuses to success in achieving these targets; and
   - celebrate successes, giving explicit recognition to managers or groups that excel.

What's the return on investment?

Is the investment in a formal strategy development process worth it for MMBs? Done right, the process helps MMB leaders capture and evaluate critical data, set priorities, and establish rational guidelines for allocating human and financial resources. A formal process also delivers additional dividends, in terms of both content and process:

1. *Content dividends*:

   - Accurate, timely perspective of the firm's strategic condition, competitive position, and the context within which it operates.
   - Tangible choices for resource allocation: specific roadmap, budgets, targets, metrics.
   - Formal, explicit guidelines for decision-making and priority-setting: a useful management tool that can be invoked over the course of implementation.

2. *Process dividends*:

   - Establishment of a common framework, databank, and language for assessing competitive position and developing competitive advantage.

"Growth demands an external, market-oriented focus, and efficiency an internal, cost-oriented focus."

- Enhanced management and stakeholder buy-in, the fruits of a participative and transparent strategy development process.
- A regular forum for airing and resolving critical issues that will impact performance and implementation.
- A streamlined and repeatable methodology that can be cascaded throughout the firm, and tailored to fit specific needs and systems.

Strategy development is never easy, particularly when the winds and tides are rapidly shifting. However, MMBs can borrow a page from successful, larger corporations, and create a practical process that helps them anticipate and strategically meet the challenges they face; and while MMB CEOs cannot turn the tides, they can collaborate with their management teams to chart a course through the shoals, fill their sails, and surge ahead of the fleet.

Keywords:
Management strategy,
Business development

Notes

1. Source: Grant Thornton web site.
2. A cross-industry survey of 305 middle market business owners and senior executives.
3. A survey of 276 senior executives from North America. Half of the respondents are from small and medium-sized businesses.
4. Typically three to five strategies are the optimal amount. Most firms encounter implementation and resource constraints when they grapple with more.
5. A survey of 5,000 US households.
6. We distribute a small set of case studies or strategic management articles from highlighting a specific process, technique, or paradigm as pre-workshop homework. Managers typically relish the analogies they perceive; the ‘‘lessons’’ are invoked during small and large group debates, and offer both a fresh perspective and a welcome, new vocabulary.
7. Customer and supplier interviews should be carefully positioned, structured, and managed, to solicit constructive, confidential feedback; a seasoned consultant can typically cover a lot of ground for you.
8. *The Merchant of Venice*, Act I. Sc. 2.
9. For more information on the nuts and bolts of optimizing implementation, see Allio (2005).

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