A PALLADIUM GROUP WHITE PAPER

Link Strategy and Operations to Achieve Strategy Execution Excellence

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Introduction

A brilliant strategy will not produce its intended results if it is not translated into operational terms that define new ways of working. It is one thing to declare important strategic objectives (for example, "Increase the number of new product introductions" or "Increase the rate of cross-selling"). But to achieve these objectives, managers must link strategy to operations; that is, they must identify the specific work processes and actions needed to reach the strategic objectives the company has defined. Only when strategy is linked to operations can we say an organization is executing its strategy. And while this observation may seem trivial at first glance, many organizations have difficulty establishing this linkage. The task becomes even more complex when managers seek to leverage technology to help forge and strengthen this crucial connection.

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In recognition of this challenge, IBM sponsored a study to examine the dynamics of linking strategy and operations. This white paper reports on the results of the study, with special focus on the role of technology.

This study is based on survey data collected from more than 200 customers of IBM Cognos solutions, which included organizations from an array of industries. Data collection took place between January and March 2009, during the most severe phase of the current global recession. In addition to this data set, seven members of the Palladium Balanced Scorecard Hall of Fame for Executing Strategy™ were included in the analysis to provide a basis for comparison. More detail about the survey is provided in the appendix.

Why Develop a Formal Strategy Management System?

We began this study with a working assumption that organizations with a formal methodology for managing strategy are in a better position to make the linkage to operations and, therefore, more likely to achieve breakthrough performance. A Balanced Scorecard—indicating the existence of a formal strategy-management approach—was in use in 49% of the participating organizations. This rate of penetration is similar to rates reported in other studies. (See, for example, Bain & Company's annual report on management-tool usage at www.bain.com/management_tools/home.asp.) On a global basis, Bain reports Balanced Scorecard usage at around 55%. Thus, the customer base of IBM Cognos solutions is similar to the global population on this dimension.

Across the 100 organizations in our study that reported using a Balanced Scorecard, about one-third are in their first year of implementation (34%). Another third (39%) have been using a scorecard for one to three years. The rest (27%) have been at it for over three years. This distribution on the duration of Balanced Scorecard use enables us to test for the effect of usage length on results achieved.

To test for results achieved (the outcomes of an organization's successful execution of its strategy), we asked organizations to report on their performance across a range of outcomes. The highest level of performance was classified as "breakthrough results" and is measured by objective, quantifiable outcomes such as increases in revenue or shareholder returns. Twenty-eight percent of the respondents reported that their organizations had achieved such results in the past year. We also asked about operational results, such as reduced cycle time, improvements in quality, and reduced costs. Twenty percent reported achieving these kinds of benefits. Finally, we measured organizational benefits such as improved internal communication and employee morale. Thirty-five percent of the organizations surveyed reported garnering such results. Only 17% reported no benefits as a result of executing against their strategy.

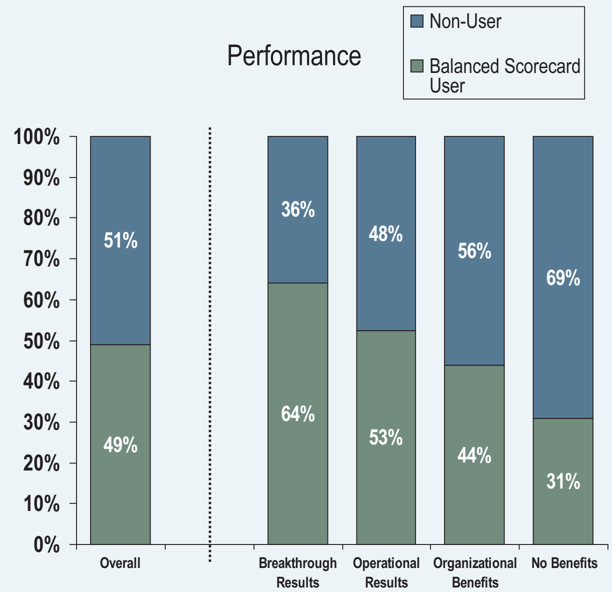
By combining these findings about the presence or absence of a Balanced Scorecard and level of performance improvement achieved, we have arrived at several observations, shown in Figure 1. Of those who report breakthrough performance, nearly two-thirds indicated the use of a Balanced Scorecard. For those achieving operational results, the breakdown is close to 50-50, with a slight edge (53-48) going to those who use a scorecard. In the other two performance categories (organizational benefits or no benefits), scorecard use is reported less frequently. Overall, then, the presence of a scorecard is associated with better performance.

These observations suggest that having a strategy-management framework in place is associated with the achievement of successful outcomes. However, a strategy-management framework may be necessary but not sufficient in itself to achieve breakthrough results. While it may be a good start, ultimately the strategy must be translated into actions that generated the desired results. There must be a connection between an organization's strategy and its operational system to produce improvements in strategic performance.

But what is the mechanism by which such outcomes are achieved? That is, precisely how do organizations link strategy to operations? In the following sections we discuss the contribution of process management and technology enablement to organizations' ability to establish this linkage so vital to breakthrough performance.

Figure 1 **Use of Scorecard and Outcomes Achieved**

- Overall, approximately half of the respondents reported using a Balanced Scorecard
- However, close to two thirds of *Breakthrough Results* organizations are Balanced Scorecard users, compared to less than a third of those reporting *No Benefits*



Process Management: Key to Linking Strategy to Operations

All organizations rely on operational processes (such as new product development, manufacturing, and distribution) to deploy their business model. For example, if a bank wants to roll out a new customer-centric strategy, it will need to design new business processes that support greater interaction with customers. This could necessitate many changes to the bank's processes that touch the customer: Online banking, call-center services, and services provided at branch locations might all be affected. To successfully execute a new customer-centric strategy, the bank should have a detailed understanding of both its current business processes as well as the intended processes—new or changed—that will support the new strategy.

However, despite the business process reengineering movement of the 1990s, many managers lack a detailed understanding of the business processes underlying their operating model. That is, they may not appreciate how current operating processes affect customers and (therefore) may not be prepared to make useful changes to their processes as dictated by strategy.

Thus, when a change in strategy requires changes to the way the organization does business, managers may not know which specific processes to change, add, or delete in order to operationalize the new strategy. Without a disciplined approach to process management, managers cannot link strategy to operations.

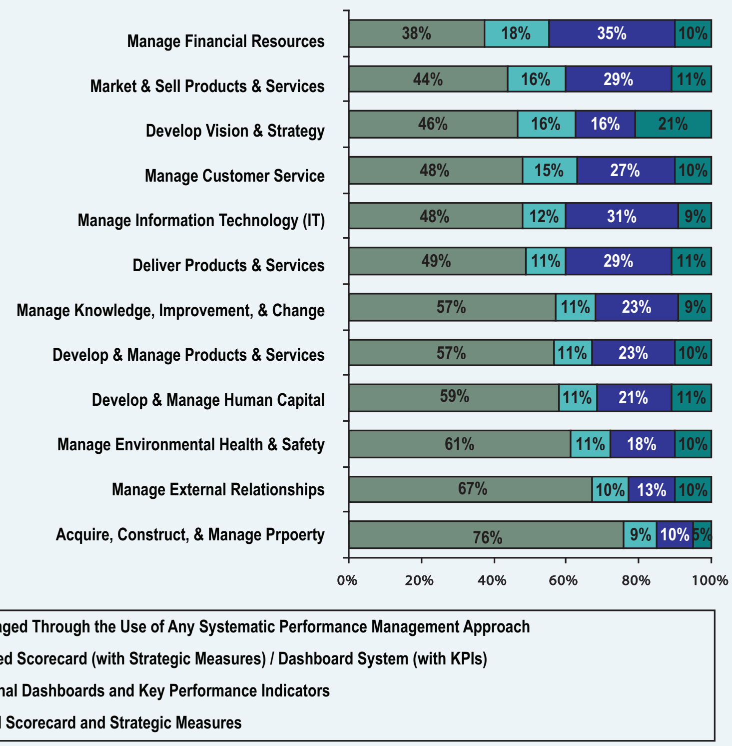
For organizations that use a Balanced Scorecard, the task of aligning strategy to operations is somewhat straightforward. That is because the scorecard includes a process perspective (in addition to a financial, customer, and learning-and-growth perspective) that provides the starting point for a process redesign effort. Without such a tool, identifying strategy-critical processes is much harder. For scorecard users, the process perspective provides a first approximation to guide the effort to link strategy and operations.

In this study, we examined participating organizations' use of process-management tools such as scorecards and operational dashboards. For purposes of data collection, we used as our reference model the Process Classification Framework developed by the American Productivity and Quality Center (www.apqc.org). This model identifies 12 mega-processes (such as managing financial resources, and developing vision and strategy) that exist in all organizations. The model can be expanded to show additional process levels below the mega-processes. However, the highest summary level is sufficient for our purposes.

Figure 2 shows the degree to which organizations in this study apply rigorous management techniques (including use of scorecards and dashboards) to their critical processes. One surprising observation is that many organizations do not manage these seemingly critical processes with much rigor through the use of such tools. Other processes further down the list are even less frequently managed through deployment of these tools. We identified a management gap across all 12 mega-processes. An important question for managers to ask themselves is, "How well positioned are we to change our processes as needed to support shifts in our strategy?"

Figure 2 **Management of Critical Processes**

- The Balanced Scorecard and Strategic Measures alone are most used in developing vision and strategy
- Operational Dashboards and KPIs are most frequently used in the areas of managing financial resources, managing information technology, marketing and selling products and services, and delivering products and services
- Integrated Scorecards or a Dashboard System are most commonly used to manage financial resources



Mapping and Managing the Process Architecture

To execute their strategy, organizations must link the strategy (which is long term) to their day-to-day activities (which are short term) and identify business process improvements required by the strategy. This calls for managers to understand, document, and manage their company's process architecture—the complete set of business processes that constitute the organization's business model. Once managers document the processes behind the business model, they need to develop a set of operational dashboards to track performance of the operational system. This bottom-up approach allows management control but, absent any input from a strategic perspective, can result in a direction-less management system.

The alternative is to start by defining the strategy and then map the business processes that are most obviously required to execute it. But this top-down approach also has shortcomings; in particular, managers may neglect operational processes that are relevant to the current strategy or one that is developed in the future.

This conundrum—top-down vs. bottom-up—confronts organizations that are just starting to develop their performance-management approach. But in practice, most organizations have already established their starting point and now must decide how to evolve their management approach to marry strategy (top-down) with operations (bottom-up).

To understand how organizations are addressing this challenge, we developed a series of survey questions that examined the process-management capabilities in organizations. Specifically, we asked respondents:

- "Do you have an operational process model of the business?"
- "Do you identify the business process improvements most critical for executing your strategy?"
- "Do you link the strategy with your operating plans and budgets?"
- "Do you align strategic initiatives with business processes?"
- "Have you established the IT platform needed to support management of processes most critical to your strategy and reporting/review capabilities?"

We combined responses to these survey questions to create an aggregate measure that rates an organization's ability to manage critical processes. As shown in Figure 3, process management does help companies achieve breakthrough performance, especially when it is combined with strategy management.

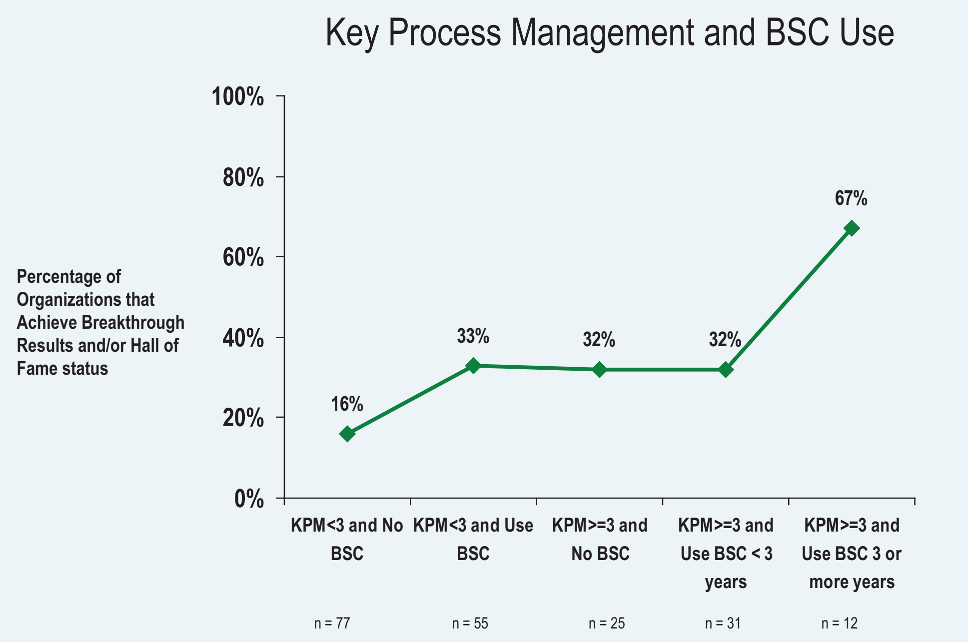
In the first group (N = 77), process-management capabilities are low (less than a rating of 3 on the 5-point scale). For these organizations, the incidence of breakthrough performance occurs at a rate of only 16%.

The next three groups (N = 55, 25, and 31, respectively) show the effect of some combination of process management and strategy management through scorecard use. In these groups, the incidence of breakthrough performance is about twice that seen in the first group. This indicates that some combination of process management and strategy management produces better outcomes.

However, the most impressive performance gains accrue to organizations that demonstrate advanced process-management capabilities and that have used a scorecard for three or more years. There were only a dozen such organizations in our study. As a group, they far outshine the others in terms of overall performance outcomes. Clearly, process management makes a significant contribution to an organization's ability to achieve breakthrough performance—especially when managers combine it with strategy management.

Figure 3

Benefits from Combining Strategy and Process Management



- Good performance on Key Process Management has a small impact on the likelihood of being a breakthrough organization unless there is use of the BSC for 3 or more years.

IT: The Third Ingredient for Success

Having identified the linkage between strategy and process management as an important contributor to performance breakthroughs, we now turn to the third ingredient for success: information technology. Top-performing organizations use IT to make the business decisions required for managing their strategy and processes. Such organizations have three defining characteristics:

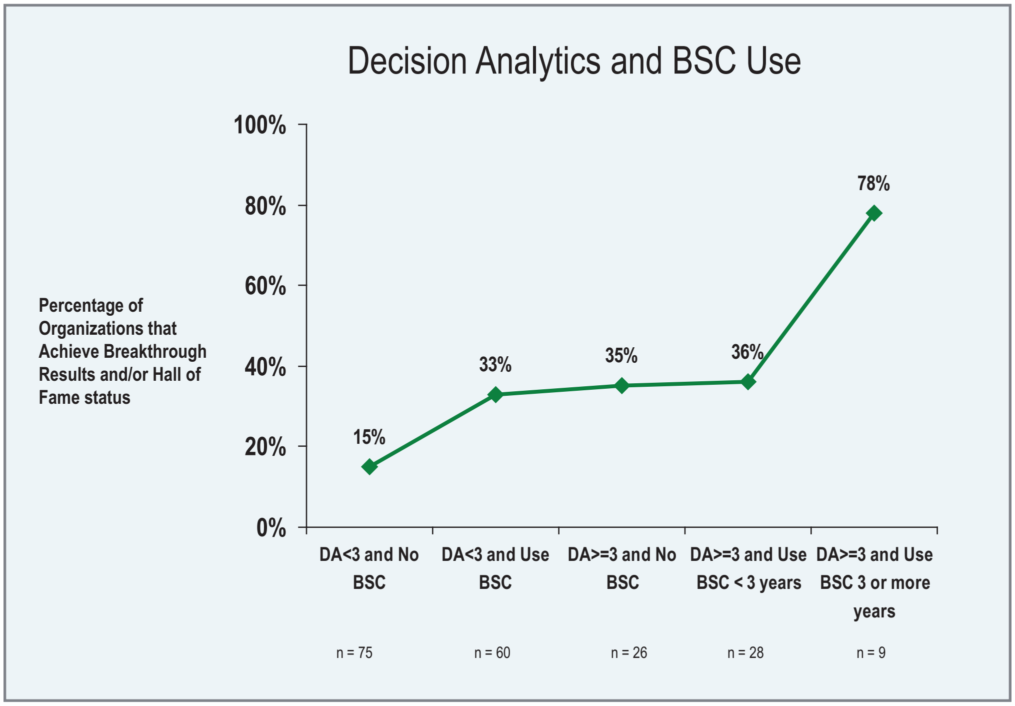
1. **Organizational Philosophy**
   - Commitment to using analytics to make business decisions
   - Organization-wide vision and plan for a robust analytical desktop
   - Experience in using technology to support strategy execution
   - Reliance on decision analytics to gain a competitive advantage
2. **Individual Decision-Maker Capabilities**
   - Access to data needed to analyze strategic performance
   - Ability to model alternate scenarios
   - Ability to embed reporting within a business process (to enable improved reporting and control)
3. **IT Capabilities**
   - Support for use of predictive analytical techniques (such as data mining)
   - Responsiveness to changes in the business and ability to support the information needs required for decision making

All three of these characteristics are important for success. The latest "silver bullet" IT solution will be useless if the organization does not also have the right organizational philosophy and does not prepare individual decision makers to leverage the new capabilities placed at their fingertips.

Figure 4 shows how the combination of all three characteristics listed above—which we collectively describe as decision analytics—can dramatically improve the likelihood of breakthrough performance for an organization.

Figure 4

Combining Decision Analytics with Strategy Management to Improve Performance Outcomes



The pattern in this figure is similar to what we saw with process management. By itself, and with or without the presence of a strategy-management system, decision analytics does improve the likelihood of breakthrough performance. In fact, the presence of a strong decision-analytics capability—or a weak decision-analytics capability in combination with the use of a scorecard—roughly doubles the likelihood of breakthrough performance for an organization. However, when decision-analytics capabilities are very strong, and when the Balanced Scorecard system has been in place for three or more years, the chance of breakthrough results doubles again, yielding a five-fold increase in likelihood of such performance. Clearly, decision analytics can make a significant contribution to success—especially when this capability is aligned with an organization's strategy-management system.

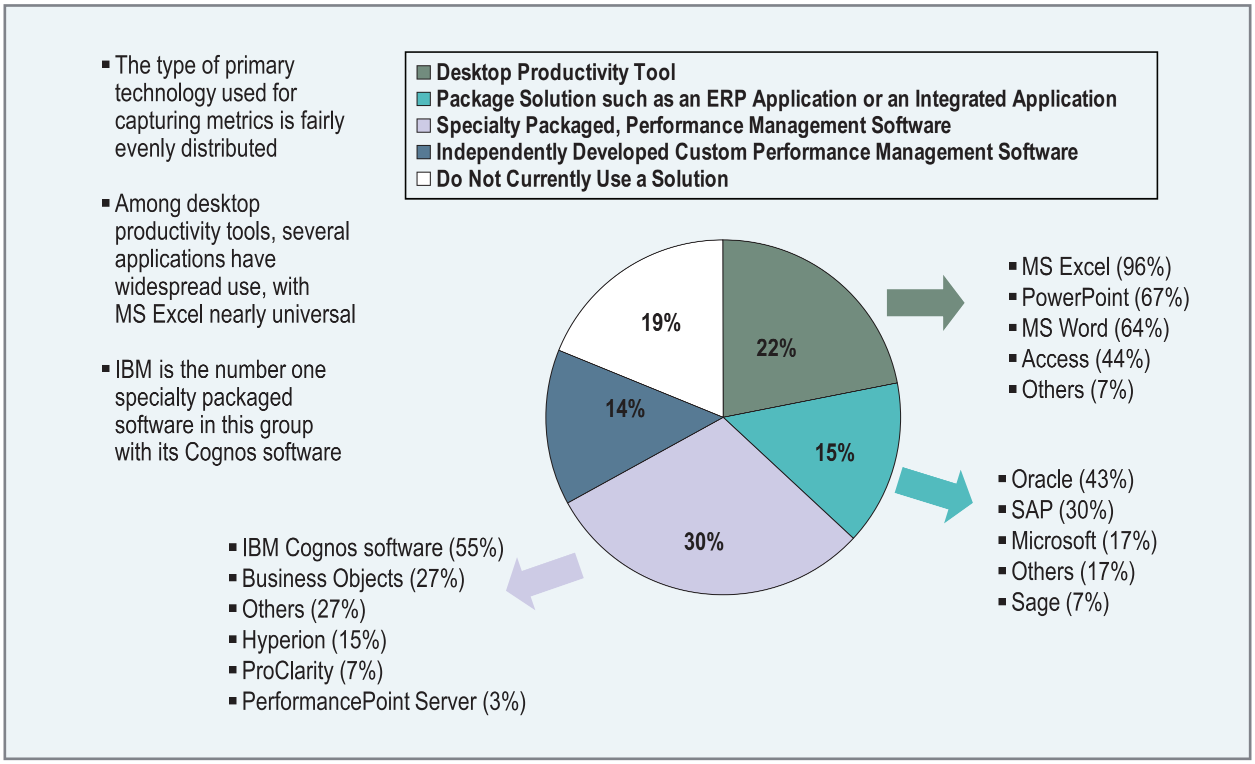
Using Technology to Measure and Report Strategic Performance

The most successful organizations link their IT system to their system for managing strategic performance. That is, they use IT to measure and report how well the company is executing its strategy. The right IT system, for instance, can help managers identify and address problems such as lack of progress on implementation of a strategic initiative, failure of an initiative to deliver the promised business results, or failure of a strategy-critical business process to operate as it should.

In this study, we examined the tools that organizations are currently using to capture and report strategic-performance data. We saw a fairly even distribution across types of tools, with a slight edge (30%) going to specialty packaged performance-management software. Almost one-quarter (22%) of the organizations participating in the study reported primarily using a desktop productivity tool, with the remainder reporting use of a package solution (15%) or an independently developed custom solution (14%). Almost two in 10 respondents (19%) report no current solution in use whatsoever. (See Figure 5.)

Figure 5

Technology Used to Capture and Report Strategic-Performance Data



Within each overall category, we identified multiple software packages in use. IBM Cognos specialty packaged software solutions are the leading packages in use. The entire Microsoft Office suite of products is used widely by those organizations employing desktop productivity tools. And Oracle is identified as the leading package solution.

Of the 39 respondents who do not currently use an IT solution, 13 of them plan to purchase one within the next two years. IBM is the primary provider these respondents are considering. For managers interested in gaining the advantages that decision analytics can offer, an important question to ask is, "Which approach to technology will provide us with better access to better data to enable better decision making?" While many—if not most—organizations start their scorecard reporting efforts through the use of desktop tools, they eventually must confront issues of scalability and data integrity, which specialty packaged solutions are better prepared to address. Managers should determine when and how to migrate to the superior solution—with an eye toward making their organization's strategy-management system as reliable and useful as possible. The timing of making the transition from desktop tools to packaged solutions should be considered carefully.

We have seen numerous examples of organizations that began this journey by acquiring more sophisticated tools than were necessary. These organizations decided to back away from such tools because they found them too onerous when applied to the new process of strategy management. This resulted in some rework and delay before managers could begin their first round of strategy performance reporting in earnest. We have also seen cases where desktop solutions remained in place too long in the organization. This delayed the move to a new stage of management maturity, in which managers could integrate strategy reporting (via scorecards) with operational performance reporting (via dashboards).

The ultimate goal of building an integrated performance-management solution—combining strategy and operations management—should be the same for all organizations. But the path leading there will differ depending on the competencies already in place within each organization and the point in the journey where the organization starts.

Summary

The body of research linking successful strategy management and organizational excellence continues to grow. The study on which this white paper is based furthers the discussion by generating additional insights. It is becoming clear that top-performing organizations combine best practices in both the strategic and operational arenas. Organizations that report achieving breakthrough performance as a direct result of executing their strategy and that report using the Balanced Scorecard (especially for three or more years) outperform other organizations in both strategy management and operational execution. And while organizations report using a variety of technological aids to capture and report strategic-performance data, IBM Cognos is the clear choice for specialty packaged performance-management software among our study respondents.

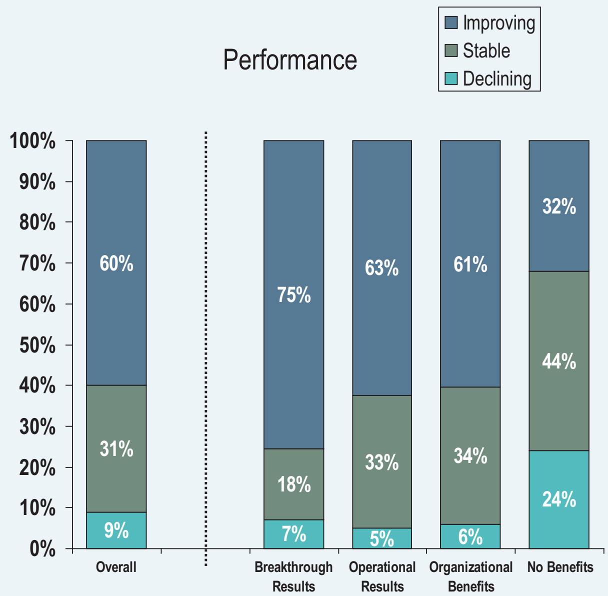
Looking Ahead

This study took place amid one of the deepest recessions in the past 80 years. That some respondents indicate they are still achieving breakthrough results testifies to their own management capabilities. (Of course, being in a recession-proof industry, such as food or essential consumer products, or being a low-cost producer also helps during difficult economic times.)

We could not resist asking our survey respondents to project the direction of their organization's performance over the next three years. Six in 10 thought that their organization's performance would improve during that time frame, while only about one in 10 (9%) foresaw a decline. "Breakthrough results" organizations (those who tend to combine strategy management, process management, and decision analytics through IT) reported a significantly brighter outlook than did other respondents. Meanwhile, "no benefits" organizations were less likely to see their organization improving in the near future; indeed, they were more likely to see it declining than were other groups. (See Figure 6.)

Figure 6 **Three-Year Outlook**

- Six in ten respondents see the direction of their organization improving over the next three years
- *Breakthrough Results* organizations have a notably brighter outlook than do those reporting no benefits



The message is clear. To create a brighter future for their organizations, managers would do well to follow these three principles: manage strategy through the use of a formal system, develop a better understanding of their enterprise's process architecture so they can link operations to strategy, and advance their company's IT infrastructure so decision analysts have the right tools to do their jobs.

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Appendix

Data for the 2009 IBM Strategy Execution Excellence survey was collected between January and March 2009. The survey consisted of four demographic questions, a section on general management principles, a section on operational principles, and nine questions concerning organizational outcomes. A total of 246 surveys were completed. Twenty-one surveys were completed by educators and 21 by consultants. These populations were removed before analysis to restrict the population to those actively working to link strategy with execution within their organization. Two hundred and four (204) responses were thus included in the present analyses. A total of seven BSC Hall of Fame organizations (collected in the fall of 2008) were also included to serve as a comparison group in many of these analyses.

Outcome Groupings

Respondent outcome groupings were determined as follows:

1) If a respondent answered "yes" to the question "Has the organization achieved quantifiable breakthrough results as a direct result of executing against its strategy?" the organization was placed in the Breakthrough Results group. If they also indicated that they were using the Balanced Scorecard (BSC), they were placed in the Breakthrough Results + Balanced Scorecard group.

2) If they achieved breakthrough results but did not indicate Balanced Scorecard use, they were placed in the Breakthrough Results + No Balanced Scorecard group.

3) If they answered "not yet" or "no" to the "breakthrough results" question, but "yes" to the "operational improvements" question ("Has the organization achieved process improvements or other operational benefits as a direct result of executing against its strategy?"), they were placed in the Operational Improvements group.

4) If they answered "not yet" or "no" to both the "breakthrough results" and "operational improvements" question, but checked at least two of the organizational benefits items (in response to the question "Indicate any other organizational benefits that have been achieved by your company as a direct result of executing against its strategy"), they were placed in the Organizational Benefits group.

5) If they did not meet the criteria for any of the above groups, respondents were placed in the No Benefits group.

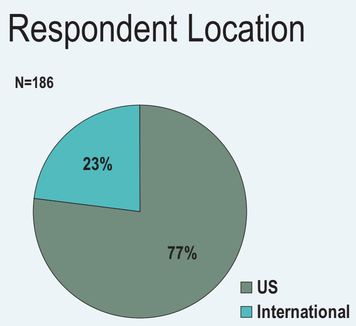
All items were analyzed by outcome group, employing ANOVA with post-hoc Tukey tests for continuous items and Chi Square analyses for non-parametrics. A limit of $p<.05$ was employed to determine significance.

Profile of Survey Sample

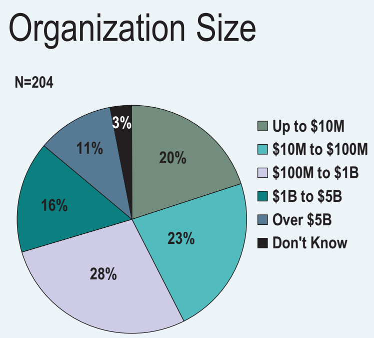
A wide variety of organizations were represented in the survey. Twenty-three percent of respondents represented organizations outside the United States. Organization size as represented by annual revenue (or budget for non-profits) ranged from under $10 million to over $5 billion. (See Figure A1.)

Figure A1

Location and Organization Size



- Close to one quarter of respondents were outside of the United States



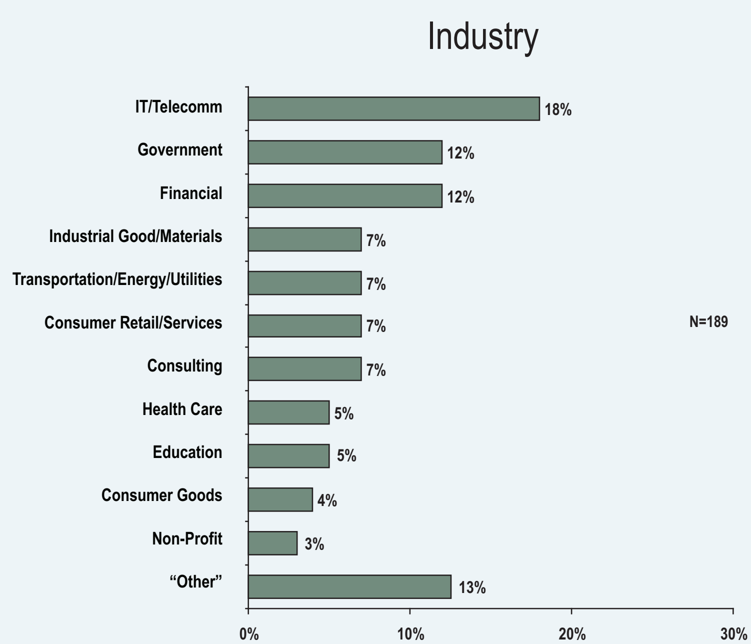
- Organizations reported a wide range of annual revenues

While the greatest number of respondents represented Information Technology/Telecomm (18%), Government (12%), and the Financial sector (12%), respondents came from a variety of other industries as well. Thirteen percent of respondents merely listed their industry as "Other." (See Figure A2.)

Figure A2

Respondent Industries

- IT/Telecomm was the top industry of respondents, followed by Government and Financial Institutions
- Thirteen percent of respondents simply identified their industry as "Other"



Organizational Outcomes

The 2009 IBM survey also collected organizational-outcome performance measures. Respondents were asked the types of measures that their organizations use to evaluate performance and the projected direction of that performance over the next three years.

When asked what performance-outcome measures their organizations use to assess the effectiveness of their strategy, revenue growth (73%) and profit (70%) far outpaced all other indicators. Also, some respondents mentioned return measurements such as ROI, ROA, and ROCE (46%) and EBITDA (35%). P/E (12%) and EVA (8%) were identified by the fewest number of respondents. (See Figure A3.)

Figure A3 **Performance Measures Used**

- Seventy-three percent of respondents indicated that their organization uses revenue growth to assess the effectiveness of strategy
- Seven in ten indicated that their organization uses profit
- EVA was the measure identified by the smallest number of respondents