Operational Excellence:

The New Lever for Profitability and Competitive Advantage

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Palladium
Executing Strategy

FOREWORD

We are pleased to welcome this important study on linking operational excellence to strategy execution. The work integrates the strategy execution expertise of Palladium with the technology-enabled operational discipline of SAP. The study shows how operational excellence is a critical and necessary component for successful strategy implementation. The survey of 101 enterprises reinforces the conceptual framework introduced in the study: companies that build and align their operational capabilities for strategic advantage earn a distinct execution premium in their business performance. The paper provides valuable evidence about the benefits of achieving aligned operational excellence.

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INTRODUCTION

Better. Faster. Cheaper. Every organization is grappling with these concepts today as economic uncertainty spreads around the globe. Instead of pursuing ambitious expansion plans, many organizations are focusing their efforts on short-term results. They are trying to identify what can be trimmed or eliminated in their operations to protect their profit margin or simply survive in the global marketplace.

But the current economy also offers a unique opportunity for businesses to transform their operations into an instrument of strategic competitive advantage. We observe that leading organizations are redoubling their efforts to find new ways to execute with greater efficiency and effectiveness—to achieve operational excellence without sacrificing the value their customers expect.

In the fall of 2008, prompted by emergent new thinking on business network transformations, innovative management processes, and powerful, next-generation technology, Palladium Group embarked on a multistage research project. Our goal: to explore operational excellence with a fresh eye, repositioning the concept within the new context of linking strategy and operations. We initiated this research to show chief operating officers and key senior executives how to respond quickly to the near-term pressure to reduce costs without losing their ability to take advantage of future growth opportunities. As our research confirmed, cost efficiencies are the main source of profitability for companies, while improving the customer experience is the primary source of revenue growth. Certainly, achieving short-term survival is essential. But establishing a foundation for repeating these kinds of operational successes, while preserving the ability to pursue longer-term strategic objectives, is key to sustaining superior operational performance and competitiveness.

In this paper we provide a brief overview of a six-stage model for building an operational strategy management system as described by Drs. Kaplan & Norton in their new book *The Execution Premium*. You will learn how the strategy management system extends into operational management and decision making by leveraging three key components: people, processes, and technology.

Our research also involved surveying 101 organizations representing a wide range of industries in order to explore the relationship between their management practices and the performance results they have achieved. Among our most important findings: IT, if aligned well with strategy, plays a very significant role in determining the ultimate chance of execution success. Integrated, end-to-end software solutions, together with operations governed by robust strategy management systems, constitute a proven method by which organizations and their entire business networks can achieve the Execution Premium.

As Jeffrey Liker has shown in his book *The Toyota Way,* "Toyota has turned operational excellence into a strategic weapon." It is our hope that, by absorbing the insights from this white paper, you will have a much clearer understanding as to how you can quickly enable your organization to achieve operational excellence—and reach new levels of profitability and competitive advantage now.

LINKING STRATEGY AND OPERATIONS

Survey after survey shows that business leaders are increasingly recognizing the paramount importance of strategy execution. According to the Conference Board's 2007 CEO Challenge, "execution excellence" has surpassed profit and top-line growth as a focus for CEOs around the world. This recognition comes in the wake of numerous other studies over the past two decades demonstrating the widespread failure of organizations to execute strategy, from the two seminal *Fortune* articles that revealed that 90% of organizations failed to execute strategy,[1] to *Profit from the Core* author Chris Zook's finding that only 12% of companies successfully execute their strategy.[2] The public sector suffers the same failure rates, according to a recent *Barron's* survey that found that only 15% of federal government programs executed their strategies as intended.[3]

But those who don't merely recognize the importance of strategy execution, but act on it, get results. A 2006 Palladium Group survey of 143 organizations showed that of the more than half the respondents that were using a formal strategy execution management process, nearly 75% were outperforming their peer group. Among those without such a formal process, 75% were underperforming, or at most, matching the average performance of their peers.[4]

Executing strategy depends on a number of factors, perhaps most important, its effective integration with operations. As Balanced Scorecard creators Robert Kaplan and David Norton noted

> A visionary strategy that is not linked to excellent operational and governance processes cannot be implemented. Conversely, operational excellence may lower costs, improve quality, and reduce process and lead times; but without a strategy's vision and guidance, a company is not likely to enjoy sustainable success from its operational improvements alone…
>
> Companies generally fail at implementing a strategy or managing operations because they lack an overarching management system to integrate and align these two vital processes.[5]

Alignment between all the moving parts is crucial—from sharing a common understanding of the strategy and its goals to relying on an integrated model to design, measure, and monitor performance of day-to-day activities and strategic initiatives alike. Alignment—of people, processes, and technology—helps the organization optimize resources, opportunities, and performance. It enables the whole to create value that exceeds the sum of its parts.

All three components must be well established, and well connected, in order to achieve the following:

1. *Ensure* alignment between strategy and operations through the use of "strategic themes"

2. *Transform* existing processes (or introduce missing processes) by selecting the appropriate process transformation tools

3. *Engage* operational excellence "theme" teams

4. *Optimize* strategic decision making

Most experts concur: alignment is vital to successful, sustainable strategy execution. Alignment requires having a management process that integrates activities across traditional functional lines, along with information systems that enable and promote alignment. It depends on transparency.

This suggests that organizations today need a broader definition of operational excellence, one that takes into account operations' integral tie to strategy, one that considers strategy management itself as a process warranting performance excellence. And because we know that high-performing organizations review, refresh, and adapt strategy continuously, as the environment changes—whether, for example, due to internal innovation or a shifting competitive landscape—so must operations have a built-in capacity for ongoing improvement.

THE EVOLUTION OF OPERATIONAL EXCELLENCE

Traditionally, operational excellence has meant optimizing business processes, generally production and manufacturing. Its purpose has been to satisfy customer demand, improve quality, or boost productivity and efficiency. Over the past few decades, it has evolved to include not just *process improvement* (through quality programs, Lean Manufacturing, or Six Sigma, for example), but also *process automation* (IT), or outright *process redesign* or reengineering à la Michael Hammer—the wholesale top-down deconstruction and reconstruction of a process to streamline and optimize it to best serve customer needs.

Certainly, operational excellence applies not only to manufacturing but equally to service-based businesses, many of which have adopted the rigorous disciplines of Six Sigma. It is also important in shared services and other internal partnerships. With the rise of the extended enterprise—businesses and their networks of interdependent alliances—it also applies to integrating with partners. Where these alliances include outsourcing relationships, the risks as well as the increasingly higher-level and higher-value processes involved demand attention to, and new requirements for, process management and operational excellence.

> Operating processes produce and deliver goods and services to customers. For a period in the late twentieth century, many scholars and companies believed that managing operations was the most critical component of any organization's strategy. Inspired by the remarkable results achieved by Japanese manufacturers in transportation, electronics, and optical industries, most companies placed a high priority on redesigning, reengineering, and continuously improving their critical operating processes.
>
> Companies' efforts to achieve operational excellence were largely successful. Many enjoyed dramatic improvements in the quality, cost, and responsiveness of manufacturing and service delivery processes.
>
> R. S. Kaplan, D. P. Norton, chapter 3, "Operations Management Processes," in *Strategy Maps: Converting Intangible Assets into Tangible Outcomes* (Harvard Business School Press, 2004)

WHAT IS OPERATIONAL EXCELLENCE—AND WHY IS IT SO CRITICAL TODAY?

Operational excellence is, and has always been, about reaching the height of operational efficiency—doing things better, faster, and cheaper. No organization can afford inefficiency and waste, particularly in periods of belt-tightening. The tightly run, highly efficient organization can undercut competitors and win market share. Moreover, the ability to respond and adapt to rapidly changing market conditions becomes a matter of survival.

But today, operational excellence means much more—and its implications are more far-reaching. While not a strategy in and of itself, operational excellence has enormous implications for strategy management and execution. Whether your strategy entails being the low-total-cost provider, being

a product or service leader, or focusing more on customer intimacy, operational excellence as a supporting strategic theme is not just a foundation for survival (in good times or bad)—it's a key lever for improving profitability and competitive advantage.

Often strategy management and operations management occur at different levels of the organization, with little interaction and, in some cases, no interdependence. Operations, quality, and engineering executives must recognize their link to strategy. Perhaps more important, senior executives must begin to acknowledge the role of process management in strategy execution—that operational excellence is inextricably tied to strategy excellence. And management itself must be viewed as a process (or set of processes) unto itself, one that often requires new processes and that encompasses the broad definition of operational excellence.

Like innovation, operational excellence need no longer be confined to a discrete role in product development or manufacturing. It can touch every organizational function and process. Instead of a siloed approach—pursuing efficiencies within discrete areas (e.g., manufacturing, sales, procurement)—organizations can adopt an end-to-end approach that links business processes, not merely functional areas, and that does so seamlessly. In other words, organizations can unify all their operations—for example, manufacturing, procurement, and after-sales service—to run them as one. This end-to-end approach both requires and provides complete visibility throughout the process chain, which, in turn, promotes greater efficiency than could be achieved independently by silos. In fact, the 2008 Economist Intelligence Unit survey "Sustained Growth through Operational Excellence" reported that 45% of responding senior executives chose "end-to-end visibility" into operations as the most important contributor to operational excellence. For example, organizations that close the loop in integrating the sourcing and procurement processes can maximize savings in four important ways: by being able to quickly identify savings opportunities, source the best supply base, optimize the value of the contract, and sustain the achieved savings. By instituting efficiencies in its entire procurement cycle, a major chemicals specialty manufacturer cut annual costs by nearly $6 million and increased on-time payments by more than 87%.

> **The Three Components of Operational Excellence**
>
> As we see it, operational excellence involves three factors. First, it means *having the strategy management capability* to identify and focus on the "right things"—those that will provide differentiated value to your customers. Second, it involves *being excellent in executing that strategy*—consistently doing these right things better, faster, and cheaper. Finally—and perhaps most important—it involves *having the ability to ensure continuous improvement* over the long term. For that is how operational excellence enables organizations to sustain operational performance and ongoing competitive advantage.

But operational excellence is not just about managing day-to-day operations with efficiency.

Operational excellence is a way to foster continuous improvement. Achieving this benefit level, however, requires a fact-based understanding of operational performance. To address today's challenges and capitalize on tomorrow's opportunities, the COO and key operations executives must be able to define, monitor, and adjust actions aligned with the operational strategy and objectives (through, for example, the use of metrics and key performance indicators, or KPIs)—and, when necessary, change the organization's processes and performance objectives.

And here again, IT plays a central, strategic role.

Integrated applications—such as enterprise resource planning (ERP), supply chain management, and customer relationship management systems—coupled with performance management systems and advanced business intelligence systems and analytics, have

triggered greater advances in operational excellence. Successful businesses go beyond delivering functional efficiency by bringing together all these applications to unify operations and ensure tight linkage between strategy and execution. This dynamic IT architecture helps to seamlessly link end-to-end business processes together, creating a holistic view of operations. By ensuring complete visibility across the value chain, it also allows organizations to achieve extraordinary results. Not only does this transparency improve coordination and efficiencies, but it also enables real-time information flow, feedback, and adjustments. The net result: a closed-loop approach to strategy and execution that enhances collaboration, improves the quality of decision making—and heightens performance. A leading petrochemical company provides a perfect example. By streamlining its end-to-end operational processes with integrated software, the company was able to vault into the top ten position in its industry—just three years after it was founded. This world-class company enhanced its competitiveness and realized extraordinary bottom-line results, including eliminating more than $7 million in direct operating costs within a few months.

Today, integrated software delivered through open, service-enabled business process platforms enables companies to transcend corporate and national boundaries to manage entire business networks of customers, partners, and suppliers. These platforms can help create further competitive differentiation by allowing companies to reuse software capabilities, rapidly develop new processes, integrate with their partners, and drive cross-enterprise operational performance.

There's clearly no one formula for operational excellence. How your organization embraces it—whether as a top-to-bottom, pan-organizational, "meta" process, or as an approach that resides within prescribed internal processes—depends on the nature of your business, your organizational structure, and the processes you employ. Likewise, the benefits can be multidimensional, extending beyond cost savings to enhanced customer service, predictable compliance, indeed to enhanced overall (enterprise-wide) operational performance.

KEY OBSTACLES TO ACHIEVING OPERATIONAL EXCELLENCE

In many enterprises, *operational silos*, which have evolved organically as the organization has grown, represent the greatest single obstacle to allowing a holistic view of operations across processes and throughout the enterprise—and thus to achieving operational excellence. Silos affect manufacturing and service businesses alike. The resulting *poor visibility* applies not just to the lack of visibility of operational activities across the value chain, but to the lack of visibility of the strategy as well as of performance. Without visibility, the organization cannot react quickly to change. Long-term planning is impaired. Among the many critical impacts of this inability is missed on-time delivery targets.

Inefficiencies in execution represent another obstacle. These include time-consuming manual and paper-based tasks (and the high number of errors that can result from non-automated processes), redundant steps, and the inability to duplicate efficiency globally. The result is costlier operations that erode margins.
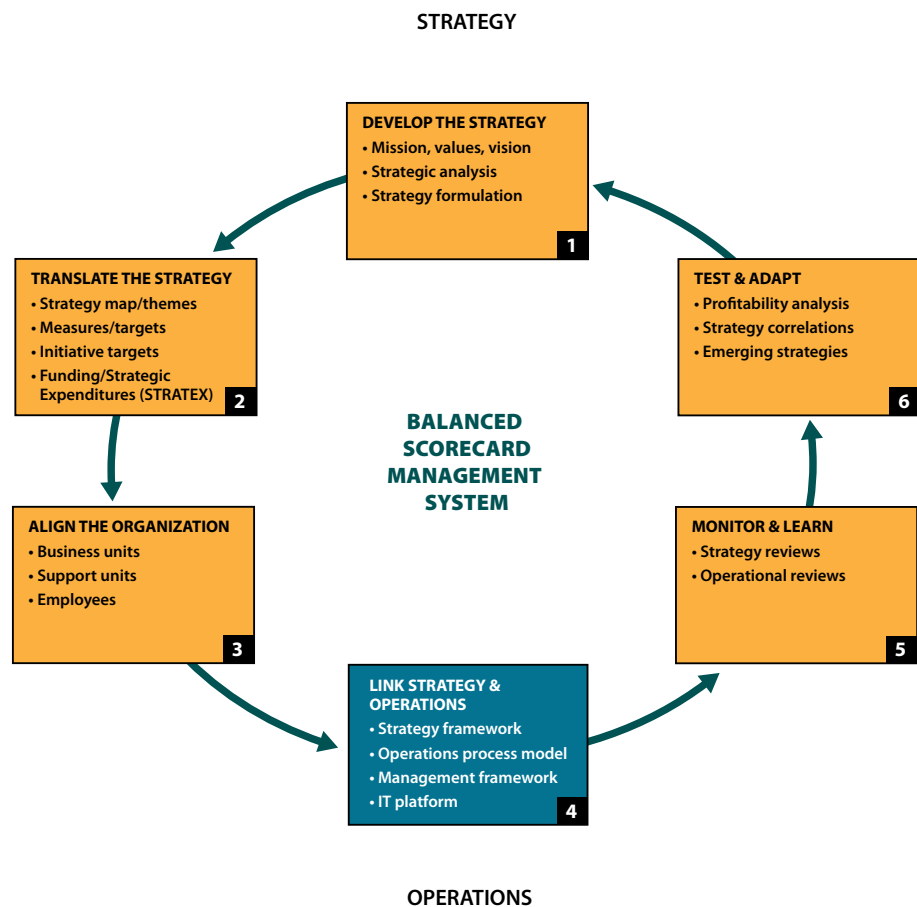
Compliance and risk management are another problem area that can impede operational excellence. Some companies lack internal and/or external controls. Others may unknowingly be committing violations, or suffering from product quality or safety issues. This can lead to complaints, regulatory investigations, and high added cost from warranty claims, penalties, and even lawsuits.

Finally, a *reactive and tactical operational culture*, along with resource constraints, impairs operational excellence. Companies focus on day-to-day operations to the exclusion of the long-term, strategic view. They take a reactive, rather than proactive, approach to improvement and innovation. These attitudes and ways are often exacerbated by the lack of tools, resources, or skills. The result: a lack of competitiveness that translates into weaker performance against industry peers.

LINKING STRATEGY AND OPERATIONS: HOW THE EXECUTION PREMIUM MODEL CAN HELP ORGANIZATIONS ACHIEVE OPERATIONAL EXCELLENCE

Kaplan and Norton's new architecture for a comprehensive and integrated management system explicitly links strategy formulation and planning with operational execution. In doing so, it helps organizations map all of the places where operational excellence should reside.[6] This architecture consists of a six-stage system (see *Figure 1*).

Figure 1. Linking Strategy and Operations: A Six-Stage System

STRATEGY

DEVELOP THE STRATEGY
• Mission, values, vision
• Strategic analysis
• Strategy formulation
1

TRANSLATE THE STRATEGY
• Strategy map/themes
• Measures/targets
• Initiative targets
• Funding/Strategic Expenditures (STRATEX)
2

TEST & ADAPT
• Profitability analysis
• Strategy correlations
• Emerging strategies
6

BALANCED SCORECARD MANAGEMENT SYSTEM

ALIGN THE ORGANIZATION
• Business units
• Support units
• Employees
3

MONITOR & LEARN
• Strategy reviews
• Operational reviews
5

LINK STRATEGY & OPERATIONS
• Strategy framework
• Operations process model
• Management framework
• IT platform
4

OPERATIONS

Adapted from Figure 1-3, p. 8 in Kaplan and Norton, The Execution Premium (Boston: Harvard Business Press, 2008).

Stage 1: Develop the Strategy. The organization clarifies its mission, vision, and values; articulates key issues and challenges; and identifies ways in which it can best compete.

Stage 2: Translate the Strategy. The organization describes its strategy (through a strategy map); develops strategic objectives, measures, targets and initiatives, as well as budgets that guide action and resource allocation. It also creates cross-functional strategic "theme teams" to lead strategy execution.

Stage 3: Align the Organization with the Strategy. Here, the organization aligns all business units, aligns support units with business unit and corporate strategies, and aligns and motivates employees to help execute the strategy.

Stage 4: Link Strategy and Operations (*Plan and Execute Operations*). This stage is ground zero for linking long-term strategy with day-to-day operations. It includes creating an operational process model, linking strategy and operations through the use of a sales and operational planning process (matching demand and supply), budgeting to align strategic initiatives with operational processes, and identifying the most critical business process improvements. It also entails establishing the right IT platform to support the management of strategic processes and reporting and review capabilities—leveraging strategic dashboards and KPIs along with operational dashboards and KPIs. This white paper focuses primarily on this stage of the model, since it is here that the so-called "rubber" (the strategy) meets the "road" (operations)—and, thus, where operational excellence opportunities arise.

Stage 5: Monitor and Learn ("Is the strategy in place—and working?"). The organization ensures operational processes are under control; confirms that the strategy is being implemented; monitors and learns from strategic performance feedback; and ensures continuous improvement.

Stage 6: Test and Adapt the Strategy ("Do the fundamental strategic assumptions remain valid?"). This involves running profitability analytics to identify sources and size of profit contribution; testing the causal model of the strategy; and identifying and recommending strategic alternatives.

A PROCESS MODEL: A PREREQUISITE FOR PROCESS MANAGEMENT

To manage processes, the organization must have a process model. With a process view of its "universe" (encompassing itself, its customers, and its suppliers), the organization can determine whether instituting change to a given process or subprocess involves implementing a quality program or other improvement initiative, or reengineering the process altogether.

Which model an organization uses is necessarily determined by the nature of its business and its strategy. Different schools of thought prevail, from the more traditional or mechanical view (emphasizing the core processes, those focused on creating and delivering the products/services) to those encompassing all processes—including management, support, and ancillary processes such as overseeing regulatory compliance.

Key Definitions

A *strategy* is how an organization creates sustainable value for its shareholders (or, as with a nonprofit, for its stakeholders and constituents). A *strategy map* provides a one-page visual representation of all the organization's strategic dimensions and assumptions. It depicts the cause-and-effect relationships among the major performance dimensions (perspectives)—financial, customer, internal process, and learning and growth—and their component objectives. (See Fig. 3, p. 11.) The strategy map shows the key elements of the strategy as *strategic themes*—clusters of related objectives and processes that constitute the major components of the strategy (e.g., "operational excellence," or "new products/ services"). (See Fig. 2, p. 11.) Themes are used to identify and combine the appropriate functions and business processes and provide a mechanism for supporting the cross-enterprise, boundaryless approach necessary for successful strategy execution. *Theme teams* are teams of managers from all of the various functions touched by a given strategic theme; under the guidance of a theme owner, each theme team is responsible for managing its particular part of the organizational strategy. So an operational excellence theme team would be made up of managers from each area of the organization that plays a part in the objectives tied to operational excellence—from manufacturing or product/service development to customer service or HR.

The process-based view, first espoused by Michael Porter (with his value chain)[7] and reengineering guru Michael Hammer, identifies primary activities (such as inbound logistics, operations, marketing and sales) and support activities (such as procurement, HR management, and technology development). More recently, the American Productivity and Quality Center (APQC), a leading organization dedicated to process improvement and benchmarking, developed its Process Classification Framework, a generic enterprise process model that identifies a whole taxonomy of operating, management, and support processes.
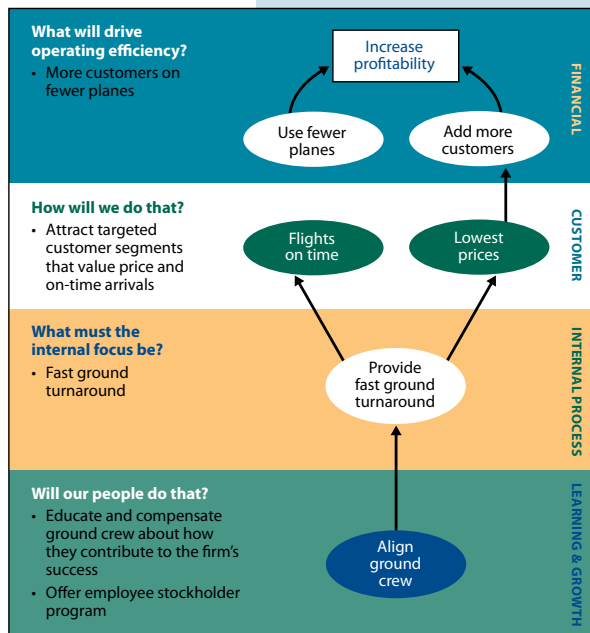
FOUR MECHANISMS FOR LINKING STRATEGY TO OPERATIONS

To link strategy and operations, organizations need the following four key mechanisms: an overarching framework (the strategy big picture and conception of how it all will work), a process model with measures of success (KPIs), an integrated management process (governance approach), and an integrated information system that provides visibility and alignment.

1. An Integrating Framework: A common framework that allows for the integrated design of the strategy/operations management system. The strategy map, with its strategic themes, is a useful framework because it describes the strategy and its components in a cause-and-effect manner, depicting the component themes across the functional areas implicated.

2. A Linked Process/Measure Model: An integrated model of the organization's operational processes (including specific activities demanded by the strategy), along with the relevant measures and targets. The Balanced Scorecard can be used to link strategic objectives and measures to the operational KPIs. This provides the mechanism for joining strategic scorecards with operational dashboards. Initiatives represent the activities that are used to introduce new processes or transform existing ones.

3. An Integrated Management Process: A mechanism that facilitates the integration of activities across traditional organizational silos, such as theme teams (governors) of the cross-functional strategic themes.

4. An Integrated Information System: Information systems designed to provide top-to-bottom and end-to-end alignment by strategic theme and process—and thus visibility throughout the value chain. These integrated systems can help to align all operations to drive efficiency and effectiveness across the operational continuum and to facilitate decision-making by providing the right insights in the right business context.
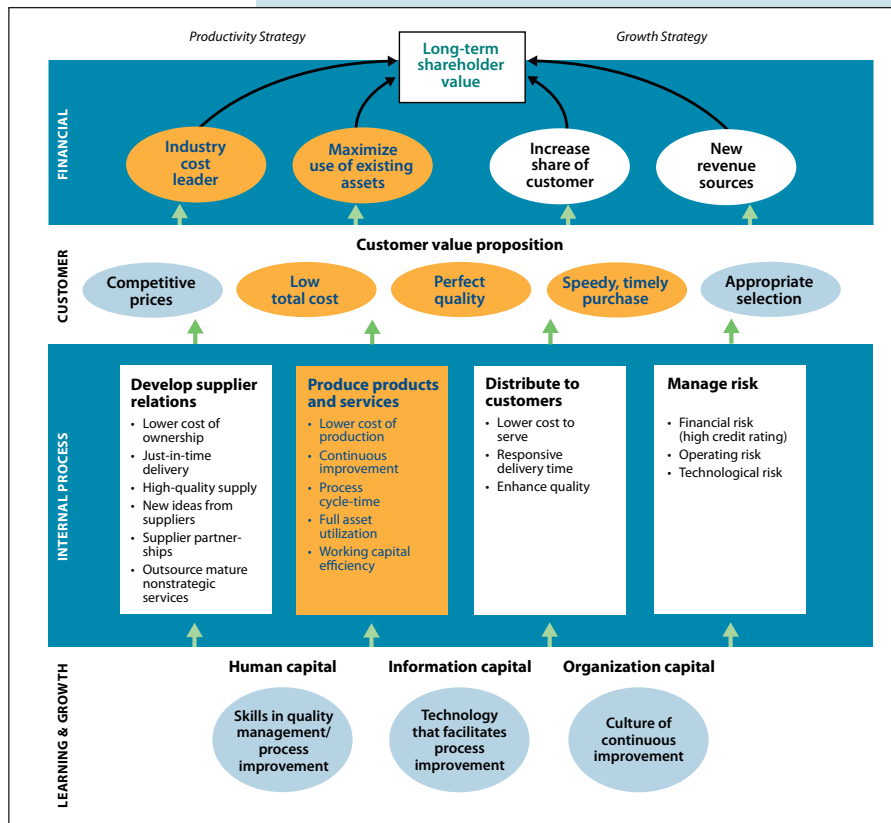
Making the Connection: Examples

Figure 2 provides an example of operational excellence (OPX) as a strategic theme for an airline, tracing how that theme translates into strategic objectives within each strategy map perspective. In the financial perspective, putting more customers on fewer planes will drive operational efficiency and increase profitability. That can be achieved by attracting customers that value low prices and on-time arrivals (customer perspective). Offering these benefits requires an internal process focus on fast ground turnaround. And to achieve that, the company must align its ground crew, by educating and compensating them according to how they contribute to the company's success, and through an employee stockholder program that gives them an investment in that success.

Let's look at how this strategic theme unfolded in the internal process perspective, using a leading low-cost U.S. airline as an example. When a number of major airlines faced bankruptcy, this airline was able to maintain a profit. How? The airline simplified seat assignment, operated logistics at a lower cost, instituted quicker flight turnaround times, and lowered maintenance costs by operating one airplane model. These operational improvements not only contributed to positioning the company among the leading low-cost, low-price airlines, but also helped the company free up resources to invest directly in customer relationships—a key component of its strategy.

Figure 2. OPX Theme: Airline*

Figure 3 shows a strategy map for an organization whose corporate strategy has a "Productivity" (or "low total cost") component, expressed as "Deliver a combination of quality, price and ease of purchase that no one else can match." This strategy comprises several operational excellence component objectives that permeate all of the strategy map's perspectives. (Note that the map shown does not reflect all the themes and objectives that comprise the enterprise strategy, and the operational excellence components are shaded.) In the financial perspective, for example, the objectives "Industry cost leader" and" Maximize use of existing assets" represent the operational excellence goals of the Productivity strategy. These are supported by the customer objectives "Low total cost," "Perfect quality," and "Speedy, timely purchase" (i.e., cheaper, better, faster). These customer objectives are, in turn, supported by four strategic objectives in the internal process perspective: "Develop supplier relations," "Produce products and services," "Distribute to customers," and "Manage risk." In the figure, we have highlighted the five measures within the "Produce products and services" objective, which represent the core (although not the only) operational excellence goals for a manufacturer or service provider. For a retailer like Walmart or Costco, or a manufacturer like Toyota, the "Develop supplier relations" objectives may represent the critical operational excellence objectives—and the source of competitive advantage.

Figure 3. Strategy Map**

OPERATIONAL EXCELLENCE: OUR RESEARCH HYPOTHESES

Our new expanded definition of operational excellence, and of the role of linking strategy to operations, is based on several hypotheses:

+ *The role of the strategy map,* created by Kaplan and Norton as part of the Balanced Scorecard management system, in helping achieve higher levels of understanding and commitment among management team members through its depiction of operational excellence objectives.

+ *The importance of aligning strategy and execution* to achieve operational excellence objectives.

+ The need to *align all operations, processes, and systems* to achieve organizational excellence.

+ *The role of cross-functional strategic "theme teams"* in managing operational excellence objectives, improving operational performance, and ultimately in achieving strategic goals.

+ The importance of *standardized, integrated, and networked technology* in reporting and managing performance to enhance decision making.

Survey Pool and Methodology

Nearly 200 respondents completed our survey. Acceptance criteria were applied to derive 101 qualified respondents (representing the same number of organizations), two-thirds of which were from outside the United States. The study pool encompassed a wide range of organization sizes—from those with $10 million in annual revenue or budget to those with more than $5 billion. Likewise, it also represented a wide range of industries. Transportation/energy/utilities comprised 23% of the sample; industrial goods/materials, 21%; and IT/telecom, 13%. The remaining 43% of organizations were spread among six other industry categories representing manufacturing and services, as well as government and nonprofit organizations. Approximately one-third of the respondents have been using the Balanced Scorecard management method for more than three years, while another third have been using it for fewer than three years. The remaining third are not Balanced Scorecard users.

Outcome categories. To understand the relative importance of specific management approaches, we established a measure of the outcomes that have been achieved through their use. In this study, we examined four "outcome categories":

1. *Breakthrough Results,* meaning the organization is realizing top-line benefits, growth in customers, increases in profitability, and so forth.

2. *Operational Results,* which entails accomplishing operational improvements, such as being able to do things better, faster, or cheaper, or to improve the customer experience.

3. *Organizational Benefits* includes achieving such "softer" internal benefits as improved under-standing and consensus on the strategy and improvements in internal communication.

4. *No Benefits* means none of the aforementioned benefits have been realized.

With these outcome measures in hand, we were able to measure the relationship between the relative strength of a particular management capability and its contribution to strategic outcomes.

To test our hypotheses, in mid-2008 we conducted an online survey of organizations that can be described as either generally interested in the Balanced Scorecard (i.e., those thinking about getting started) or those that are already somewhere along the road to a full-scale implementation. While ours is clearly a self-selected sample, we consider it representative of the general population of organizations since 61% of the respondents are already using a Balanced Scorecard as a management tool. This percentage approximates the global penetration rates reported by others (other broad-based surveys show 60% to 65% usage rates).

CORRELATING THE MODEL AND PERFORMANCE EXCELLENCE: SURVEY FINDINGS

In this section, we present the survey findings on all four components of the general model presented earlier: (1) the general strategy management framework, featuring strategy maps and scorecards (*Integrating Framework*); (2) the link to operational processes—in particular, processes that are identified by the strategy (*Linked Process/Measure Model*); (3) the role of theme teams in orchestrating the cross-functional and cross-process coordination required by the strategy (*Integrated Management Process*); and (4) the role of technology in managing performance by enabling measurement, reporting (of both strategic and operational performance), analysis, and improved decision making (*Integrated Information System*).

1. An Integrating Framework

The start of this research project coincided with the release of Kaplan and Norton's latest book, *The Execution Premium*, which describes the six-stage Execution Premium (XP) model presented earlier in this paper. We used a series of survey questions to assess the impact of the model on the outcomes achieved by organizations that have implemented (or are implementing) it in varying degrees. *Figure 4* presents the findings of the outcomes in the 101 organizations surveyed. The graphic presents a profile of the organizations and how they fall into one of the four outcome categories, arrayed by their level of conformance to the Kaplan and Norton XP model; respondents ranked their proficiency at each stage of the model on a five-point scale, where 5 = "We're best practice at this" to 1 = "We are very poor at this." The pattern in the data clearly indicates that those organizations that conform most closely to the general model have a much greater chance of achieving break-through results, thus confirming the power of the XP model.
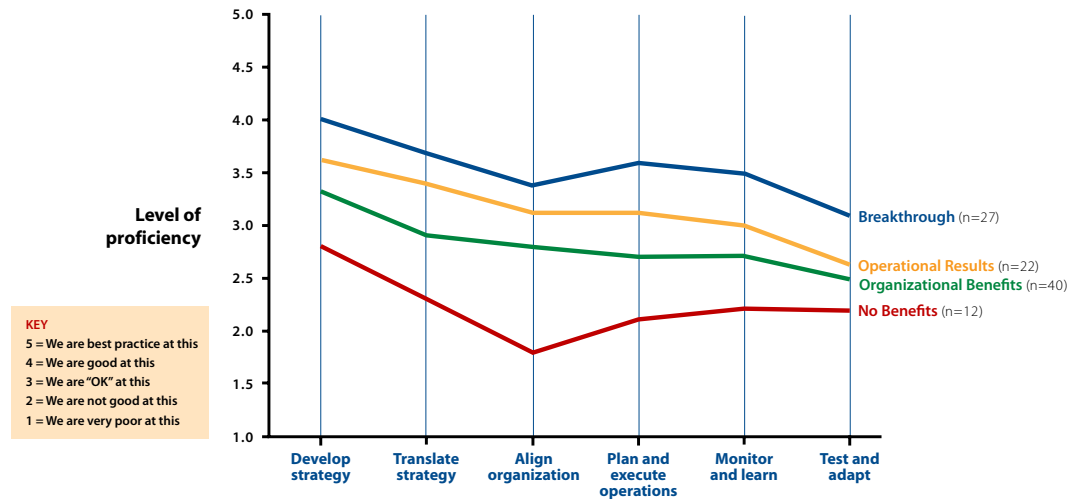
Our purpose here is not to defend the use of the BSC; indeed, there is ample confirmation of its effectiveness. Instead our purpose is to show how it works—particularly within the context of the XP management model—so that other organizations can better take advantage of this management tool.

As Figure 4 shows, three of the six XP stages are especially relevant to our current investigation. *Translate the Strategy*, Stage 2, entails using strategy maps and scorecards to describe and measure the strategy, identifying action programs (initiatives) required by the strategy, funding these action programs, and leading their successful execution. Organizations that are using or have begun to use these tools are in a better position to execute their strategy and, in turn, achieve better results. Both the Breakthrough Results and Operational Results groups report significantly better performance than the other two outcome groups.

Stage 4 of the XP model, *Link Strategy and Operations*, represents the intersection of planning and operational execution. A high score in this stage indicates that an organization is able to develop and leverage an operational process model of the business, identify the business process improvements most critical for execution, link the strategy with operating plans and budgets, and establish the IT requirements that will enable this integrated approach to function effectively. By "function effectively," we also mean generating feedback in the system to allow for continuous improvement in all affected areas. We will explore this fourth stage in the next section.

Figure 4. General Management Principles: The Execution Premium Model

Level of proficiency

KEY
5 = We are best practice at this
4 = We are good at this
3 = We are "OK" at this
2 = We are not good at this
1 = We are very poor at this

Breakthrough (n=27)
Operational Results (n=22)
Organizational Benefits (n=40)
No Benefits (n=12)

Develop strategy | Translate strategy | Align organization | Plan and execute operations | Monitor and learn | Test and adapt

Respondents felt that their organizations were best at the Develop the Strategy and Translate the Strategy stages. Breakthrough Results organizations distinguished themselves in all areas, particularly in the Test and Adapt stage, in which they ranked themselves significantly higher than did both Operational Results and Organizational Benefits organizations.

The sixth stage, *Test and Adapt*, is where IT enablement is most important in terms of helping an organization address the most critical question of all: whether the strategy is the right one—the most effective one—for achieving the organization's mission and vision. Here, again, we find that most organizations achieving Breakthrough Results report higher levels of conformance to the XP model. However, even this group's scores are the lowest when compared to its scores in the other five stages. That's not surprising, though. Typically, organizations that do well in testing and adapting their strategy have been actively implementing this strategy management approach for three or more years. It takes time for an organization to mature to the point of effectively taking advantage of each of the six XP stages. Moreover, the IT requirements in terms of tools and skillsets are high once an organization approaches Stage 6. You need professionals with capabilities in such tasks as profitability analysis, causal modeling, identifying alternative strategy scenarios, and recommending alternatives based on the feedback evidence. Many organizations lack expertise in these areas and are still too limited in their IT capabilities to be proficient at this stage.

The Drivers of Operational Excellence

Before exploring how respondents view operational excellence in driving strategic success, let's look at how they defined "breakthrough" results. Twenty-seven percent of respondents indicated they have achieved such results; for these high-performing organizations, "breakthrough" means they have delivered significant positive benefits to the customers buying their products/services (71% of respondents); they have significantly increased revenue (60%); or they have increased the number of customers (52%). Again, respondents were allowed to check more than one response category when more than a single outcome was achieved.

So how do organizations evaluate their strategic success? We explored this question in two ways. First, we asked what measures of performance respondents use to gauge success. They were allowed to check all measures that apply. The two main gauges were revenue growth (cited by more than 74% of the respondents) and profit (mentioned by 66% of the respondents). Various measures of return, such as ROI and ROA, were cited nearly 50% of the time. Less frequently used measures of success included EBITDA (29.7%), Return on Sales (21%), and EVA (17%).

Second, we examined the various forms of operational excellence that organizations are pursuing. In other words, we sought to understand the operational drivers of success. We allowed respondents to report as many as four different types of operational excellence improvements: cost, speed, customer experience, and quality. More than 40% cited improvements in customer experience as the primary driver of revenue growth—in fact, *improved customer experience was the predominant form of operational excellence reported.* Cost efficiency was reported as the primary driver of increased profitability (reported 37% of the time). The respondents view the various drivers of success differently, depending on the specific measure of success they are working toward. Reducing cost is also the most frequently cited driver of overall measures of return (e.g., ROI, ROA) and EBITDA. As we begin to peer into the operational processes that ultimately provide the "lift" necessary to achieve strategic outcomes, it is important to understand these drivers of success.

2. A Linked Process/Measure Model

Earlier, we observed that managing strategic initiatives provides the critical linkage between strategy and operations. This activity is part of the XP, found in Stage 2, *Translating the Strategy* with strategy maps and scorecards, and Stage 4, *Planning and Executing Operations.* Of all the governance activities involving initiatives—funding the initiatives, managing the initiative portfolio, and aligning the initiatives with strategy, the last has the greatest impact on achieving strategic success. But if initiatives must be aligned to be effective, a mechanism for understanding the process model of the organization must be in place. Simply put, in order to align initiatives with processes, the organization needs a process model as a reference, so that strategic initiative investments (including changes to existing processes or the introduction of new processes) can be directed appropriately.

Figure 5 illustrates that the likelihood of achieving breakthrough results is a function of two factors: key process management capability (ranked on a scale of 1 to 5) and length of BSC use. There is no question that managing key processes competently through such approaches as quality management, Lean Manufacturing or Lean Six Sigma, and continuous

improvement techniques delivers benefits. But for organizations that rated their key process management capabilities a "3" ("OK") or above—absent the use of a BSC—the odds of success were limited: no better than one in five. However, when the BSC is added to the mix, the likelihood of success more than doubles, to 50%. In this case, the duration of use is not a differentiator, so we can conclude that the combination of an "OK" or better ranking in key process management, combined with BSC usage, markedly improves outcomes. In other words, optimizing operational performance—true operational excellence— requires a strong link between strategy and operations management.
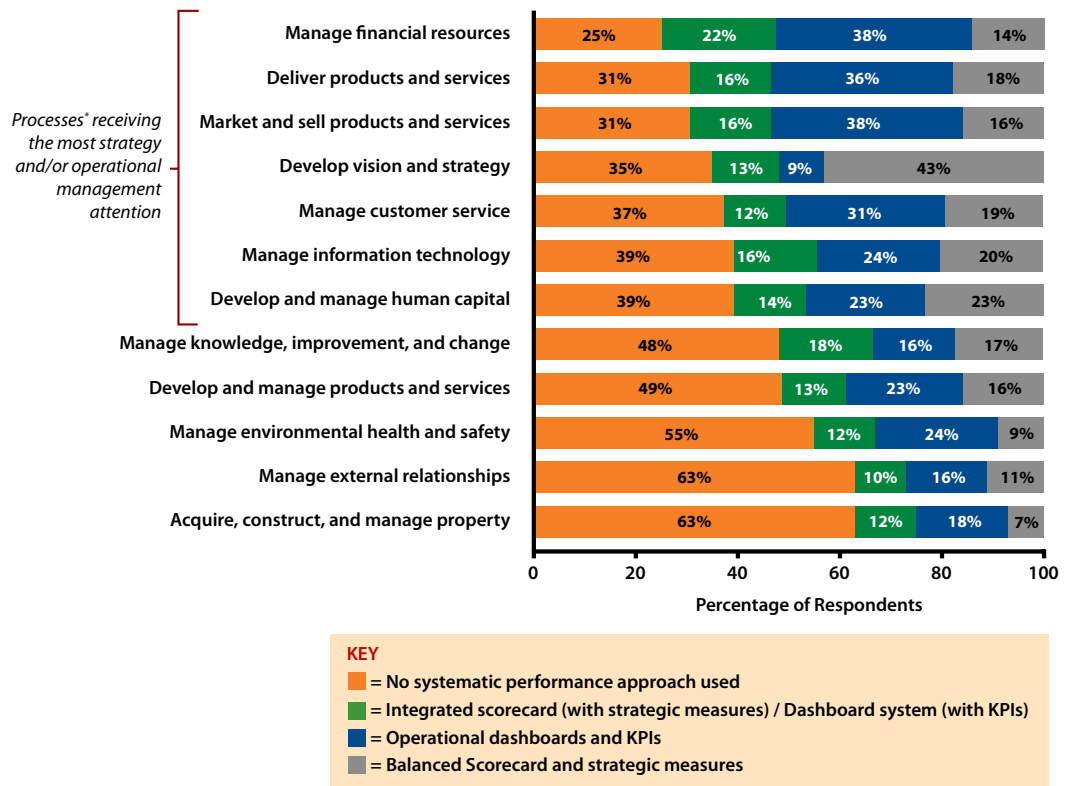
Figure 5. Key Process Management Performance and BSC Use
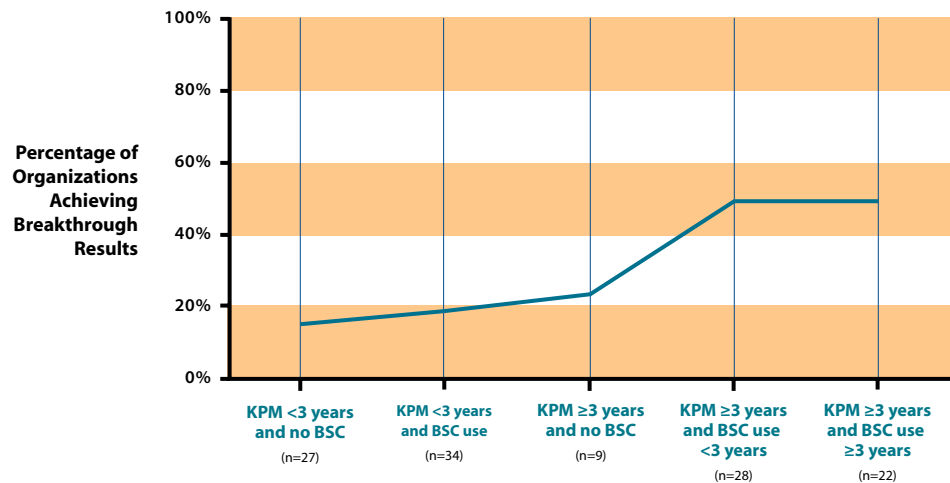
Good performance in key process management has little impact on the likelihood of being a Breakthrough Results organization, unless the organization uses the BSC. But duration of BSC use appears to be of little impact.

Now that we know that strategy management, when combined with key process management, yields a markedly higher payoff, the next question is: Which processes receive the most attention in terms of strategy and/or operational management? *Figure 6* shows where organizations have made investments in creating scorecards to manage the strategy or dashboards to manage operations, or where they have done both (or neither). The number-one area in which we find both approaches is in managing financial resources (used by 22% of respondents). This is also one of two areas where dashboards are most frequently used. The other area popular for dashboard use alone is in marketing and sales. For the delivery of products and services (i.e., where processes are used to create product and service offerings) the frequency with which each management approach is used is nearly identical. The next (fourth) process in the list is developing a vision and strategy. Not surprisingly, the scorecard is used for this process by 43% of organizations. Only 9% of organizations use a dashboard to manage this process, and both approaches are used 13% of the time. The next three processes, in descending order of usage, are managing customer service, managing IT, and developing and managing human capital. Since the combined use of scorecards and dashboards is present in only a relatively small percentage of all processes, it seems reasonable to argue that this is a major area of opportunity for organizations that want to improve their chances of achieving breakthrough results. Without access to management tools such as strategy scorecards and information management

Figure 6. How Critical Processes Are Managed

Processes receiving the most strategy and/or operational management attention

Process	No systematic performance approach used	Integrated scorecard / Dashboard system	Operational dashboards and KPIs	Balanced Scorecard and strategic measures
Manage financial resources	25%	22%	38%	14%
Deliver products and services	31%	16%	36%	18%
Market and sell products and services	31%	16%	38%	16%
Develop vision and strategy	35%	13%	9%	43%
Manage customer service	37%	12%	31%	19%
Manage information technology	39%	16%	24%	20%
Develop and manage human capital	39%	14%	23%	23%
Manage knowledge, improvement, and change	48%	18%	16%	17%
Develop and manage products and services	49%	13%	23%	16%
Manage environmental health and safety	55%	12%	24%	9%
Manage external relationships	63%	10%	16%	11%
Acquire, construct, and manage property	63%	12%	18%	7%

Percentage of Respondents

KEY
- ■ = No systematic performance approach used
- ■ = Integrated scorecard (with strategic measures) / Dashboard system (with KPIs)
- ■ = Operational dashboards and KPIs
- ■ = Balanced Scorecard and strategic measures

The Balanced Scorecard and strategic measures are most commonly utilized for developing vision and strategy. Operational dashboards and KPIs are most frequently used in managing financial resources, marketing and selling products and services, and delivering products and services. A combination of scorecards and a dashboard system is less commonly used.

Processes derived from APQC's Process Classification Framework (see p. 9).

platforms such as operational dashboards, organizations tend to manage operational processes the old-fashioned way: by fiat, gut feel, or "the way we do things around here!"

3. An Integrated Management Process

It almost goes without saying that to achieve significant strategic results, an organization needs strong leadership. Unless your organization happens to be lucky enough to be an early entrant in an emerging rapid-growth sector where excess profits are easily available, you are more than likely struggling just to stay even. Given the current global market turbulence and increasing risks at every turn, the task is even harder. Thus, leadership is correctly seen as being critical to survival. The same is true when looking for reasons why performance management programs succeed or fail. Why is it that anywhere from 25% to 63% of the major processes in organizations are not managed with either a scorecard, dashboard, or both? Certainly the difficulty in instituting such systems helps explain this management deficit. Moreover, the discipline of measurement-based performance management is still in its early years. While quality management has been applied to many operational processes over the past several decades, strategy management is still relatively new—and the discipline of applying an integrated approach to strategy and operations performance management can be considered in its infancy.

Nonetheless, new approaches for effective strategy execution continue to emerge, showing the way forward for those seeking competitive advantage. One such approach is the use of theme teams (described earlier) to manage strategy across traditional organizational lines, such as processes or functions. Our research focuses on one strategic theme—operational excellence, arguably the most common theme, expecially in a down market.

Strategic themes require strong executive-level leadership to secure adequate resources and ensure continued visibility, action, and review. Typically, one or two members of the executive team are assigned to each theme as theme "owners"—those responsible for overseeing execution of their individual theme. The original idea of the theme team needs to be expanded when we begin to formalize the linkage between strategy and operations. Theme teams that will be accountable for linking strategy and operations require broader representation from across the organization. Specifically, members of the operational management team should be added to the theme team in the interest of achieving strategic objectives driven by specific processes that link to the strategy map.

In our survey sample, 7% of the respondents indicate that they are using the theme team approach as their primary method for strategy management, and indicate notable results are already being achieved—results we would characterize as either delivering Organizational Results or Operational Benefits. But the presence of such a management approach is not yet statistically associated with achieving Breakthrough Results. Even those achieving Breakthrough Results indicate that, at best, they consider themselves merely "OK" in theme team management. This suggests that there is ample room for improvement in terms of leveraging this practice, especially in the context of fully integrating strategy management with operations management.

4. An Integrated Information System

IT enablement is the remaining critical component of the execution foundation. When we look at the worlds of strategy management and operations management from the perspective of IT, we see two very different developmental histories. The path to strategy management via the use of the Balanced Scorecard is characterized by face-to-face discussion between executives to achieve consensus on the organization's mission, vision, and strategic objectives. Early on in the development life cycle of organizations implementing this management system, technology use is generally limited to desktop productivity tools, such as spreadsheets and presentation applications. Enabling an executive team to get its collective head around a set of strategic objectives doesn't require much in the way of technology—at least not in the beginning. Certainly, more technology-centric companies may rely on their information platforms to help inform their strategy development discussions. However, implementing a strategic measurement system—even one that requires only a modest set of 20 or so strategic measures—is where the challenge of integrating the management process with the data arises. Many organizations that began with rudimentary tools, and that achieved early success, often find themselves bumping up against the limits of their technology choices. Their reliance on spreadsheets begins to test the patience and bandwidth of the team members responsible for capturing, reporting, and analyzing the data. The challenge of relying on inadequate technology grows exponentially for a large and/or complex organization. When such organizations enter their second year of Balanced Scorecard implementation, they often discover that the technology choices that got them to where they are will not get them to the next level of performance. They require more robust tools at each point—from core, traditional transactional (e.g.,

ERP) systems all the way to specialty performance management systems—to automate more of the management and reporting processes and enable them to spend more time on value-adding activities, rather than on merely managing the data. To get there, they also need an IT governance program—to ensure the needed data is being collected, to ensure data accuracy and process integrity, and to establish common formats based on corporate standards. And they need the right IT competencies and tools.

The evolutionary cycle of an organization's management of operations, on the other hand, is typically quite different from its strategy management evolution. Large-scale ERP systems have been in place in many organizations for quite some time. These implementations often followed major reengineering efforts. Thus, operational and information management systems—and their associated analytical applications—are prominent features in the world of operations. It is fair to say that, in most organizations, the level of maturity of operations management far exceeds that of strategy management. And yet it is the connection between these two worlds that makes all the difference in terms of executing strategy and achieving Breakthrough Results.

Figure 7. Primary Technology Used to Capture and Report the Performance Metrics Linked to the Strategy
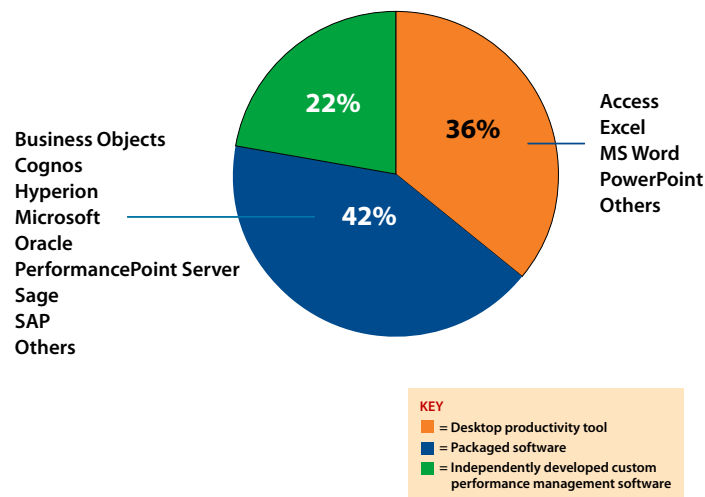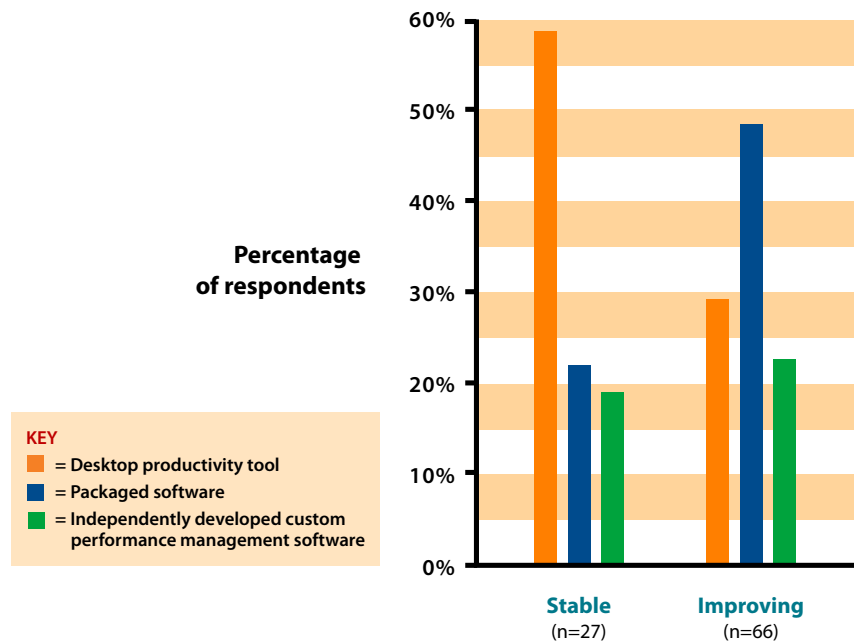

The largest percentage of respondents report using as their primary technology a packaged software application, with SAP and Business Objects dominating this category. Among desktop productivity tools, several applications are widely used, with Excel used almost universally.

We began to explore the connections between strategy and operations from an IT perspective by examining the primary technology solutions used to capture and report performance metrics that link to the strategy. While research has repeatedly shown that length of BSC use correlates with the likelihood of achieving increased shareholder returns[8] we wanted to see what relationship, if any, exists between the tools used and improvements in results. *Figure 7* shows the distribution of tool usage by major category: desktop productivity tools, packaged software (e.g., SAP Business Suite software) and specialty packaged performance management software (e.g., Business Objects enterprise performance management software), and independently developed custom applications.

Respondents were allowed to record all tools that are in use. The data show that desktop tools are ubiquitous (Excel, for example, has a 97% penetration rate) and that other tools are relied on less frequently to capture and report performance data.

The real story lies in observing which tools the more advanced organizations rely on. *Figure 8* shows the results that organizations expect to achieve over the next three years. More than 90% of the survey respondents expect their organization's performance over the next three years to be either consistent with current performance levels (27 respondents) or to improve (66 respondents). Only eight of the study participants expect their organization's performance over the next three years to drop below current levels. Figure 8 also shows the data for the "stable" performance group and the "improving" performance group broken down by software category. Here, we see that while custom software use grows somewhat (from 19% to 23%), the big story lies in packaged and specialty packaged performance management software. Reliance on packaged software increases from 22% to nearly 50% of all organizations that expect to see their business performance improving over the next three years. The desktop tool category fades considerably (from 59% to 29%) for those anticipating performance improvements over the next three years.

Figure 8. Primary Technology Solution Used to Capture and Report Performance Metrics That Link to the Strategy, by View of Performance Over the Next Three Years

KEY
■ = Desktop productivity tool
■ = Packaged software
■ = Independently developed custom performance management software

Percentage of respondents

Stable (n=27)   Improving (n=66)

Those who see their company's performance improving over the next three years are more likely to use packaged software than those who expect their company's performance to remain stable.

While the choice of software tools can facilitate improved performance, it is important to understand the pathway to organizational transformation that these tools enable. We asked two questions—about improvements in communication and improvements in alignment—to gain a better understanding of this pathway. While all automated tools can be used to communicate the strategy and cascade the strategy (and align the organization), it turns out that organizations using packaged software seem to be somewhat better

at achieving both of these organizational outcomes. Those relying on packaged software, rather than desktop solutions or custom applications, report improvements in communication 53% of the time compared to a 46% for those relying on custom solutions. Likewise, when it comes to organizational alignment, those relying on packaged solutions report success 69% of the time compared to a 64% level of achievement for those relying on custom solutions. While these differences are not huge, they are nonetheless notable— and help shed light on this expressed preference for packaged tools for those who anticipate performance improvements in the coming years.

Clearly, alternatives to the desktop solution are more attractive. Beyond efficiency and scalability, systems need the capacity to gather data from multiple sources, linking dashboards and strategy performance systems across the enterprise. The resulting end-to-end visibility across the value chain not only enhances data analysis, but helps support—and accelerate—decision making and planning. This is where operational excellence translates into competitive advantage. But the benefits even accrue in a local way: in a leading pharmaceutical's R&D group, enhanced visibility of performance metrics enables individual project work streams to conduct their own analysis and implement localized process improvements.

Figure 9. Decision Analytics Performance and BSC Use
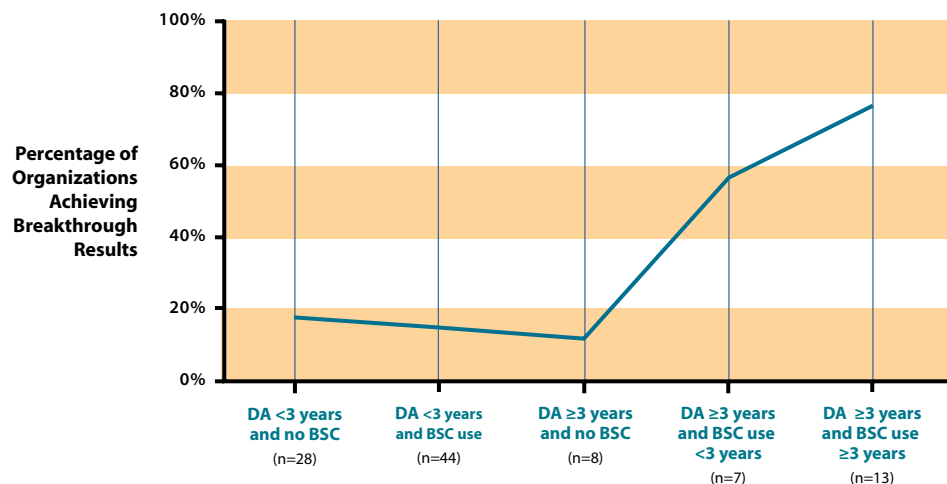
Decision analytics has little impact on the likelihood of an organization achieving Breakthrough Results, unless it is used in tandem with the BSC. The longer the BSC is used, the greater the likelihood of being a Breakthrough Results organization.

A final point concerning the role of IT. One of the important drivers of ongoing strategic success is how well an organization leverages its decision analytics in the last two stages of the XP model (*Monitor and Learn* and *Test and Adapt*). To help us understand the role of decision analytics in achieving strategic success, we developed a composite score of an organization's ability to perform decision analytics based on data access, organizational maturity, use of analytics, scenario analysis capabilities, and several other dimensions. The results of this analysis are presented in *Figure 9*. Here, we believe, is the most striking finding of our entire study. The use of decision analytics alone does little to improve the

chances of strategic success for an organization (less than 20% report Breakthrough Results). However, when decision analytics is paired with BSC use, the odds of success rise dramatically to a 57% chance of Breakthrough Results (when BSC usage is fewer than three years) and to 77% when the BSC has been in use for more than three years. Interestingly, the three greatest contributors to the decision analytics composite score were (1) organizational maturity, (2) the organization's commitment to utilizing analytics for making business decisions, and (3) IT's responsiveness to changes within the business and how well it supports the information needs required to make decisions. These last two items—both relating to the impact of analytics on improved decision making— yielded the highest ratings for Breakthrough Results organizations!

This compelling finding parallels our earlier observation concerning the role of key process management. Having a middling-to-strong capability in either key process management or decision analytics doesn't do much to improve an organization's chance of strategic success. Think of these as silver bullets that can only travel so far. But when these are paired with a solid strategy management approach—based on the BSC—your chances of success improve many times over.

By creating an operationally driven IT architecture based on integrated, end-to-end software solutions, organizations can transcend silos to unify operations and create transparency across the enterprise. This end-to-end visibility can help augment the traditional notions of operational excellence—greater automation, standardization, integrated controls for compliance, to name a few—to create new sources of value. Whether the results are improved customer service and satisfaction, cost reductions, quicker access to critical information that informs decision making, or continuous improvement that enables best-practice innovation—today's IT-enabled operational excellence has more enterprise wide impact than ever before.

A STRATEGIC IMPERATIVE: TURNING OPERATIONAL EXCELLENCE INTO SUSTAINABLE SUCCESS

As more organizations recognize the primacy of formal strategy management, embrace the notion of optimizing the strategy-operations connection, and begin to take advantage of powerful new technologies that provide end-to-end linkage of organizational processes, operational excellence takes on new meaning. As a way of supporting strategy execution, operational excellence is an important lever in boosting profitability and sustaining competitive advantage. But on a fundamental level, we cannot lose sight of the role operational excellence plays in helping organizations—and their entire business networks—weather volatile markets. In today's uncertain economic environment, as organizations seek to shore up their defenses and strengths, trimming costs and driving greater efficiencies assume new importance. Operational excellence is not only a lever to a promising future, but it can represent a lifeline in a turbulent present.

Certainly, combining all three factors—a strategy management framework, solid key-process-management capability, and strong IT enablement based on integrated, end-to-end software solutions that link strategy to operations—is the best recommendation we can make to those organizations that want to turn operational excellence into sustainable success.

Endnotes

1. R. Walter Kiechel, "Corporate Strategists Under Fire," *Fortune*, December 27, 1982; R. Charan and G. Colvin, "Why CEOs Fail," *Fortune*, June 21, 1999.

2. Study described in Chris Zook and James Allen, *Profit from the Core* (Harvard Business School Press, 2001).

3. Thomas G. Donlan, "Delusions of Adequacy," *Barron's*, March 6, 2006.

4. A 2006 Palladium survey of the BSC Online community; cited in Robert S. Kaplan and David P. Norton, *The Execution Premium: Linking Strategy to Operations for Competitive Advantage* (Harvard Business Press, 2008), p. 4.

5. Ibid., p. 1.

6. For more on this subject, see R. S. Kaplan and D. P. Norton, "Integrating Strategy Planning and Operational Execution: A Six-Stage System," *Balanced Scorecard Report*, May–June 2008; Kaplan and Norton, "Mastering the Management System," *Harvard Business Review*, January 2008; and Kaplan and Norton, *The Execution Premium* (Harvard Business Press, 2008).

7. Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (Free Press, 1985).

8. Aaron D. Crabtree and Gerald K. DeBusk, "The Effects of Adopting the Balanced Scorecard Returns," *Advances in Accounting, Incorporating Advances in International Accounting* 24 (2008) 8–15. This study provides an independent confirmation of the relationship between BSC usage and the achievement of improved shareholder returns.

About this Project

Besides conducting the survey and producing this white paper, we also conducted in-depth interviews of several selected organizations that reflect diverse industries, approaches, and developmental stages. Through case studies (to be published separately), we will describe how these organizations are striving for—and achieving—operational excellence through their management discipline.

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