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Strategic databanks: design for success

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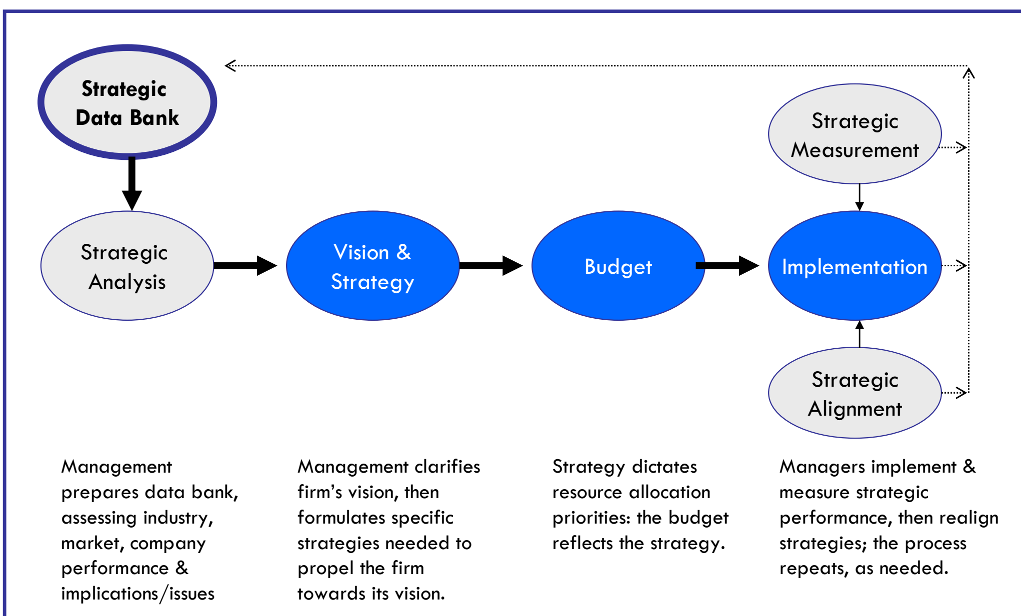
For many firms, the strategic planning process is compromised from the outset, because the management team lacks a multidimensional strategic data bank -- one that can crystallize the issues and opportunities the firm faces. While data abound, many managers lack critical and balanced information. As a result, subjective opinion and selective historical performance reviews overly influence strategic decisions. Key managers make impulsive or gut-based decisions about how to best allocate resources, respond to competitive threats, or seize (apparent) opportunities in the marketplace.

In contrast, decision-makers in high performing firms systematically cultivate critical information. They capture, and share, a range of inputs on the firm, its markets, the industry, and the environment, then translate these data into useful form[1]. Armed with the right data, the management team does a far better job of strategic analysis, paving the way for the formulation of vision and strategy, which can then be captured in a budget. The last two steps in the process are implementation and performance tracking, where again, good strategic information plays a critical role, as shown in Figure 1.

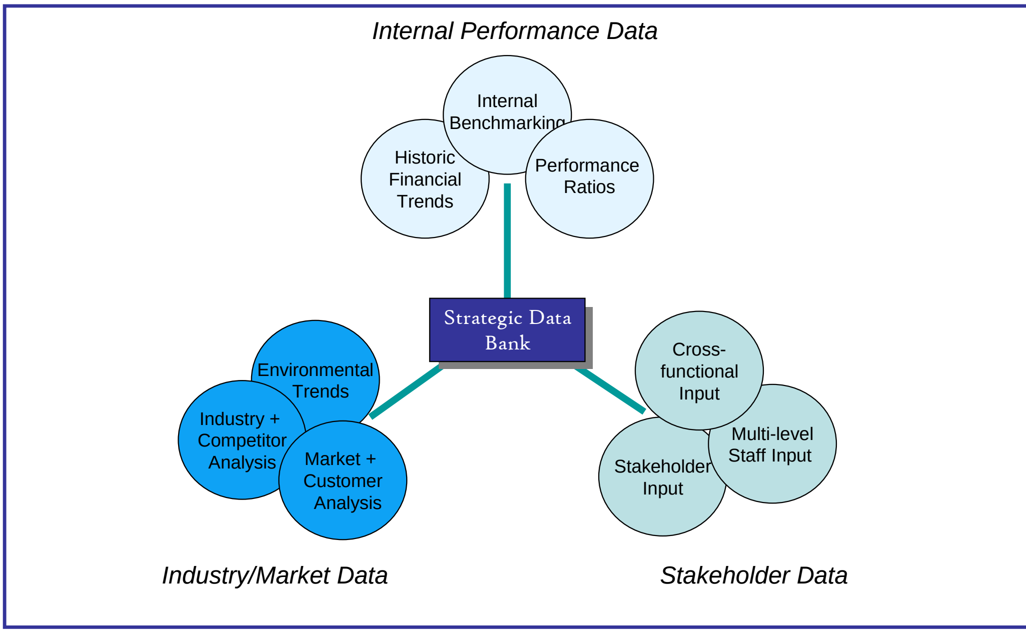
Figure 1 **The strategy process**



Don't sophisticated companies know this already? Yes, but experience suggests that many senior managers do not have ready access to information that provides a comprehensive and robust perspective on how the firm is performing, the dynamics at play in the marketplace, competitor behavior, stakeholder perceptions, resource availability, and the implications of trends in these areas for the firm. The consequences of not having this information can be serious: strategies that miss the mark, fail to engage stakeholders, or can't be implemented.

What are the key content categories in a strategic databank? Our work with hundreds of manufacturing and service firms in North America, Europe, and elsewhere suggests that there are three primary sets of input that characterize a 'strategic data bank', as shown in Figure 2.

Figure 2 **Strategy data bank**



Strategic data bank guidelines

When your management team begins to prepare for the strategy-development process, the goal is to produce an insightful view of the dynamics of a firm's internal and external operating environment. But how best to characterize the firm and its current strategic condition? High-performing managers:

- Structure a succinct, accessible, and illuminating databank.
- Establish a common language and a shared perspective.
- Engage a cross-functional team of managers in the active process of assessing what's relevant.

Here are four practical guidelines for developing a useful strategic databank:

1. Assemble the building blocks: explore and translate historic performance

It seems obvious that any strategy-development program would include a thorough financial performance review, and yet there seems to be no consensus on what financial data and format are standard. In many privately-held firms, comprehensive financial data are only accessible on a 'need to know' basis, if at all. Even in publicly-held firms, access does not equate to familiarity or fluency.

A surprisingly large number of functional managers find it difficult to navigate an income statement, cash-flow statement, or balance sheet. Even talented managers fall prey to organizational or functional myopia; the pace of change and the struggles of

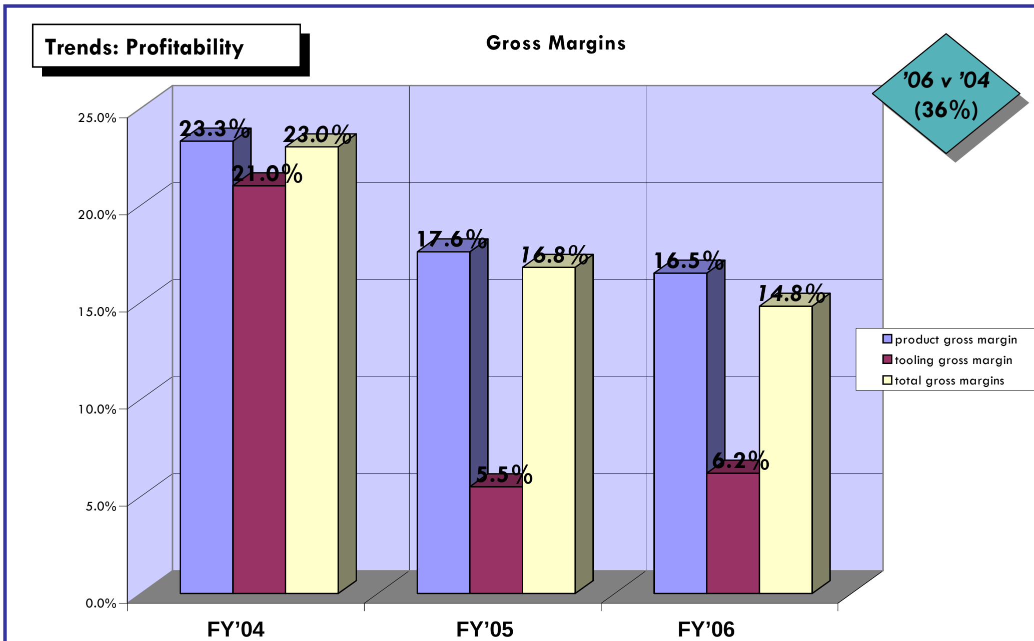
> "Subjective opinion and selective historical performance reviews overly influence strategic decisions."

implementation pull their focus inexorably inwards, to the company, the division, or the functional unit, and away from the customer and the market. Particularly in more mature firms, it's not unusual for functional managers to concentrate explicitly on their own unit's set of performance metrics.

How often do senior managers get a holistic look at the overall health of the entity over time or take the opportunity to assess and discuss the implications? And how often have non-financial managers been given a guided tour of the firm's performance, in language they can comprehend? Not enough! Some key inputs:

The financial trend walk. The first step is to develop a clear profile of recent trends. The pace of change in today's marketplace suggests that three years is a reasonable timeframe for most firms. One approach is to provide the management team with a "big picture" tour of trends, and provoke structured discussion about their implications, in 15-20 simple graphic slides. Figure 3 shows an example slide addressing gross-margin trends for a specialty plastics manufacturing firm.

Figure 3 **Financial trend analysis**



Gross margins have suffered with the reduction in revenue: we can't absorb enough fixed overhead at a $50M revenue run rate.

New pricing and tight control of shop floor performance can boost gross margin percentages by 3% - 5% -- we need to cross the 20% level!

While managers were aware of increasing pricing pressures and rising costs, the extent of the firm's decline was not widely known, and when recognized, it compelled the team to scrutinize pricing, cost of goods, and overhead levels to find opportunities to recover. A new initiative to elevate tooling margins was also engineered to help buoy overall profitability.

Table 1 highlights some other financial indicators to scrutinize, along with the strategic issues they usually provoke.

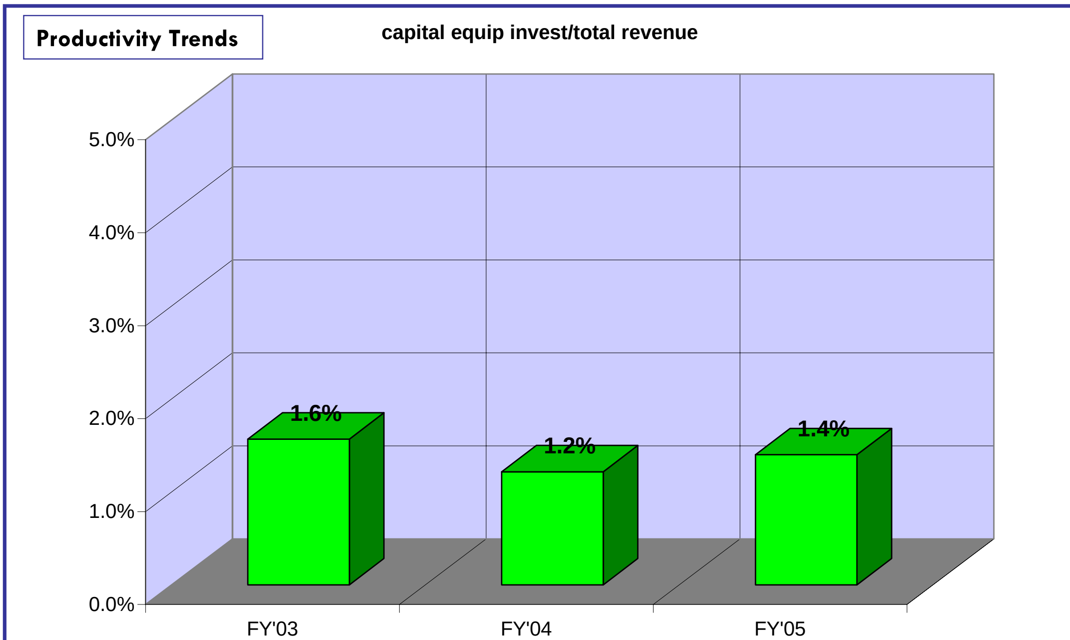
Table I Financial performance walk: three-year trends

Category	*Example Trend Graphs*	*Example Issues*
Revenue	Dollar, unit	sources of revenue, over time
	Mix: product type	leaders + laggards by class
	Mix: channel, region	driving factors; resource allocation
	Concentration: top 5 customer rev / total rev	customer preferences + power
Gross margin	Dollar, percent overall	sources of profit, over time
	Dollar, percent by product type	price + cost levers
	Dollar, percent by key market segment	price + cost levers; segment emphases
	Dollar, percent by channel & region	segment importance/attractiveness
S, G&A	Dollar, percent of revenue	absolute + relative burden
	Key subcomponents of S,G&A	weighting, return on investments
EBITDA	Dollar, percent of revenue	momentum, levers
Cash Flow	Operating Cash, Capital Inv., Free Cash	effectiveness, short + long-term impact
Net Income	Dollar, percent of revenue	effectiveness, capital structure

Performance ratios. The next step is to juxtapose these same data in innovative ways, using ratios that the management team may not regularly utilize, to gain further insight into the forces that are affecting the firm's performance.

At a growing automotive-component-manufacturing firm, for example, key managers were routinely urged to minimize capital-equipment investment in order to preserve cash – and, at the same time, to drive margin improvements via COGS reductions. These are worthy goals in the short term, but the snapshot of investment intensity shown in Figure 4 underscored for the team that they were operating in "harvest" mode. By avoiding investments in upgrading capital equipment at the same time that they were experiencing accelerated growth, they were stretching their infrastructure to the limit.

Figure 4 Example performance benchmarking



We have invested in capital equipment, but still not much relative to sales: is it enough to deliver improvements in productivity or profitability?

Revenue has grown 22% and more is projected: how much longer can we sustain throughput levels on current equipment?

The risks associated with maintaining this low investment level were substantial, in light of the firm's aggressive programs to expand into new market segments over the next three years with its major OEM customer base.

Table II lists a number of robust ratios that can compel managers to take a step back from their functional or divisional perspectives, and consider the entity (and its progress) as a whole.

Table II Key performance ratios

Category	*Example Trend Graphs*	*Example Issues*
Growth	Revenue growth: key segments + overall	sources of growth or decline
	EBITDA growth: key segments + overall	sources of growth or decline
	Average unit price: key products + overall	customer mix, competitive positioning
	Revenue from new products/total revenue	innovation, product mix
Productivity	Revenue/square foot	manufacturing productivity
	Revenue/employee	staff productivity
	EBITDA/square foot	insourcing versus outsourcing
	EBITDA/employee	role definition, overhead burden
	Capital equipmt investment/total revenue	investment intensity, sustainability
	New Products: avg. + median days to market	speed to market, responsiveness
Efficiency	Inventory turns	cash flow, inventory mgmt
	Throughput rate: key products	value chain, process capabilities
	Capacity utilization	asset leverage; insource/outsource
	New Products: avg. + median days to market	speed to market, responsiveness
Quality	% ontime delivery	customer service performance; speed
	warranty + returns cost/total revenue	customer-perceived quality
	reorder rate %	customer satisfaction; growth potential
	defects/total volume (by segment if possible)	manufactuing process controls
Profitability	Return on Net Assets	ability to leverage assets to make profit
	Return on Equity or Investment	capital structure; stakeholder satisfaction

Divisional benchmarking or SBU benchmarking. In multi-divisional businesses or multi-business corporations, it's also helpful to compare and contrast performance across the firm. A small set of slides portraying selected ratios from the above tables often provides insight into relative and overall firm performance, and lays bare how resources have been allocated to generate impact.

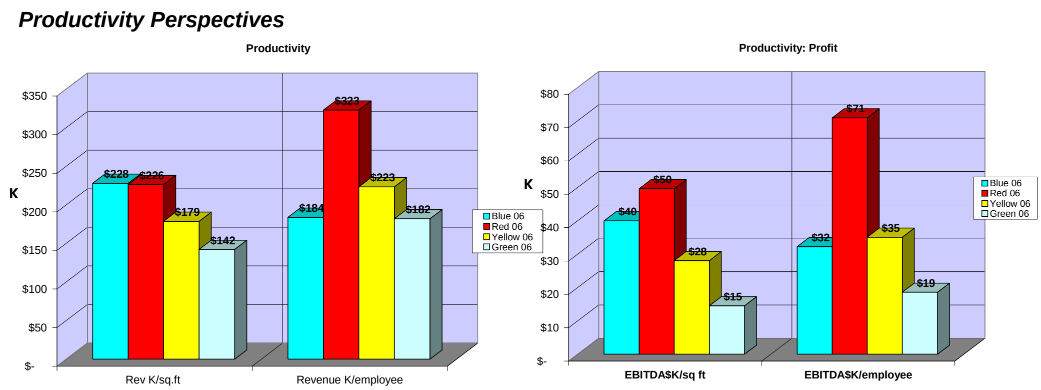
Figure 5 on the following page illustrates how one equipment-manufacturing firm contrasted performance trends for the prior year across business units.

The discussion this provoked produced a valuable insight. The key question: how did the top performers manage to achieve such dramatically higher productivity? The group deduced that the Red division's decision to outsource several key fabrication processes delivered more in terms of both revenue (it sold more product more quickly) and profit (its vendors made product subcomponents less expensively than it could in-house).

2. Put information in context: external

Even sophisticated firms often lose sight of the bigger context for evaluating their performance; inevitably their managers' focal point drifts from outside the firm to inside. Good strategy focuses on maximizing a firm's competitive advantages in serving its stakeholders, so it follows that a good strategy databank includes timely and accurate input on customers (the markets), competitors (the industry), other stakeholders, and other relevant trends that might impact the company. The critical categories of stakeholder input include:

Figure 5 Example internal benchmarking



- Blue generated substantial improvements this year, but Red continues to lead in these classic productivity measures, when sales or profit generation is the focus. Lessons?
- Yellow still trails in the productivity: profit/facility metric. Status of SKU reduction?
- Green is the overall underperformer. Implications for process or facility setup? Implications for balancing fabrication?

Customer profiles. Top management tends to lose intimate contact with customers as firms grow and mature, and while it seems obvious that the strategy databank should include information about how key customers are behaving, more than half of all respondents in a recent global management survey reported that "insufficient customer insight is hurting our business."[2]

In fact, it's fairly common for managers to:

- Rely heavily on folklore, or the sales team's unstructured "conversations" with buyers, as the primary or sole input.
- Overlook the hard data the firm does have, for example, embedded in order analysis and trend analysis.
- Look backwards at historic behavior rather than forwards at probable future behavior.
- Resist questioning customers directly about strategic issues like pricing, demand, the components of 'value,' competitors, or firm performance, out of fear that it may "spook" them or send the wrong signal.

Just how valuable is analytic insight into customer behavior? For a regional manufacturer of hardware accessories, for example, careful order and margin analysis of key customers yielded some surprising and counterintuitive insights.

The firm's largest customer, a multinational home-improvement retailer, had aggressively rolled out a package of the firm's product line to an additional 150 of its stores, across a variety of regions and market types. Overall volume and revenue ballooned. Upon closer scrutiny, however, the seemingly successful rollout was a calamity for the manufacturer: reorder rates plummeted as stores that were unprepared to merchandise the entire product line relegated unwanted inventory to the back of the store. The rollout quickly tanked program performance as measured by the customer's key metric GMROI (see Table III).

Table III Key customer order analysis

	fy05	fy06	% Change
Sales/store	$ 12,432	$ 13,849	11%
Avg Gross Margin	24.10%	28.20%	17%
Reorder rate	12.4	7.6	-39%
GMROI*	**299**	**214**	-28%

* gross margin % x inventory turnover

The consequences: the retailer resisted reordering for those stores that were out of stock, and soon de-listed the product line, destroying the firm's momentum and sending shock waves through their supply chain. The lesson: careful analysis, and better insight into the customer's performance criteria, can help the firm navigate growth and sharpen its survival skills.

In sum, at least three key sources of quantitative and qualitative customer input enrich the strategic databank:

1. Customer performance analysis, including sales-order size, order/reorder frequency, sales mix, regional distribution, warranty, and cost-of-sales analyses.

2. Formal interviews with key customers, where they are invited to define the elements of quality and value for their organization, weigh in on your firm's performance, profile or compare competitor performance, and offer specific, constructive input regarding their service/quality expectations for the future. Interviews with a cross-section of customer staff can also be critical: front line employees may have a different perspective from the buyer or purchasing agent, especially regarding competitor and end-user issues and trends.

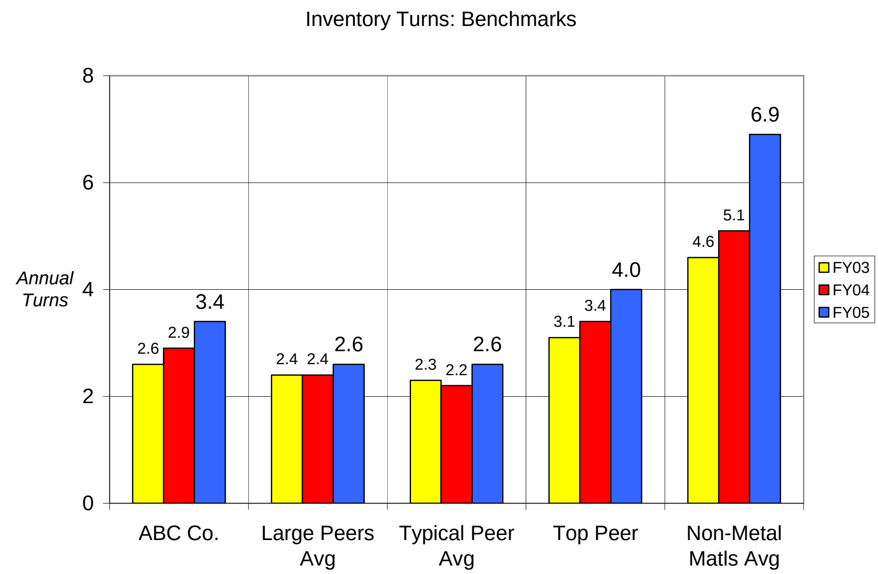
3. Customer strategy profiles: it's equally important to solicit direct input from customers on their strategy, in terms of vendors, structure, and product/service offerings to their customers. Can you determine if they are growing or contracting? Expanding their product lines or focusing/streamlining? Deploying new merchandising, promotional, or sales tactics to reach their customers? Potentially acquiring competitors, merging, restructuring, or in-sourcing operations? Answers to these questions may have profound impact on how your firm positions itself.

Capture the results in succinct summary presentations for the general review of the management team.

Peer or process benchmarking. Benchmarking is not a revolutionary concept or technique. Yet benchmarking data are often vehemently rejected by managers who complain, "You just can't compare us to them…it's apples to oranges." The most immediately relevant comparisons certainly emerge from head-to-head comparisons with direct competitors. But even when public data are not accessible, "look-alikes"—firms outside the industry operating with similar processes or making similar products for similar types of customers—provide valuable benchmarks.

For instance, for a large distributor of specialty metals, inventory management is a core process. Internal benchmarking showed that the firm was making solid incremental strides in improving inventory turns, year over year. But as Figure 6 reveals, the firm lagged not just the top performer in its industry, but also the average for industrial materials distributors in an adjacent sector.

Figure 6 **Example peer benchmarking**



• We're on par with the average peer – but lagging the top performers, and only half as capable as non-metals distributors…

• What product type, customer segment, or process is holding us back?

Realizing that other firms with similar processes were producing far higher inventory turns, the management team launched a process analysis that revealed a key bottleneck in fabrication. A modest capital investment at several distribution centers led to substantially improved performance – creating significant strategic advantage rather than merely achieving incremental goals.

Competitor and industry profiles. Just as current customer profiles sharpen the management team's understanding of the demand climate, competitor profiles provide essential insights too. Operations, quality, engineering, and finance executives all need input on the environment in which the firm competes. They may have valuable perceptions to share with the rest of the strategy team regarding structural changes within the industry (e.g., changes in supplier positioning, pricing, or structure). Key questions to address:

- Who are our current and emerging competitors (identity, location, scope, size, structure)?
- What is their apparent strategy and bases of competition? Key segments served? Recent changes or trends? Are there new or emerging competitors?
- How do we stack up against the competition, in terms pricing, quality, service levels, breadth/scope?
- How can we best define the overall market (key segments, size, growth, structure)? Are there attractive segments we (or others) aren't serving?

No firm competes in a vacuum, and it's important to periodically step back from the day-to-day fray to consider the impact of broader forces on the industry as a whole. The strategic databank should also include input on these driving forces -- governmental, regulatory, technology, environmental -- and their likely impact on the firm in the short, medium, and longer term.

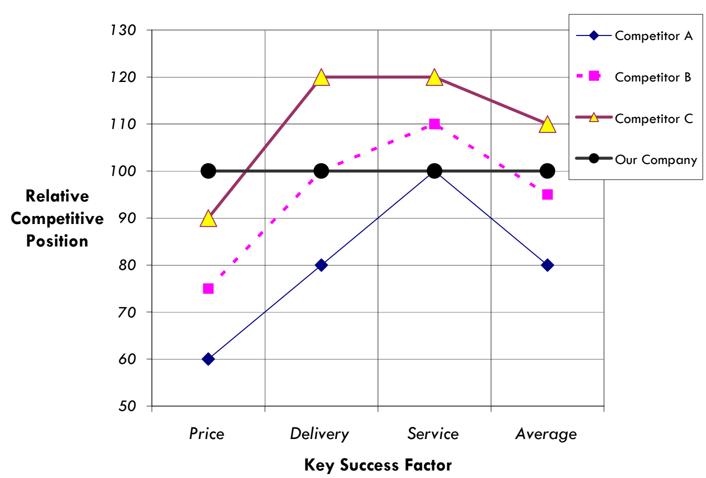
Table IV highlights some of the classic tools for a focused assessment of competitive position.

Table IV **Industry and competition data**

Category	Example Data
Competitor Profiles	Size, scope, reach, structure Strategy, positioning, bases of competition Key product lines, customers, est. share Strengths, weaknesses, trends
Industry Structure	5 Forces analysis (Porter) Industry maturity/life cycle Key success factors
Market Profiles	Key segments: size, growth, attractiveness Market share by segment, competitor
Competitive Position	Maturity/ relative competitive position array Product portfolio array Market growth/share array
Environmental Forces	Regulatory policy trends Technology shifts/alternatives Environmental issues/trends

When the 18-person senior-management team at a 25-year-old construction-equipment-leasing company undertook a competitive analysis using these tools at its its strategy-development workshop, the managers were startled by the results. The team had previously focused on large, national competitors, and shaped their strategy to address head-on competition with these players. When challenged to identify the key success factors for their customer base, three strategy teams arrived at the same answer: price, delivery speed, and service quality. A simple comparative profile highlighted that small regional players exerted an even greater threat than prominent national competitors, as illustrated in Figure 7.[3]

Figure 7 **Relative competitive position**



Key Success Factors	Competitor A	Competitor B	Competitor C	Our Company
Price	60	75	90	100
Delivery	80	100	120	100
Service	100	110	120	100
Average	*80*	*95*	*110*	*100*

Management's response was to formulate new marketing and operational strategies to expand the firm's regional presence via satellite locations, minimizing fulfillment time to regional customers, and maximizing equipment-utilization rates.

3. Put information in context: stakeholder perspectives

Good strategy seeks to enhance stakeholder[4] satisfaction, and it's reasonable to assume that capable managers are sensitive to stakeholder perspectives. But the intensity and pace of day-to-day business can distract managers and serve to obfuscate that line of sight. And organizational or functional boundaries can prevent critical, timely input from reaching top decision-makers.

For a growing transportation-component manufacturer, for example, new ownership funded a series of rapid acquisitions of regional and national competitors. To senior management, the purchase of two competitors in the northern US sent a strong signal of the firm's commitment to growth and expansion. Other stakeholders drew different conclusions: operating staff in the Midwest plants feared imminent consolidations, leading to anxiety and turbulence on the shop floor; a top-10 volume customer inferred that the firm was planning to raise prices, and so accelerated its own plans to bring in-house the production of a commodity-product line; a key supplier, fearing the consolidation of purchasing under the new corporate umbrella, reallocated limited-supply steel shipments to other customers to avoid potential disruption of its sales volume. Each of these stakeholders threatened the firm's forward momentum and, ultimately, the implementation of its strategy.

A series of structured, confidential interviews with key stakeholders can help identify "critical issues" that are germane to both strategy formulation and implementation. The input from the staff typically includes frank feedback on how the firm "really works" (or doesn't), and urgent insights from the front lines and external stakeholders can include valuable insights on trends, market forces, and competitor or technology developments. Here's a recap of the three essential sources of input worth vetting:

1. Cross-functional staff perspective: structured interviews with managers representing a broad array of functions across the firm. The finance department, for example, has crucial input about not only accounting issues, but also key customer or supplier behavior; the customer-service group may offer invaluable feedback from the front lines about product design, quality, or engineering issues.

2. Multi-level staff input: by interviewing not just senior managers but also a cross-section of mid-level and junior staff, the strategy team can gain further insights into how the firm is really performing, as well as its risks, opportunities, and potential obstacles. The dangers of soliciting this kind of politically sensitive input are more than compensated for by the rewards: it engages the staff in the process (sending a strong positive message to the group that diverse opinions are valued), and highlights potential misalignment in the very systems that senior management will lean on to drive implementation.

3. "External" stakeholder input: the firm operates within a larger context, and while senior managers hope they've developed a 'global perspective,' it rarely includes timely and strategically focused feedback from a comprehensive range of key players outside the firm. Customer input is essential, but not sufficient. Key suppliers can offer valuable insight into the behavior of competitors, the supply chain, and the firm's own order patterns or bottlenecks; regulators can offer perspective on emerging legislation or licensing requirements that may affect the cost of doing business; consumers or consumer groups can offer advance warning about how the firm and its products or services are perceived, and how the market environment overall is evolving.

"Even sophisticated firms often lose sight of the bigger context for evaluating their performance; inevitably their managers' focal point drifts from outside the firm to inside."

How best to capture the data generated from these sources for the senior-management team? The goal is to compel management to sincerely confront issues, however sensitive, that may hinder the firm's ability to implement. One technique is to distill the input into 10-15 important themes packaged in a set of slides; for each critical issue, a series of unattributed direct quotations summarize stakeholders' perspectives. Actual quotes jumpstart discussion, and minimize the political danger of raising painful issues[5]. Guided discussion can help clarify these issues, and the team should be challenged to address or resolve them as they develop strategy, minimizing barriers to implementation.

4. Carefully manage the data-preparation process

While the strategic-databank ingredients described above are essential, the data-gathering process is also important and represents a real opportunity to engage a broad cross-section of stakeholders, improving the likelihood of implementation. Some process guidelines:

1. Structure an inclusive data-prep process. Better data usually flow from diverse inputs. A formal process (with clear guidelines for balanced input) helps convey to the broad stakeholder base that you're setting rational priorities for the firm's growth and evolution. But just as important, the mere invitation to contribute can energize and mobilize diverse constituencies across and beyond the firm. A compressed schedule for amassing and processing the data is also critical: busy managers need to secure the best available information, not exhaust themselves or their teammates with a drawn-out and endless quest.

2. Stick with a simple, consistent format. Editing and packaging the data you acquire is another essential and underappreciated step. One frequent challenge is the breadth and diversity of source materials: the MRP system may spit out numbers in a format that differs from the department's own or conflicts with a trade group's market analysis. Take the extra step to translate these materials into a succinct, common format; this helps managers focus on what's important, and compels them to organize and distill their thoughts ahead of time. As a result, they come better armed and in better command of material that is more accessible to the rest of the team. An added benefit to a standard format: data can be refreshed easily throughout the year, simplifying comparisons to previous periods.

3. Consider engaging qualified outside counsel. Time and management energy are precious resources. A good, practical consultant can enhance both the process and the outcome by:

- soliciting a range of sensitive input from stakeholders who may be reluctant to speak frankly or critically to their own boss or customer.
- accelerating the data-gathering, and distilling data dumps[6]
- challenging conventional wisdom, drawing analogies to other firms or industries

However, the consultant should not be the sole data-gatherer. Consider appointing several cross-functional team leaders (representing finance, marketing, sales, production, engineering, and other key functions) to spearhead the hunt.

4. Challenge management to present the results. Astoundingly, even when a good databank has been prepared, the strategy team does not often take full advantage of it; reports are circulated for (passive) review, or buried in stacks of backup fodder. One approach to counteract this is to convene an intensive and off-site workshop with the strategy team, where the first half of the agenda focuses on strategic assessment – that is, on presenting and rigorously analyzing the databank. Performing can be a wonderful adrenalin-inducer: by compelling managers to stand up and present the data to their peers, you increase the odds that the data are correct and that the implications are more energetically explored[7].

To recap

Good strategy hinges on having timely, balanced, and high-quality data, and a talented team of decision-makers prepared to interpret and respond to these data. Without a robust strategic databank, each manager's opinion about where to go or how to compete is equally valid: the loudest, most persuasive, or most insistent person in the room wins. A successful databank, by contrast, helps managers forge better, fact-based decisions about strategic direction and priority. It serves to:

- Engage managers in the strategy development process, by encouraging them to scrutinize the driving forces and levers at work in the industry, the markets served, and within the firm itself.
- Level the playing field, giving equal weight and equal access to a range of perspectives and functions.
- Help managers both quantify and qualify strategic choices, and articulate a defensible rationale for the strategies they choose to pursue.
- Sharpen internal performance monitoring, paving the way for better surveillance as the team turns from strategy development to implementation.

Notes

[1] The integration of the classic industrial-organization perspective (Bain, Mason, Porter), which favors industry structure & dynamics, with the resource-based view, which emphasizes the firm's unique resources and capabilities, is a balanced perspective that we've called "Practical Strategy:" see *Practical Strategy For Family Business*, Michael K. Allio & Robert J. Allio, Tata-McGraw-Hill, 2005.

[2] If customer audits are positioned as a forum for constructive and strategic input, rational customers will respect the firm's investment and management's commitment to improving performance.

[3] The methodology shown is simple and qualitative: the scoring does not weight any particular dimension more greatly than another, although managers should clearly explore the relative importance of these performance dimensions, and wherever possible, corroborate their assumptions of customer-perceived success factors with actual direct customer input.

[4] "Stakeholder" is here defined as anyone who has a stake in the firm's activities: employees, Directors, shareholders, suppliers, regulators, shareholders, bankers, unions, government officials, customers, and consumers all qualify.

[5] It doesn't hurt to invoke what management team termed the "RFZ" ("The Retribution-Free Zone") – an explicit reassurance from the CEO to the strategy group that frank and constructive commentary will be entertained without risk of punishment.

[6] Beware of over-reliance on the consultant: managers should collaborate closely with the hired help so that they 'own' the material, understand the analyses, and can present the results to their colleagues and other stakeholders themselves.

[7] For more information on managing the strategy-development process, please see: "Practical Strategy Development, A Wise Investment For Middle-Market Businesses," Michael K. Allio, *Journal of Business Strategy,* Vol. 27, No. 2, March 2006, 31-42

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