THE PROFITABILITY CATALYST

The Two Most Important Elements of Profitable Growth – #1 Strategy

By John Howard, Founder and Principle Adviser

What makes a business healthy and allows it to grow? The answer is *"Making a Profit!"* The two most important elements that lead to profitable growth are having a ***decisive strategy*** and ***operating efficiently*** so that cash flow, profits and return-on-assets can go up. In this article, we will explore the strategic elements.

"Strategic blunders, top-level decisions, are the primary culprit a remarkable 81 percent of the time in destroying business value." (Booz&co.)

A business's economic development begins as an entrepreneurial bottom-up process. It is a social phenomenon and includes things like products, money, labor markets, capital markets, and governments.

Each business becomes a market participant in the overall economy; a learning organization that adapts to changing environments and accumulates knowledge over time. Each business has purpose, intelligence and problem-solving and has to deal with rules, constraints (i.e. profits) and competition. The overall process is a feedback loop and the market is always selecting what works best, lowers cost, what's cool, etc. In other words, is there on-going and increasing demand for the product?

It starts with seeing a need in the market, developing a *core idea* and taking a "position" within a market space. It evolves into a business model and strategic plan (how a company plans to reach its objectives and is constantly in motion). A company's "position" is the one *core idea* or perspective that must be championed through everything that it does, both internally and externally. It could be based on the product, service, or specific activities such as quality or delivery. It just needs to be a true differentiated advantage. This "position" is what creates and adds customer value able to capture market share and revenue for endurance and growth.

The business model is the explanation of how a firm translates this idea into value – money ($) – its monetization points, and becomes a critical part of the strategic operating plan. A good business model might reflect this equation: *Recurring Revenue + Fixed Cost Leverage = Superior Cash Flow*.

Typically, the entrepreneur provides capital ($) or finds other funding sources to implement the business model and strategic plan. And, by understanding the 18 sources of extraordinary profitability and return-on-assets, a business can develop a strong strategic operating plan and operate efficiently, enjoying positive cash flow, higher profits and return-on-assets, not just some haphazard existence.

As a business develops its opportunities, it wants to "lock-in" a pattern of self-organizing behavior around its "economic value system or position". It applies the concepts of market design and attraction to exchange information, build the supply chain, attract sellers (agents) and acquire new customers to increase demand and

scale up. And as this value exchange system becomes adopted across many individuals and organizations it generates more money for its products and services and can be sustained over time.
The bottom line – is if a business can significantly differentiate and position itself for competitive advantage then it can develop a dominant strategy and USE IT! The two essential strategic choices are *WHERE-TO-PLAY* and *HOW-TO-WIN*.

Drilling deeper, defining a basic business strategy requires answers to just these three questions:

- Who is the target customer?
- What is the value proposition, *core idea – market position*, to acquire customers?
- What are the essential resources and capabilities needed to deliver that value proposition?

Without clear and coherent answers to these three questions, a company may have an exciting vision, a compelling mission and some goals with many actions under way, but won't have a real strategy.

Some companies that successfully answered these three questions are: Nucor – made the jump to making steel from scrap metal, Intel – made the strategic leap to go from memory into micro-processors and PayPal decided to make commercial transactions easier, more universal and safer. These are classic examples of companies that did a great job of knowing their target market, developing a core idea to service that market and building the essential capabilities to deliver their product with exceptional quality.

In addition, the market strategy must be responsive to change, builds and stretches the ideas, resources and products that yield competitive advantage (a differentiated position) and ultimately profits. Companies emphasizing this type of strategic management approach are both better performers and have more agility than those that do not. Three of the most basic strategic factors – must have all three for ultimate success – are:

1. Strategic Thinking – these organizations establish market leadership via a strong strategic management and planning process – applying a broader thought process and the blending of analysis, deductive and inductive thinking. Then differentiate, select and amplify the best ideas. They know how to think creatively from the several perspectives described below (there are many more):
    a. Inside-out – means identifying the innovative ideas, business models and plans that are percolating up and down the hierarchies of an organization.
    b. Outside-in – is the marketing and sales process focusing more directly on customer needs and anticipating new needs. What are the trends?
    c. Longer-term thinking is associated with strategic decision-making and starts with differentiation, basic core products and capabilities and considers how best to use them. By looking ahead and reasoning back, a business can anticipate where its initial decisions will ultimately lead, and use that information to calculate its best choice.

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   d. Causal thinking simply means selecting between a given set of means to achieve a pre-determined goal.
   e. Effectual thinking is more entrepreneurial thinking – imagining possible new ends using a given set of means.

   These are all innovative high impact ways to make a company more robust and responsive to the market and are not generally practiced by most companies.

2. <u>Making Strategic Moves</u> – these entrepreneurial organizations are constantly strategizing, identifying choices and making decisions, and implementing the best ideas for a profitable future.
3. <u>Organizational Strategy</u> – having a shared vision and values, communicating and acting on them so they become part of an organizations belief system. They are good at developing and controlling the organization via information, decision-making, motivators and structure to support the chosen strategy. They support dialogue, not office politics knowing that *"Culture eats strategy for breakfast",* as prophesized by Peter Drucker.

Successful companies need to focus on *Strategy Work*, the process of generating business strategies. These

strategies are the choices or scenarios that lead to different outcomes. Most corporate strategic plans have little to do with strategy. They are simply one-to-three year rolling resource budgets and sales projections. Calling this strategic planning creates false expectations that the exercise will somehow make the company money. These resource budgets simply cannot deliver what the management team really wants, a pathway to substantially higher performance and profit. We must separate the annual rolling resource budget from *Strategy Work*.

From the highest level, companies became market leaders when some sort of window of opportunity opened and the leader was the company that was first to successfully jump through that window, not exactly the first mover, but the *first to get it right.* There are two ways to proceed…

1. Innovate your way to success by anticipating – creating something new or
2. Exploit some change in your environment – in technology, consumer trends, laws, resource prices or competitive behavior – and ride that change rapidly and with skill. This is the most successful way that companies make it.

The question is…how does a company *"take a good position"*? Real *Strategy Work* consists of making these types of market, operating and regulatory judgments and is the essence of strategic thinking. They can be starting points for taking a "position" by placing a value on that potential revenue. What that future may or may not be. Then, by taking a "dominate my market" approach, leaping and staying focused, it might be successful.

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It is "strategic" if it is likely to significantly alter the trajectory of future performance and by investing in resources that will be made more valuable by the changes or strategic moves. Drilling down, we want to look at the heart of a business for developing strategic choices, such as:

1. **Assessing** current strategy, marketing, finances, operations and product development to find profitable impact areas for immediate action and *implementing the recommended initiatives.*
2. **Finding the hidden assets.** They are everywhere: undervalued business platforms, unexploited customer insights / assets or underutilized capabilities.
3. **Planning and systematizing** to increase quality, differentiation and productivity - **DO NOT** be ruled by events! Use systems that are more effective and develop an exit plan.
4. **Training and cross-training management and employees** on leadership, teamwork, accountability, effective meetings and overcoming internal friction and politics for dramatically better operation and resource flow.
5. **Obtaining the necessary financing** by increasing and achieving consistent cash flows from operating activities and leveraging existing resources to accumulate profits. Those activities that do not increase value or are not core to the business are candidates for outsourcing.

Then we select the best choices (the best judgment wins) and amplify the successful ones. Ultimately, strategic thinking is the process used to develop the clear connections between the positions we take and their economic outcomes…where each business is unique and can profitably grow.

It takes entrepreneurial *insight* and *intensity*, active risk taking, to generate a set of ideas and then quickly and decisively act on them. Almost all innovation flows from the unexpected combination of two or more things (think Apple – able to combine music, hardware, software and social technologies into a desirable product).

Ideas activated, selected and put into action, are the "magic formula" for extraordinary wealth. So, companies need access to and, in some cases, control over the right knowledge, resources and skill pools. This is the concept of "strategy dynamics". Strategy dynamics studies how those changes would shift various dimensions of a business and industry as they progress into the future.

Businesses also need to develop their "strategic agility" and mirror the dynamics of their marketplace, which consists of two components…

- The ability to respond to threats and reduce risk and
- The ability to search actively for better positions in the market, exploit new opportunities and reallocate resources as strategy changes.

Strategic agility explains between 60% - 70% of the performance differences between companies and between 20% - 40% of the differences in financial performance. So, by implementing a robust strategy process you can significantly increase the odds of long-

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term profitable growth in your favor.

The grand challenge of strategic management is to manage the balance between stability (sustain our economic loop) and agility. Companies that enjoy enduring success have core values, purpose and competencies that remain fixed while their business strategies, resources and practices endlessly adapt to a changing world. Higher performers are quicker to observe changes in their competitive marketplace, orient themselves in new marketplaces, decide what to do and *do it*. They are the quick responders.

Stay Healthy, Profit and Grow!

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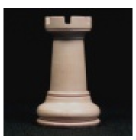

John Howard is known as "*The Profitability Catalyst*™" due to his tested-and-proven strategies and frameworks for increasing cash flow, profits and ROA…backed-up by his B.S. degree in Chemistry and MBA in Business Systems. He has worked in and with both small and Fortune 500 manufacturing companies for over three decades, including ADC Telecommunications, ABL Canada and U.S. Steel and played key roles in founding or launching four companies. Specializing in turnaround or growth situations, John helps companies respond to rapid change by working with leadership and management to help them become more profitable, flexible and higher velocity organizations; keys to long-term endurance and growth. His advisory insights into the human side of change management provide ***"Game-Changing Guidance for 100% More Profits!"***

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