# Choosing Successful Strategies: A Checklist for Executives and Entrepreneurs

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## Abstract

Every day, executives are confronted with strategic investment decisions. In this paper we draw on decades of making these decisions for a well-known Fortune 500 company to provide a straightforward way to choose successful strategic investments. A successful strategy requires a significant opportunity, the ability to extract value from that opportunity, and an investment balanced with the returns possible from that opportunity. We begin with five basic questions which should be asked of any strategic investment opportunity. The answers to these questions are often enough to indicate that the investment opportunity should not be pursued. The next step, assuming the venture passes these questions, is to evaluate the details of the opportunity through the checklist we provide. The purpose of the procedure presented here is to allow executives to identify and pursue the best available opportunities or, as we say in the last section, to go make money.

## Keywords

*Investment, Executives, Entrepreneurs*

## Introduction

### *Investing In New Strategic Opportunities: How To Navigate The Decision*

Every day, executives are confronted with strategic investment decisions. These strategic choices are real, meaningful choices, both in the early, entrepreneurial stages of the firm's development (Child, 1995, 1972) and when larger firms contemplate acquisitions (Harris, 2007) or large, strategic R&D investments (McAneney & Berkman, 2004). Despite the importance of these choices, the management literature has remarkably little to say on the subject. In this article we draw on prior literature and on the first author's many years of making these decisions for a well-known Fortune 500 company to provide five key questions for managers to ask about any strategic investment opportunity. In many cases, the answers to these questions are enough to indicate that the investment should not be pursued. If the answers to these questions are satisfactory, the investment may be a good strategic opportunity. Potential strategic opportunities should be run carefully through a checklist of the key drivers of a successful business strategy. The checklist we provide here is also based on the literature and on the first author's decades of experience with evaluating potential strategic investments and making decisions on whether or not to pursue them.

A successful strategic investment requires a significant opportunity, the ability to extract value from that opportunity, and an investment balanced with the returns possible from that opportunity. In this article, we discuss how to evaluate the details of the opportunity, the means by which value will be extracted, and the investment required. While the literature include excellent discussions of, for example, the differences in strategic investment decision-making between firms in different countries (Carr & Harris, 2004), the most recent discussions of exactly how to go about making these decisions are neither recent nor necessarily prescriptive (Berg, 1963; Bower, 1971; King, 1975; Klammer, 1972; Klammer & Walker, 1984). A checklist that is straightforward, time-tested, and current is needed.

The purpose of these procedures is thus to allow decision-makers to identify and pursue the best available opportunities. Walking through the procedure can also be used to prepare new ventures for presentation to corporate decision-makers or, in the case of entrepreneurs, presentation to angel investors or venture capitalists.

***Five Key Questions***

Though this article focuses on the decisions faced by executives in existing firms, we mention angel investors and venture capitalists above to make a point. Strategic investments, whether in new businesses within an existing company, existing ventures, or new startups, are made based on the premise that the assets invested will be used profitably. To see if they will be, there are five key questions that must be answered satisfactorily before any more in-depth questions can be asked. These questions are:

*1 - What are you going to sell?* This question may seem straightforward, but until it is answered clearly, the opportunity cannot be evaluated.

*2 - Who are you going to sell it to?* The answer to this will let you determine the size and profitability of the target market.

*3 - Why do they want to buy it?* Many proposals never answer this question. Many of those which do fail to give a credible answer. If there is no good reason why the target market will part with their money to buy the product, there is no good reason why an executive should fund an organization to provide it.

*4 - How will you get it to them?* Even if the business has a clearly defined product and a clearly defined market that wants or needs the product, it will still need to deliver the product. These logistical details can break a business that isn't prepared for them. At the preliminary stage, precise details may not be needed, but a workable plan is necessary.

*5 - How will you make money?* New businesses fail as often as not. Many of these have good products, customers who want the product, and established channels for getting the product to the customers. What they lack is a way to make money doing so. A business that can stay afloat is not enough to deserve investment. Unless the opportunity demonstrates a workable way to make a significant profit, it is unlikely to be a better investment than U.S. Treasury bills, which are a much safer bet.

***Opportunity, Value Extraction, and Investment***

Assuming the business plan still sounds good, the checklist we present in the next section will let you evaluate the details to decide if this opportunity is actually worth pursuing. The checklist addresses details of three major considerations: the opportunity, the value extraction method, and the quality of the investment. Elements of the five key questions addressed above appear again here.

The *Opportunity* should be characterized by a large, growing market, within an industry or market segment that has favorable economics. The customer value should be clear and the competitive response likely to be minimal or manageable. The investment necessary should provide technology or capabilities or channels that can be leveraged to take advantage of additional markets. The technology should also be sustainable and reduce future investment costs for similar initiatives.

*Value Extraction* from an opportunity will occur when you have competitive differentiation, the competitive response is minimal or manageable, you have market presence, and it is clear how you will make money. Additionally, your margins must be good, and come from more than the initial sale. The technology should be extendable to other markets, and you should control key elements of the value chain and be able to deliver the product or service to the customer more efficiently than anyone else.

A reasonable *Investment* will be characterized by a good "opportunity / investment" ratio, a lack of need for acquisitions, partnerships or licenses, and a business area still growing in value that fits with your other businesses.

## The Opportunity

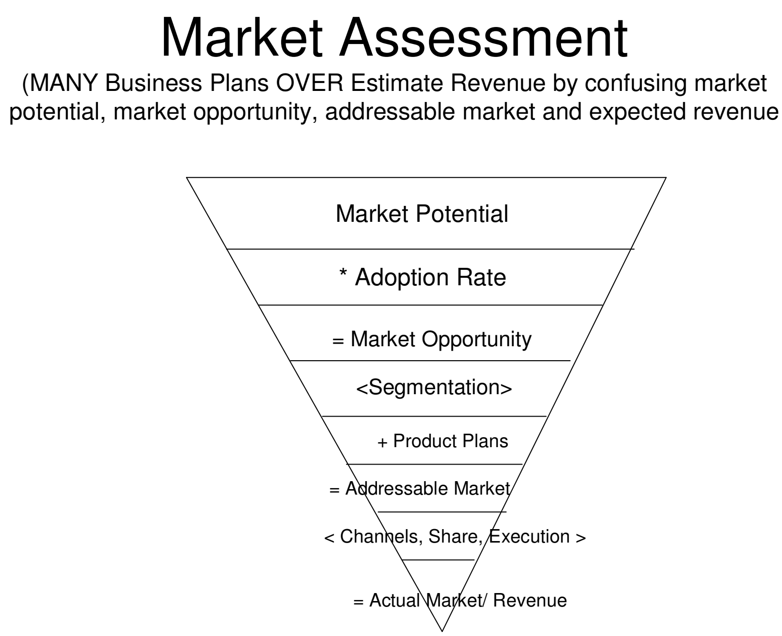
You want an opportunity that will allow you to be successful in a big way. So does the competition (Thijssen, Huisman, & Kort, 2006). The customers want value. In evaluating the opportunity, you must see if it offers you the chance to satisfy a large number of customers for a long time without being poached by the competition (Kim & Mauborgne, 2005). In evaluating the opportunity, you will need to consider five factors: Market definition, size, and growth rate; market extensions; the economics of the industry; the value proposition for the customer; and issues of sustainability and leverage. In each we clearly identify what the desired situation should look like. The less the situation resembles the one we describe, the more suspicious you should be of investing in this opportunity.

***Market Definition, Size, and Growth Rate***

The desired situation is one in which you have carefully defined and determined the size, timeframe and growth rate of the market, and the business proposed is in a large, growing market. In evaluating the market you should look for more detail than when you were asking the five key questions listed above. The first two answers here should be much more detailed than the corresponding ones in the first round: *Who, exactly, is the customer? How many are there?*

These answers should be assessed bearing the diagram in figure one in mind: Many business plans overestimate future revenue because they confuse market potential, market opportunity, addressable market, and expected revenue. Another question to ask about the optimistic plan in front of you is: *Is the market size and growth rate representative of the market today or of a potential market at some future point in time?*

Assuming the market today is worth entering, the next question to address is: *Do we have the technology and product / service features required by the customer?* If not, and if these features cannot be easily, quickly, and inexpensively added, this is probably not the right opportunity. Otherwise, the next questions are: *Is the market segmented and is our forecast consistent with the market sizes of the segments we can serve? Do we have channels to deliver the product to the customer?* If your answer to these questions is yes, and if the answers to all the earlier questions are good, then proceed. Otherwise, stop. This is not a good investment opportunity for you.




**Market Extensions - Vertical or Horizontal**

The desired situation is one in which investing in the business proposal will provide either technology platforms or channels that can be leveraged to take advantage of additional markets. You will get additional gross margin from existing technology or channel investments and you can extend the reach of your business. Important questions to ask are: *Do we have technology or channels we can use to take advantage of this market opportunity,* *with limited investment? Will the investment we make in this proposal provide us the ability to exploit other markets by using the technology or channels we develop?*

If the answer to both questions is yes then proceed. If the answer is no, stop. This is not a good investment opportunity for you.

***Industry Economics***

The desired situation has favorable economics in the market or industry. There are many areas to consider. Each should be evaluated in its turn, and the investment should not be pursued unless your evaluation of these areas is favorable.

*Supply & Demand.* Industry supply should be less than or equal to industry demand. If supply is significantly greater than demand returns will normally be low. If it is easy to enter an industry or add capacity, barriers to entry are low and the returns of the industry or market will also be low.

*Industry Consolidation.* Industries where consolidation has already occurred will be difficult to penetrate unless you make a major acquisition and become one of the top players. Industries that have not yet consolidated offer an opportunity to get high returns if you can become a leader in the industry as it consolidates. If your strategic investment opportunity offers an innovation that customers will value and the top players in the market will not be able to copy, or if you will be making a small investment to capture an underserved niche from which you may expand later, this may not be an issue.

*Industry Structure.* Monopolies or oligopolies are preferred to highly fragmented industries. Highly fragmented industries experience brutal price competition as companies attempt to gain market share. Oligopolies have limited incentive to compete on price. Industries facing favorable government or legislative priorities will thrive.

*Cost Structure.* Your cost structure must be globally competitive.

*Other Considerations.* Your product development process must be capable of keeping up with the technology pace of the industry. You should have reasonable economic power over your customers – such as because alternatives are not available or switching costs are high. The ROIC in the industry should exceed the cost of capital, must be sustainable, and you must understand why the returns in the industry are currently high.

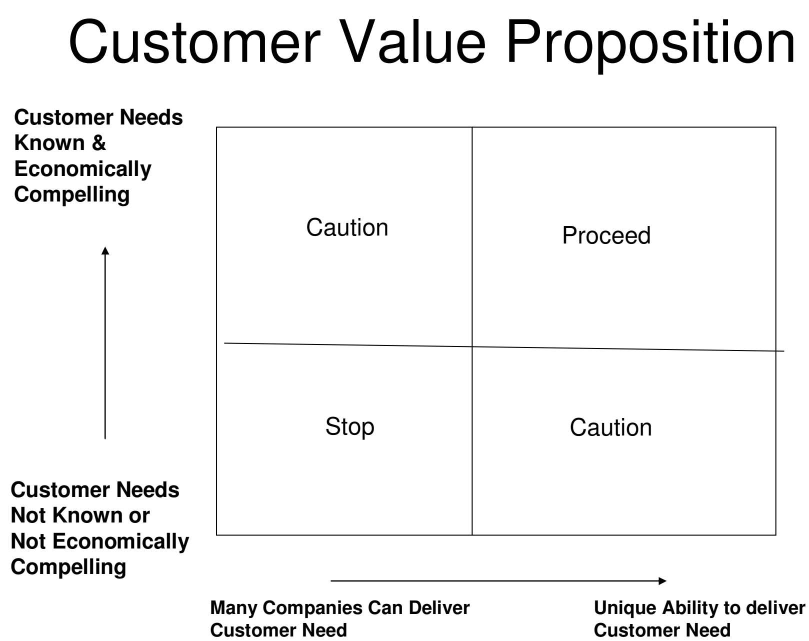
Key industry economics questions to ask are thus: *Does aggregate supply exceed aggregate demand or can it? Is the industry currently consolidated? Can you be #1 or #2? Is our technology differentiated and sustainable? Is our cost structure competitive on a global basis? Do economic forces favor us or the customer? Has the Return on Invested Capital (ROIC) been high in this industry and is it anticipated to stay high?* If you are not or cannot become a leader in the field, be cost competitive, and a driver of industry consolidation you should pass on the proposal. For you, it is not a good fit.

***Customer Value Proposition***

Value is defined by the customer and delivery is the responsibility of the provider. Customers selects the vendor meeting their needs best. The desired situation is one in which the customer needs are known, defined, quantifiable, and best met by you. You must sustain a competitive edge in meeting these customer needs to achieve long term success.

Again, these questions echo the first-round five key questions, and again here you should expect greater detail. Key questions to ask are: *What, exactly, are you going to sell? Why would the customer want to buy it? What criteria will the customer use in their purchase decision? Can the customer value be quantified and can our advantage in* *delivering that need be quantified? Can we deliver the things that will drive the customer value and simultaneously price the product or service to make money?*

You should proceed if the customer needs are known, economically quantifiable, and you can meet those needs better than your competition. Otherwise, stop. This is not a good opportunity for you to pursue.




***Technology Sustainability & Leverage***

The desired situation is one in which there are no substitutes anticipated to displace your technology over the planning horizon. This can be due to scientific or technology constraints, patent barriers, or other reasons. AT&T, for example, enjoyed a government-mandated monopoly for the first several decades of its history. Additionally, your investment in the technology should be leveragable to develop future generation of products or service that will extend your competitive position.

Key technology questions to ask are: *Do you have patents or trade secrets that will prevent competition? Can the patents be worked around or the trade secrets reverse-engineered? What would be the cost and timeframe to work around the patents or reverse-engineer the trade secrets? Are there basic science or technology constraints that will inhibit alternative technologies? Will an investment in this technology be useful or reduce the investment necessary for future product plans?*

If patent, science, technology or other barriers exist that will prohibit or severely inhibit the introduction of alternative technology solutions and the investment can help offset future investment requirements than you should proceed. Otherwise, stop.

## Value Extraction

A good opportunity may still not be worthwhile. Assuming the opportunity itself looks good, you need to find out if you will be able to extract enough value from it. Remember that Treasury bills are always an option. In deciding if you will be able to extract sufficient value, you will need to consider competitive differentiation and response; market presence potential, the value proposition for the company; the business model and margin; economies of scale and scope; technology control platforms, scale and extensions; and your degree of control over the value chain.

***Competitive Differentiation & Competitive Response***

The desired situation is one in which you will have significant, customer-valued differentiation against your competition, and the competitive response to your strategy will be nominal or manageable. You need to have the ability to provide a product or service to the customer that others cannot provide. If you will be noticed by your competitors, you need to be viewed by them as a serious threat with market presence, brand, and critical mass. If you will be a "small dog" in the industry without a competitive advantage you will face the likelihood of a severe response from your competitors when you enter (Porter, 2008, 1980). Key competition questions to ask are: *What can you provide that other competitors cannot provide? What will the competitive response be to your strategy? Will you be a small or large player in the industry?*

Proceed if you believe you will be competitively advantaged and perceived as a real player in the industry. If you are advantaged but perceived as a "small dog" in the industry, your competitors will respond aggressively and try to inflict serious pain on you. If you are not advantaged and are also a small player in the market do not proceed.

***Market Presence: Market Share, Brand Recognition, & Channel Control***

The desired situation is one in which you will have large market presence characterized by the largest market share, customers who recognize and trust your brand, and economic power (i.e., you can set the end-user price) over your channel. Under these circumstances you will have economies of scale, higher prices, and require less marketing and selling expense to drive volume. Key market presence questions to ask are: *Will we have dominant market share?*

*What will be the driver of that share? Do customers recognize and value our brand? Will the channels carry our product because our customer demand will drive volume and value to them with little expense on their part?*

You should proceed if you believe you will have a strong market presence. Otherwise, stop.

***Company Value Proposition***

The desired situation is one in which the price of the product meets the needs of the customer and the price simultaneously allows you to make money. Additionally, the price must be competitive in the marketplace. Key value proposition questions to ask are: *Will we make money? Will we be priced competitively? Does the price provide enough money to make both us and the channel happy with this product and still provide value to the customer? Are our margin estimates realistic compared to our market share estimates and the competitors?*

Proceed if the above conditions can be met. Otherwise stop.

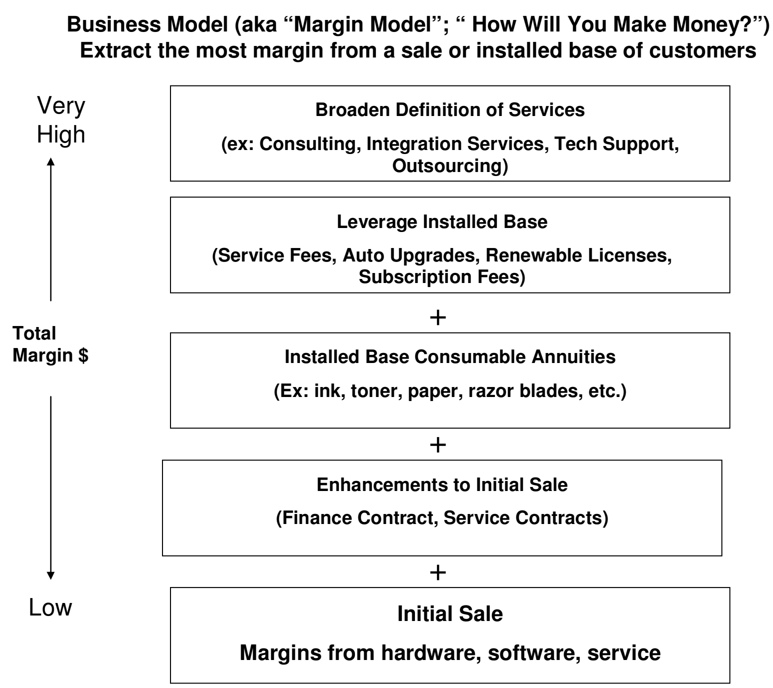
***Business Model & Margin Outlook***

The desired situation is one in which the customers provide margin to the company from the purchase of multiple products or services from the same sale. Typically these would include the initial product sold, post-sale service, financing charges, and post-sale consumables (e.g., razor blades for razors, ink cartridges for printers), though other possible sources may be available for particular products.

Additionally, it would be best if customers are "locked in" for long periods of time because the sale is part of a “closed system" sale – a system where the customer cannot buy components for the system from other manufacturers due to patent limitations. It would also be best if the switching costs for the customer are high. All these should result in high margins over a long period of time. Thus, key business model questions to ask are: *How will you make money? Can you extract margin from the initial product sale, service, financing and annuities from the sale? Can you extend the customer into other margin streams (services, upgrades etc.)?*

*Is the product or service a "closed" or Semi-closed" system making downstream annuities guaranteed? Will switching costs for customers high?*

Proceed if you believe your business model will be robust, you will have the ability to extract significant margins from the customer, and the switching costs will be high – otherwise stop.




***Economies of Scale & Scope***

Economies of scale and scope are important cost drivers (Porter, 1998). An economy of scale is driven by volume and can occur in manufacturing, channels, or R&D. An economy of scope is driven by having multiple businesses which commonly use core capabilities you have in your company. The desired situation is one in which you have both. Key scale and scope questions to ask are: *Will the proposed strategy be successful enough to* *generate large volumes and generate economies of scale in manufacturing, channels, or research? Will the proposed strategy use some platform or capability we currently have?* These capabilities could be in design, manufacturing, IT, distribution or some other component of the value chain of the company.

Proceed if you will have both economies of scale and economies of scope. Hesitate if you have one. Stop if you have neither.

***Technology Platforms, Scale, & Extensions***

The desired situation is one in which your core technology investments or design platforms can be extended easily to additional products or future product generations or can be used to serve multiple different vertical markets. In either case you get additional margins with nominal incremental investment. Key platform extendibility questions to ask are: *Will the investment required provide a series of products capable of serving multiple markets? Will the investment required provide a channel that can be used to serve multiple markets?*

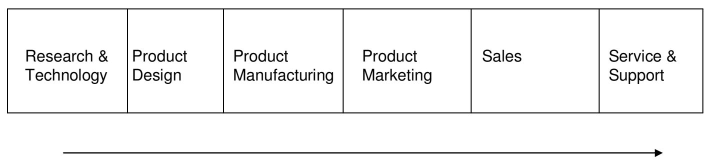
Proceed if either or both is possible. Stop if neither is possible.

***Control of the Value Chain***

The desired situation is one in which you control and have the internal capabilities that are critical to the delivery of the product or service to the customer (from technology invention to product commercialization, sales and service). Your margins will be higher if you control the value chain (Porter, 1998). If key functions are missing, you face the need to outsource or partner, which will result in lower margins or the inability to execute the strategy. Key questions to ask are: *How will you get the product to the customer? Do you have the internal capabilities that are critical to the delivery of the product or service to the customer?*

Proceed if no critical gaps exist; stop if they do.

## The Relationship Between Value Chain, Business Model, and Margin




Control of the Value Chain & a good Business Model are needed to have good margins

## The Investment Required

You are looking for large strategic opportunities with low to moderate required investments. These are hard to find. Your focus should be on finding opportunities that are balanced well with their investments. High investment, low margin business suggest a challenge and risk to value creation. In considering the investment required to pursue the proposed strategic opportunity, you will need to consider the opportunity / investment ratio; the need for acquisitions, partnerships, or licenses; and your financial capacity and portfolio priorities.

***Opportunity / Investment Ratio***

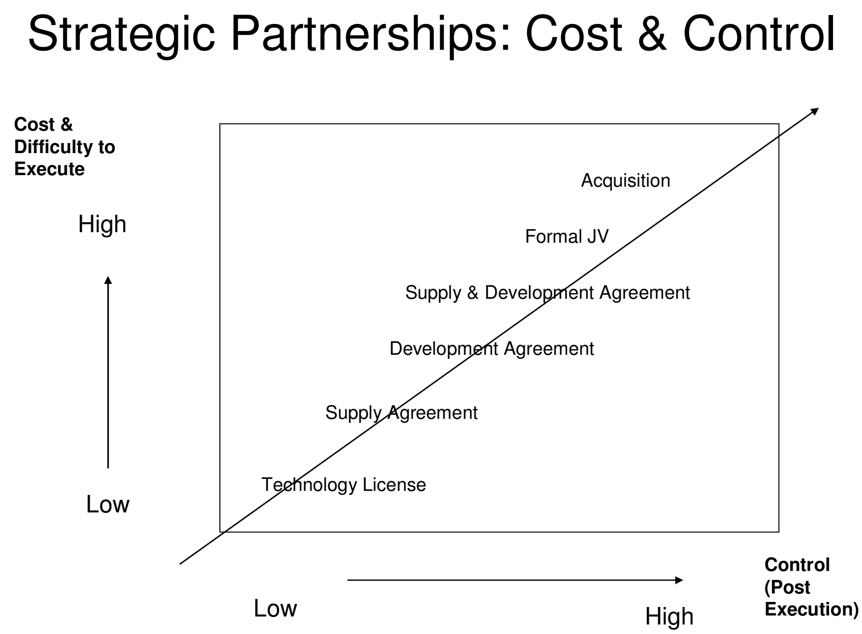
The economics of the proposal will depend on the number of years investment is required, the number of years sales are expected and the profit margin of those sales. A rough rule of thumb is that the opportunity must return at least 3-10 times the investment required. The fewer years the investment is required and the more years sales are likely to continue, the lower this ratio needs to be. The table below provides some example figures based on some rough estimates (e.g., net income = 10% of sales, capital = depreciation); your specific investment will require a detailed version of this table with every assumption closely examined.

| | | **Years of Sales** | | |
|---|---|---|---|---|
| | | **3** | **5** | **7** |
| **Investment Timeframe (years)** | **1** | 3.8 | 2.6 | 2.1 |
| | **2** | 7.1 | 4.9 | 3.9 |
| | **3** | 10.0 | 6.8 | 5.5 |

## Acquisitions, Partnerships, or Licensing Needs

The desired situation is one in which acquisitions, partnerships, licenses, and joint ventures are not needed for the proposal. They are all expensive, difficult to execute, and can dilute control. Key questions to ask are: *What do they provide? Can't we do this proposal ourselves? What if we fail in our negotiations?*

Proceed if acquisitions, partnerships, and licensing are not needed. Stop or proceed with caution if any are required.




### Financial Capacity & Portfolio Priorities

The desired situation is one in which the proposal is for a product line that is strategic to your company, the business value is still growing, and you have the financial capacity to compete. Key capacity and portfolio questions to ask are thus: *Is the business strategic or non-strategic? Has the value peaked or is it growing? Do you have the financial capacity to compete?*

Proceed if the proposal is strategic, its value is continuing to grow, and you have the financial capacity to compete. Otherwise, stop.

## Now Go Make Money

Truly successful business plans will fulfill the requirements outlined in this paper. Most proposals will not meet all the criteria listed but can still deliver adequate returns. The key to making strategic investment decisions is selecting the business plans with the highest probability of success. The purpose of this paper has been to provide a checklist to insure the best selection. Knowing and doing are two very different things, however, and understanding the five key questions and the extended checklist presented here are of little value if you do not put them into practice when you are making strategic decisions. This checklist has been used and refined over decades of decision-making in a Fortune 500 company. When used, it has resulted in profitable decisions; when ignored, decisions of a less profitable nature have ensued. It is the hope of the authors that the reader will use this checklist in making future strategic investment decisions, with highly profitable outcomes.

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