

TOPIC 1

Strategy Development, Then M&A

Topic 1 presents an overview of the fundamental elements typically addressed in the strategic planning process; explores a number of work activities, approaches, and ideas pertinent to the process of developing strategy; and explores where mergers and acquisitions (M&A) fit in the strategy development and execution process.

The reader is encouraged to take the time to read through the Appendices referenced in the text of this and all remaining Topics in conjunction with the narrative to gain the appropriate level of understanding of the subject matter discussed. Appendices are either presented at the end of this and each remaining Topic or are available for review and download on this book's companion Web site (see the About the Web Site page for login information).

M&A IS ONE OF MANY BUSINESS DEVELOPMENT OPTIONS

- M&A in an operating business is one of a number of means to accomplish a strategic goal and generally results from a strategic planning and strategy development process.
- M&A activity is the strategic activity of investor groups (equity funds, venture capital funds, etc.).
- The work involved in strategy development in manufacturing or service firms is often found to be frustrating and difficult.
- The questions, introspective search, dialog, and answers often are time consuming and unclear, particularly to the operating executives doing this work who are used to dealing with issues and process refinements of running a business and making decisions.
- The operating executives include chief executive officers, chief financial officers, chief operating officers, operations directors, plant managers, manufacturing managers, chief marketing executives, or sales officers.
- The operating executives, however, are the source of the knowledge gained over years in the business that matters most in developing strategy.

- The work agenda must acknowledge early on that strategy development deals with issues and questions that do not have great clarity. The answers to these questions usually surrender not to analysis but to participants' best thinking and judgment.
- The strategy development team should move along as fast as the pace of capturing and quantifying judgment allows and determine where complementary off-line research and analysis by the team and or team analysts is needed to enhance the judgment.
- Avoid a heavily research-driven process.

STAGES INVOLVED IN THE STRATEGIC PLANNING PROCESS

- *This section provides a general overview of the key elements of the strategic planning process* usually employed in an operating company and indicates where M&A fits in. The information is presented in the Strategy Planning Process Engine in Appendix 1.1.
- *Corporate vision* embodies a brief, understandable, timeless statement of the rationale for why the firm exists (not what it does or wants to be) and the core principles that govern how the firm and its employees will conduct business and themselves during its existence.
- *Corporate mission* embodies a brief, understandable, realistic statement of what the firm wants to be (and be seen as) in the medium term, say 15 to 20 years.
- *Corporate strategies* are brief, understandable, achievable action statements of intent, direction, and desired result that are necessary to achieve and that, if achieved, will move the firm toward its mission (if not achieved, they will prevent achievement of the mission). These strategies are intended to create sustainable competitive advantage in the organization's market space. These strategies emanate from the strategy development process discussed later in this topic.
- *Initiatives* are big, achievable activities and programs that individuals and teams rally around and participate and take ownership in. Initiatives are necessary to complete and, if completed, will move the firm toward realization of the desired results embodied in each strategy. They are usually multiyear in duration. M&A is potentially one of a number of business development initiatives.
- *Key performance indicators (KPIs)* are descriptions of relevant, timeless indicators of performance in operating and functional support processes and initiative realization.
- *Metrics* are relevant, preferably quantitative measures by which to gauge performance toward and achievement of initiatives and of KPIs.
- *Goals* are brief statements of this year's (perhaps part of a multiyear goal) expected achievements and related metrics of achievement for each initiative or KPI. Goals are owned by individuals and teams and provide a clear measure of personal and team performance.

- *Results* are measurement based, integrate with incentive plan design and rewards, and provide the basis for measuring goal achievement and making cyclical, periodic adjustments to strategy, initiatives, metric targets, and goals.

STRATEGY DEVELOPMENT—WHERE AND HOW TO CREATE VALUE

- *The essential thrust of strategy development* is identifying *where to create value* (attractive market spaces to enter or maintain and defend) and *how to create value* in the spaces selected. (What are the enabling capabilities and strategies required to close the capability gaps that exist for the firm to compete in the identified spaces and create enduring stakeholder value?)
- M&A is one of a number of means of closing the capability gaps. Other methods include organic development, in-house start-up, licensing, joint ventures, and other contractual arrangements.
- The process involved in detail strategy development usually includes the two steps noted above, which are shown in the Strategy Development and Gap Closure Engine in Appendix 1.2.
- Many of the process steps presented on Appendix 1.2 may not be carried out explicitly in reaching strategy conclusions in businesses that prefer a more intuitive strategy development approach, but they probably reflect the thought processes and trade-offs made by intuitive strategy developers.
- Do not underestimate what a highly skilled and experienced strategy development consultant can offer to drive the strategy development process. Experienced experts will, at the very least, provide a voice of reason, contrast, and clarity to the process. More often they will provide the results of external research and insights, options, points of focus, and direction, which are all of timeless value to the user.
- There is also great benefit to focus the due diligence process (normally applied to acquisition targets as discussed in Topic 10) internally (the firm's due diligence self-assessment) as part of the firm's strategic planning process. Doing so captures much of the knowledge of the firm's capabilities discussed later in this topic, as well as the business and valuation drivers discussed in Topic 10 and attractive market criteria discussed in Topic 4.

WHERE—IDENTIFY CUSTOMER'S INITIATIVES AND ATTRACTIVE MARKET SPACES

- *Identify your customer's (and your customer's customers) strategic initiatives* in the market spaces you are now engaged in (See Appendix 1.2). Also identify their current and future product and service needs and requirements that will fulfill their initiatives (B, Appendix 1.2):

- By doing so, you can identify where are they going, what will they need to get there, and what is most important to them to enable them to succeed. You will also identify what capabilities will be necessary for vendors to excel at to meet their customers' product and service requirements (B1, Appendix 1.2). Consider the following:
 - Closely follow industry trends.
 - Hold "customer futures" conferences for your industry and its future.
 - Talk to your customers: How can you be in their future?
 - Attend customer industry conferences and trade shows.
- *Identify new attractive market spaces* (B2, B3, Appendix 1.2) and the future product and service requirements of those spaces worthy of developing, entering, and defending (B, Appendix 1.2). Identify the capabilities necessary to meet those product and service requirements (B1, Appendix 1.2).
- *Use brainstorming techniques* to identify adjacent and new market space ideas. Cross-reference them to the results from these idea-generating methods:
 - Search Web databases for ideas on where others are placing investments.
 - Interview pension advisors and venture capital and equity investors for investment trends and developing sectors.
 - Interview "blue sky" thinkers for megatrends and implications on business sectors.
 - Perform top-down growth segment identification methods using macro, segment-oriented databases. Where is growth and investment occurring?
 - Examine the value chains in growth sectors to identify the key value-creating enablers and inputs to the identified attractive macro sectors: What is the key ingredient, enabler, or activity in the value chain that adds the critical function to the end products and services within the sector?
 - Identify the key value-added ingredient sector of the value chain that becomes the target market space in the attractive sector.
 - Question industry experts to identify the value chain and enhance the analysis.
 - Cross-correlate the findings from each method.
 - Perform activity and capability extension analysis as discussed later in this topic.

HOW—IDENTIFY YOUR ACTIVITIES AND CAPABILITIES—EXTEND THEM

- *Identify your business's internal activity and capability strengths* (Activities, Capabilities, and possibly Competencies) (C, Appendix 1.2).¹
 - Activities and capabilities are all the relevant things done in the business to serve customers in one way or another.

¹This activity and capability extension analysis is grounded in the excellent work of John Stempeck, of Avalon Associates, Boston, MA, a strategy development consulting firm.

- Activities and capabilities as illustrated in Appendix 1.3 are evaluated in terms of how well they are done and the relative state of evolution of the activity within the company versus the requirements in targeted market spaces and as practiced by principal competitors. They are described as follows:

How Well the Activity Is Practiced in the Company

- Leader or cutting edge; equal to or just okay; follower or lagging behind

State of Evolution of the Activity as Practiced in the Marketplace and as Required to Meet Future Market Requirements

- Emerging, recently developed, gaining traction
- Required and undergoing change
- Mature, subject to competitive replacement

Activities and Capabilities Might Include, for Example

- Conceiving, designing, assembling, fabricating, engineering
- Proposal preparation, selling, order taking, chemical synthesis
- Milling, cutting, folding, drawing, welding, bending, preparing, polishing
- Field service, customer inventory management, distributing, delivering
- Some activities may be competencies (see below)

Competencies Are the Reason(s) Customers Come Back

- Competencies are the conjoint result of excellent business process execution (combinations of activities performed at a cutting-edge level) and deep capabilities described in terms of years of know-how, education, and unique learned and applied skills that are utilized in work activities.
- Competencies are observable and identifiable by customers as activities performed that they rely on most heavily and are not easily replicated by the competition.
- Bain & Company defines a core competency as a deep proficiency that enables a company to deliver unique value to customers. It embodies an organization's collective learning, particularly of how to coordinate diverse production skills and integrate multiple technologies.²
- Customer interviews asking why customers rely on you, buy from you, and keep coming back rather than going to the competition are often the most productive way to identify competence. Customers may say:
 - "They always deliver on time in full quantities needed."
 - "Their product always functions to spec under the harshest use conditions."
 - "They can solve any technical design and application problem we throw at them and do it quickly."
 - "Their technical and delivery proposals to our conceptual requirements leave no questions unanswered—we know what we are going to get."

²www.bain.com/management_tools/tools_competencies.asp?groupcode=2.

- A company's competence is the conjoint process/capability set that leads to the end result desired and identified by the customer.
- Competencies allow a company to stay in business.
- There are many capabilities, business processes, activities, and skills; they are not necessarily competencies.
- There is usually only one competency in an organization, if any at all.

Activity and Capability Extension Analysis

- Perform activity and capability extension analysis (D in Appendix 1.2) to identify adjacent market application potentials.³ Once you understand your key activity and capability strengths (perhaps competencies) as practiced in your segment, extend these activities into other potentially attractive segments.
- Ask key staff to examine where else (other served markets segments, other product or technical applications) your key activities and capabilities can be practiced, as illustrated in Appendix 1.4.
- Perform key word searches of your activities descriptors on databases to identify other "where used" potential market segments. Then analyze the segments to determine how attractive they are, who plays there, and how deep and how profitable the value chain in the sectors are (B2, B3, Appendix 1.2).

HOW—IDENTIFY YOUR CAPABILITY GAPS VS. MARKET AND PRODUCT REQUIREMENTS

- Compare your existing company activities and capabilities (C, Appendix 1.2) with those required to defend present or develop or enter new attractive market spaces (B1).
- Identify your capability gaps (G) and consider alternative ways to close the gaps: M&A, joint venture, acquire or license technology, build a capability organically, etc. (see the Attractive Market Composite Assessment Engine in Appendix 1.5 for an illustration).
- Do you have what it takes to compete there? What capabilities do you need?

HOW—IDENTIFY YOUR CAPABILITY GAPS VS. COMPETITION

- Compare your existing product and service offering strengths (E, Appendix 1.2) with existing competitor product and service offering strengths (E1) by conducting customer interviews and internal assessments. Identify product and service gaps (F) and possible gap closure approaches.

³This activity and capability extension analysis is grounded in the excellent work of John Stempeck, of Avalon Associates, Boston, MA, a strategy development consulting firm.

- Compare your existing company activities and capabilities (C, Appendix 1.2) with those of your competition (C1) in present and new attractive market spaces.
 - Identify the competitive gaps (H): What does it take to meet or beat the competition and close the gaps? Identify possible gap closure approaches (see the Capabilities versus Competitive Assessment Engine in Appendix 1.6 for an illustration of this process). Are you better or worse than the competition? What capabilities do you need to improve?

HOW—DEFINE ATTRACTIVE MARKET CRITERIA, RATE MARKETS, CLOSE GAPS

- Define attractive market criteria (I, Appendix 1.2), and measure and rate each market space identified against the criteria (see Topic 4 for an illustration of attractive market criteria). How well does each potential market stack up against your criteria for an attractive place to compete: well or not well? Do you want to be there or not?
- Perform a strategic option assessment (J, Appendix 1.2) of the capabilities that are required to defend, develop, enter, and exploit success and close gaps in each attractive market space.
- Identify the likely mode of closing the capabilities gap or achieving market penetration, such as in house start-up, acquisition, joint venture, technology license, and so forth (J1, appendix 1.2).
- Rate the expected effectiveness of successful penetration into each new attractive market space, given each likely entry mode considered (K, Appendix 1.2) against the firm's key business investment success criteria, including, for example:
 - Extent of activity overlap (Appendix 1.5)
 - Level of difficulty (to enter, develop, defend) given the likely entry mode
 - Level of competitive risk (Appendix 1.6)
 - Level of likely realization of opportunity potential given the likely entry mode
 - Amount of time required to succeed given the likely entry mode
 - Level of human resources required to succeed given the likely entry mode
 - Level of dollar investment required given the likely entry mode
 - Level of impact if risk cannot be managed given the likely entry mode
 - Level of confidence in the size of the opportunity as described given the likely entry mode
- Establish a composite rating for each market space (K, Appendix 1.2) of the attractive market criteria rating (see Topic 4) combined with the composite assessment of penetration success (see the Attractive Market Composite Assessment Engine in Appendix 1.7).
 - In this way, identify the most attractive markets with the highest likelihood of meeting the success criteria threshold given the mode of entry (see the Attractive Market Composite Assessment Engine in Appendix 1.7). In the illustration in Appendix 1.7, Market F has the highest composite score for

- attractiveness and the highest likelihood of meeting the market penetration success threshold given the mode of entry.
- *Rank order and prioritize the market spaces* (K, Appendix 1.2) by the composite result, and identify the cumulative resource (financial or otherwise) requirement.
 - *By synthesizing the output from the prior steps, identify the selected initiatives* (L, Appendix 1.2) to enter and develop the new or existing market space and/or close the market, capability, and competitive gaps such as:
 - In-house start-up initiatives: new product development, hire new staff and technical resources (sales, marketing, research and development, etc.), license technology, training, and so forth.
 - M&A initiative: acquire, merge, joint venture, alliance (L1, Appendix 1.2).
 - *Perform a strengths, weaknesses, opportunities, and threats (SWOT) analysis*⁴ (J2, Appendix 1.2) for the company as a whole, as illustrated in Appendix 1.8. Identify your key company-level SWOTs and isolate active strategies or steps that will:
 - Optimize each strength in your markets and close gaps.
 - Correct or minimize the impact of your weaknesses and close gaps.
 - Take advantage of each key opportunity available to you and close gaps.
 - Minimize the impact of each imminent threat. And close gaps.

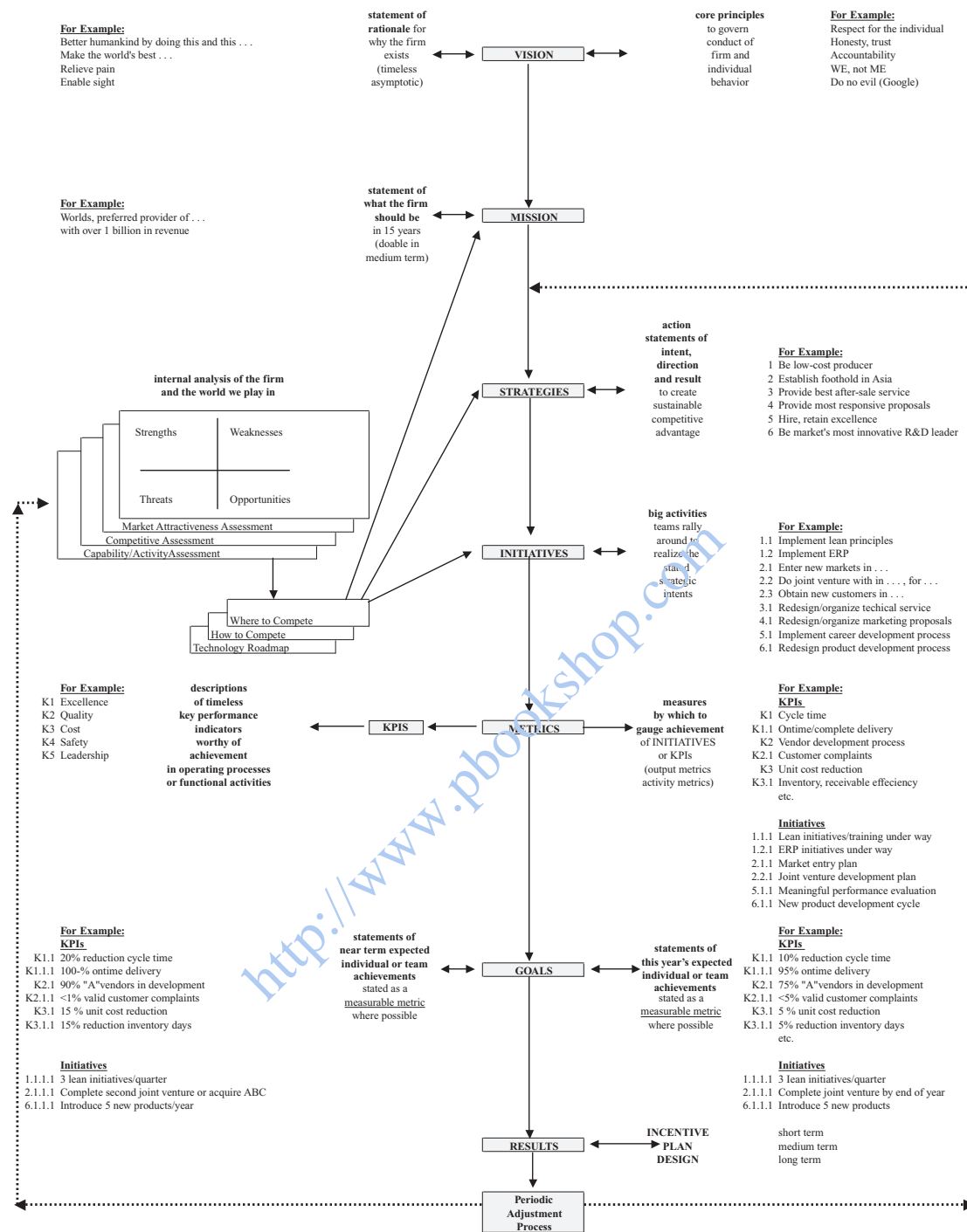
HOW—IF M&A IS VEHICLE TO CLOSE GAPS. IDENTIFY TARGETS

- *Where M&A is the likely or chosen entry mode, identify M&A target opportunities* (L1, M, Appendix 1.2) to close the gaps in the most attractive and highly rated new or existing market spaces and engage in the M&A process (see Topic 2). Consider these approaches to identify acquisition targets:
 - Develop a search mandate identifying the sought-after industry, market space, capabilities, technologies, products sought, and so on (see Topic 4).
 - Provide the search mandate to finders, search firms, investment banks, and the like (see Topic 4).
 - Interview large companies and universities that may be interested in dispositions of technologies or nonstrategic fit businesses in the market spaces identified.
 - Conduct data mining to identify the producers of the critical value-added input in the market spaces identified. For example, search Thomas Register, Compustat, Standard & Poor's, One Source, and Hoovers, among other sources.

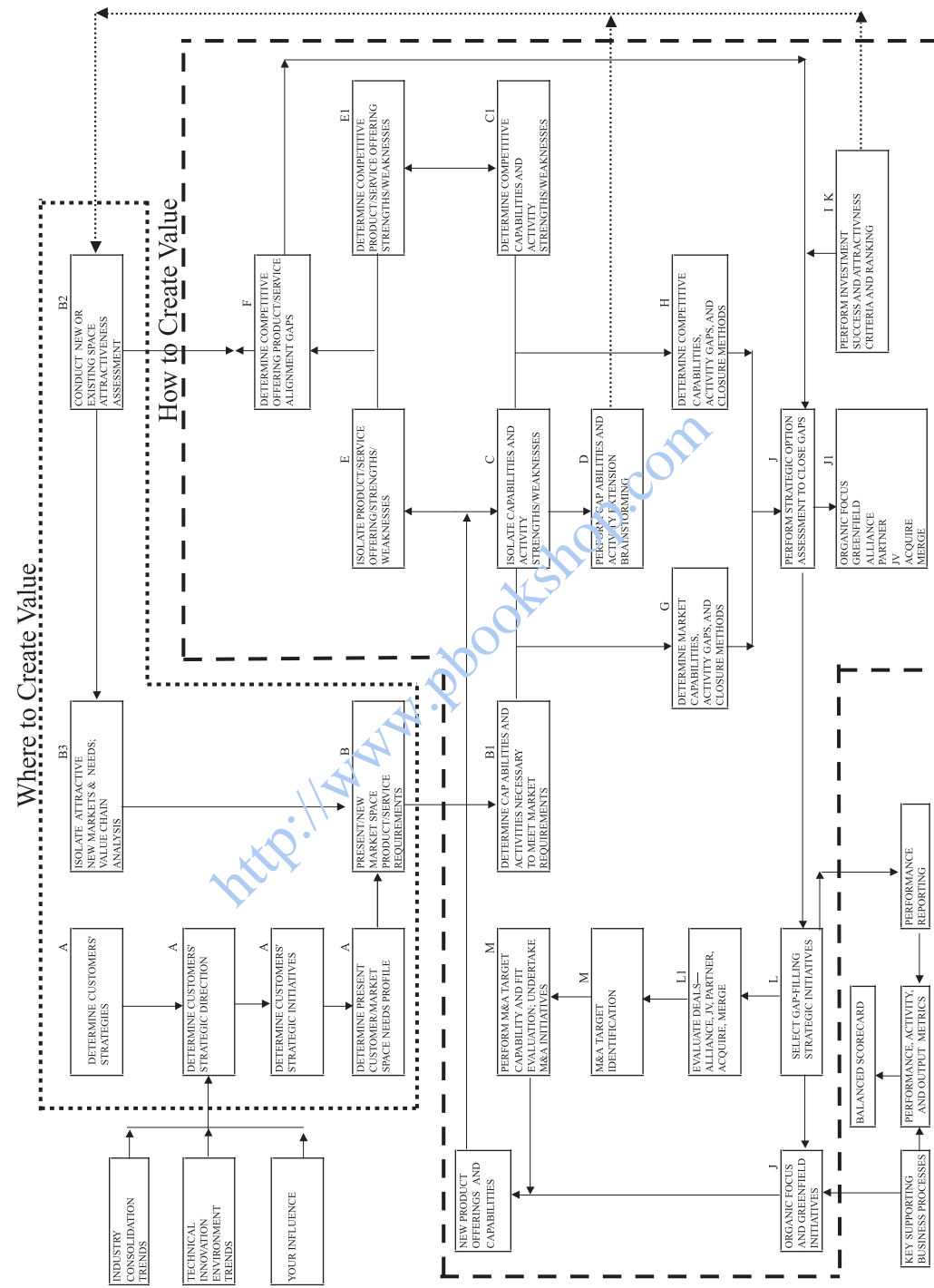
⁴SWOT analysis is credited to Albert Humphry of Stanford University, but its origin is not entirely clear. See www.marketingteacher.com/swot/history-of-swot.html for a survey of the origins of SWOT analysis.

- *After target identification and preliminary fact finding and evaluation, measure the fit (M, Appendix 1.2) of each target's capabilities combined with the buyer's capabilities (as if the entities were combined) versus the requirements of each market, as illustrated in Appendix 1.9, to determine which acquisition candidates in which market provide the most improved gap closure, on a pro-forma post acquisition combined basis.*

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APPENDIX 1.1 Strategic Planning Process Engine: Core Essentials



APPENDIX 1.2 Key Process Steps to Identify Where and How to Create Value and Close Strategic Gaps

The following Appendices, as well as those presented earlier, are available for viewing or download on the Web site for this book at: www.wiley.com/go/emott. Please see the About the Web Site page at the back of this book for login information.

APPENDIX 1.3 Activity/Capability Analysis: Us versus the Market

APPENDIX 1.4 Activity/Capability Extension Analysis: Where Else Used Brainstorming Example

APPENDIX 1.5 Our Capabilities versus Market Requirements Assessment Engine

APPENDIX 1.6 Our Capabilities versus Competition Assessment Engine for Market A

APPENDIX 1.7 Attractive Market Composition Assignment Engine: Composite Assessment of Likely Penetration Success in Each Target Market

APPENDIX 1.8 SWOT Analysis Chart

APPENDIX 1.9 Competence Alignment Engine of Acquisition Targets in Markets F, A, J

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