

The Hedgehog Principles

Or the first steps to building a business that sustains you for years to come

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Introduction to the Hedgehog

One of the greatest business management books of the last 20 years would have to be “Good to Great” by Jim Collins. The book is the result of a research project into the question: “What makes average companies turn into great companies”.

A number of the conclusions that Jim Collins gets to in “Good to Great” translate very well into the world of small business.



In particular I have seen time and time again with clients, friends, colleagues and in my own business that what Jim Collins refers to as the Hedgehog Principles are highly applicable to building a Fun business ... a business that sustains you for years to come.

I won't go into too much detail here about why Jim Collins refers to hedgehogs, except to say that it is about simplicity and single-mindedness... A hedgehog does one thing really really well in defence of himself, and that is to roll up into a perfectly formed spikey ball when under attack, and he does that over and over, never tempted to vary his approach.

The Hedgehog Principle states that a long term successful business must be able to answer three questions unequivocally. Many businesses can answer 1 of the three, some can answer 2 out of 3 and a very few can answer all three. Long term sustainable success, and therefore the mark of a FUN business, is absolutely dependent on there being complete clarity in the business about all three questions at once.

A Fun Business strives to be “The Best in the World” at something

THE FIRST HEDGEHOG PRINCIPLE

Someone has to be the best in the world at something.... It might as well be you



The first of the three questions is this: What can we be “The Best in the World at?”

This is a big question, but it needs to be your starting point... What are you and your business prepared to strive to be the best in the world at, day in day out, without fail?

It is simply not good enough anymore in the 21st century to answer that question the way most business owners do by saying that you give really good customer service or that your prices are great or that you provide really good quality. All your competitors are saying exactly the same thing... (I have never yet spoken to a business owner who tells me they give average customer service, their prices are average and their quality is fair to middling). And if you and your competitor are offering exactly the same of most things to most people... one of you might as well close up... What are you committed to being better at than anyone else?

Shout from the rooftops

Customers want to know what sets you apart from everyone else and they will actually make up their own mind about that prior to making a decision to purchase from you or someone else. As long as you don't clarify the first hedgehog question for yourself though, you are leaving it in the hands of your customers to work out what they think sets you and your competitors apart. I can guarantee you that it will change your business if you take control of answering that question for your customers, and start to shout from the rooftops what you are better at than anyone else in the world.

Also a quick word about that sentence: “To be the Best in the World”. Many business owners tell me that it is unrealistic to be “The Best Plumber” in the world for example, because the world is a big place, and they operate as a plumber in Sydney's Eastern Suburbs or as a carpet cleaner in Perth, or a bike store in Adelaide. Who is to say there isn't some phenomenally successful plumbing business operating in New York or Paris or Timbuktu? And besides that, they say, how would you go about

measuring something like that worldwide anyway, when you operate in a small geographic area?

Striving to be

I have two things to say about that:

- 1) The Truth and the question are about an intention to “Strive to be”... there is nothing to say you can’t strive to be the best plumber in the world, even if you’ll never actually know for sure if you truly are.
- 2) For small businesses I would like you to consider the statement to refer to “Your World” as opposed to “The World”, so if your business is a local business in a single suburb of a city for example, than “The world” would refer to “Your World”, in other words in the case of the plumber, he could be referring to being the best plumber in Sydney’s Eastern Suburbs.

The other issue to consider is what “The best” really means. I think for most small businesses “The Best” would have to refer to a quite narrow niche. To stick with the example of the plumbing business, being “The best Plumber” is a term that is most likely too broad to be able to be useful.

The Plumber might instead focus on a particular sub- speciality in his profession. So he might focus on being the best emergency plumber for example, burst pipes, blocked drains etc.

I have a client, who I refer to in one of my previous books, who owns a chain of supermarkets and his “Best in The World” statement is to be “The Best Small Supermarket in Sydney”... quite narrowly defined to a geographical area as well as a particular speciality in other words.

Being absolutely committed to be “The Best in the World” at something will massively increase the Fun you will have in your business, I promise.

A Fun Business is Passionate about that 'Something'

THE SECOND HEDGEHOG PRINCIPLE

Without Passion everything falls over



The second of the three questions of the Hedgehog Principle is: what are we absolutely passionate about, what will we happily jump out of bed for day in day out, year in year out?

Many other business authors have written about the importance of this question. I refer to a number of them in the resources section for this topic, but one of my favourite authors on this topic is Simon Sinek who wrote a book called "It all starts with Why" in which he demonstrates the mantra that "People don't buy What you do, they buy Why you do it".

There is also a parallel old maxim that states, "People do business with people they know, like and trust".

There is no doubt that there is a deep truth in these statements. People want to know what you stand for, what your values and beliefs are, they want to know what you run hot and cold for and it is that knowledge that helps them decide to do business with you as opposed to your competitors more than anything else.

I know an electrician who is passionate about safety and who will literally not be able to sleep at night if he is not completely comfortable that all his customers are sleeping safely, not at risk of house fires or other electrical accidents. He is so passionate about this, that he has infused his staff with this passion and it is reflected in everything the business does and the way it markets itself. Customers hear his safety messages and see his passion about safety come through in all his communications and the attitude of staff etc. As a result customers are getting to "Know, Like and Trust" the business and they are keen to do business with it.

You can be passionate about so many things in relation to your business. Your passions do need to relate to your customers needs of course. You might be passionate about South American frogs, but that isn't going to help you market your optometry business to your customers.

You might be passionate about cleanliness or making people smile or being a trendsetter or punctuality or helping people achieve their dreams, or leaving the world a healthier place or seeing people improve their diet or life.

The point is that you must honestly ask yourself the question about what drives you in your business, what gets you out of bed in the morning and how that relates to what your business does.

So the plumber I talked about before might be passionate about punctuality, because he knows how frustrated he gets and disrespectful he finds it when people make him wait. So he might arrive at this statement in relation to the first two hedgehog questions: We are the best maintenance plumbers in the Eastern Suburbs of Sydney and we arrive on time or it's free.

Whatever it turns out to be, but get clear about it because as they say: If you don't care about your business, your customers certainly won't either.

Oh and let me give you a hint... your passion for making money won't do as the answer to this question. Your customers are actually not interested in your desire for money, sadly. They are very happy for you to make lots of money but only after you give them what they want first.

A Fun business makes Sustainable Profits from that 'Something'

THE THIRD HEDGEHOG PRINCIPLE

A business that doesn't make profit... is a hobby



The third of the three questions of the Hedgehog Principle relates to money, profit, business model and sustainability.

The question is: How can we create a long-term sustainable economic model around the answer we gave to questions 1 and 2?

This question is actually more complicated than it seems for many businesses and most businesses never really sit down and work the question out properly.

Lets have a look at the different components of the statement first:

Three components

There are three components and working backwards, the first is "The Something" this is the answer to questions 1 and 2. Just because we are passionate about something and we are the best in the world at delivering that something doesn't

guarantee we are able to build a business out of it... As a client of mine once said: "The market for buggy whips, just isn't so big anymore".

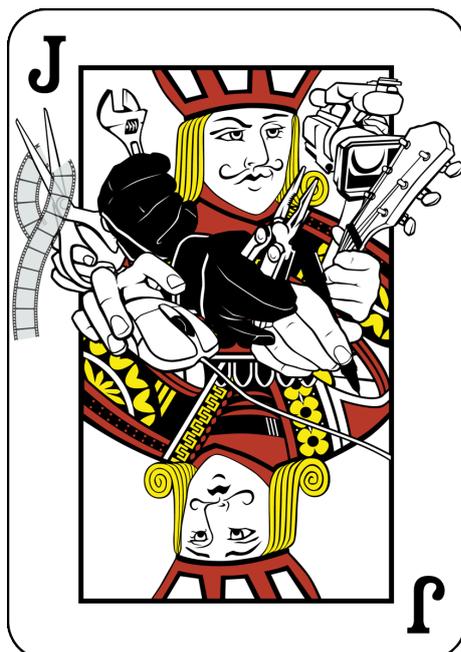
In the case of the plumber the situation might seem obvious, but does he know if he can get enough consistent work doing maintenance plumbing? A problem could be for example that with maintenance work it "never rains but it pours" for example and one moment you and your staff are standing around wondering what to do and the next moment there are more jobs than you can fit in. So the plumber's thinking around the business model might lead him to keep his team small and build relationships with a number of other plumbers in the area that he can subcontract work out to when it gets really busy.

Or he may decide that The Eastern Suburbs is too small a geographic area to be able to deliver a steady stream of work. Or he could decide to add a second service to his offering such as emergency hot water service replacement etc etc. The consequences of looking at this question might lead him in all sorts of directions.

Second component

The second part of the question is about profit, making money in other words. A business must make money. That is a simple truth. A business that doesn't make money will not survive. How much money the business needs to make is a question that is complex to answer and the question is often muddled up with cash-flow, which is really something entirely different to profit and I will talk about cash a little further on.

Many small business owners also confuse their own "drawings" or wages with the profitability of the business.



Firstly if you are a business owner, the business will in all likelihood need to provide for your financial needs, unless it is a very part time business or you have a trust fund (and even then it is wise to make the business pay you a "wage" of some sort). So in thinking about the Profit part of the Truth, I would strongly suggest that you separate your financial recompense for being the CEO or General Manager of the business as well as the Jack of All Trades from the Profitability of the business.

A business also needs to make a level of profit to provide a return on investment to the shareholders...the investors. This might just be the

business owner of course, but if the business owner or other investors have put money into the business either through actual investment or in foregoing a reasonable payment for their time (this is called sweat equity in investor's worlds) they need to get something in return. Lets say you've invested \$200,000 into your business over time. You could have stuck this money into a term deposit and been paid \$10,000 per year for as long as you'd invested the money (5%). And lets face it, you love your business, but your money would be a lot less risky deposited in a bank (even allowing for recent financial shocks) than invested in your business, so it wouldn't be unreasonable to expect a greater return than the term deposit rate.

Money to grow



Also, a business needs funds to grow, actual cash. (Don't confuse cash with profit. Profit may simply show up on your Profit & Loss Statement and not in your bank account. Cash is what you can use to pay your own bills with, see below the example about payment terms) Many small business owners don't truly understand that statement, and this article is not the right forum to get into too much detail

on this topic, but especially while businesses are in a growth phase, they will be thirsty for cash and the best way to slake that thirst is by having profits.

(The simplest example that illustrates this point is the one that comes from "payment terms". If a significant proportion of the income of a business derives from customers who get to pay their bills on 30 day or more trading terms, meaning they pay for services 30 days after the end of the month, than there will always be a significant sum of money outstanding to be collected... and the faster the business grows, the larger that sum of money will be and hence the more money - cash - the business needs to have available to pay it's own expenses)

Third component

The third part of the Truth mentions sustainability. This is not the kind of sustainability that the environmental movement refers to specifically (although that certainly makes for good business too), but the ability of your business to generate profit and cash flow year in year out... In other words, if you don't think about the sustainability of your business model you might end up with a flash in the pan.



In the example of the plumber, it can happen that the plumber lands a contract with a strata management company to carry out all their maintenance work in Sydney. The Strata company manages a whole bunch of apartment blocks, so in one swoop our favourite plumber has literally launched his business from himself and an apprentice to 4 vans and 6 employees, triple the revenue and at very nice margins, thank you very much, as long as he keeps everyone happy and does a

good job... Happy days all round....

But now, suddenly his business is reliant for 75% of its revenue on one source, one client effectively. And although this might seem like a nice lark, it actually makes the plumber's business highly vulnerable and exposes it to enormous risk. The Strata company can go bankrupt or some other plumbing company might come in and make them a better offer or the company might decide to tender all their maintenance work on public tender next year, or one of the plumber's staff does something bad on a job and the contract is cancelled and suddenly our plumber stands to lose the lion share of his revenue overnight.

Vulnerability to growth

Well, ok, that's a shame, but he could just go back to the situation as it was before with himself and an apprentice, couldn't he? No he can't anymore. At least not so easily anymore, because a lot of his overheads are now locked in. He has taken out a lease on a small factory and 3 new vans and invested in lots of equipment, he employs an office assistant and of course he now has six plumbers on the payroll who need to be paid every week. He doesn't have the flexibility to drop all those overheads overnight. Many small businesses have gone bankrupt under exactly this scenario.

So a sustainable business model for the plumber and all businesses must include a consideration of that kind of risk. A good rule of thumb is to ensure that your business is not reliant on one customer for more than 10% of its revenue for example.

And finally, the last reason why a business must make profit... Because it is good fun...

It is simply a heap of fun to make money and to see the balance sheet grow.

If you make sustainable profits, from doing something you are passionate about and are committed to be the best in the world at, you'll have as much fun as you can have with your clothes on. And if you are not in business to have a lot of fun... I suggest you go and find an easier way to make a living.



The above is an extract from “The Ten Truths for having Fun in Business... or How to Build a Business that Sustains you for Years to Come” by Roland Hanekroot. More about Roland Hanekroot and “The Ten Truths for Business Owners” trilogy here:

<http://newperspectives.com.au>