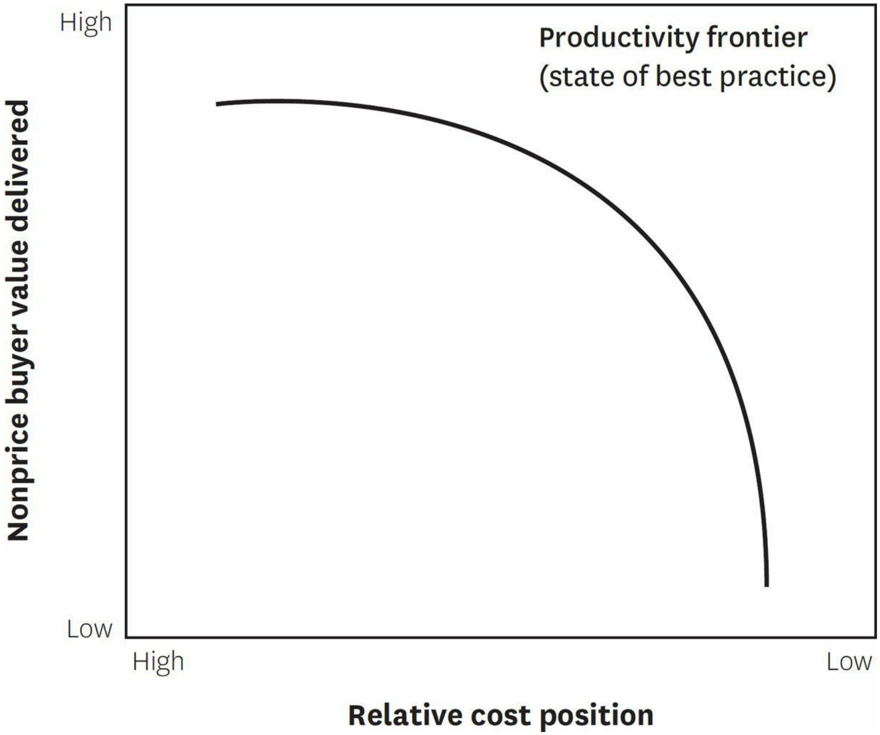
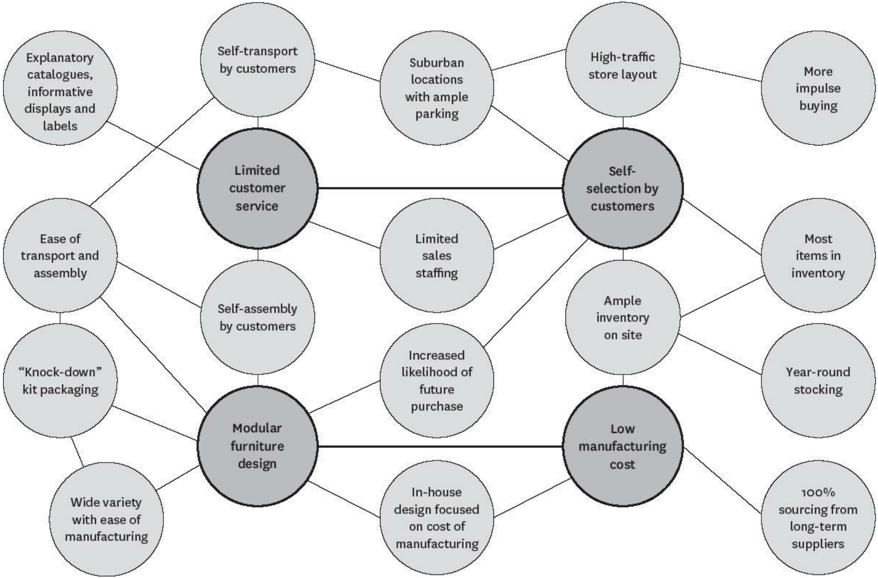
Operational effectiveness versus strategic positioning


Productivity frontier
(state of best practice)
High
Low
Nonprice buyer value delivered
High
Low
Relative cost position

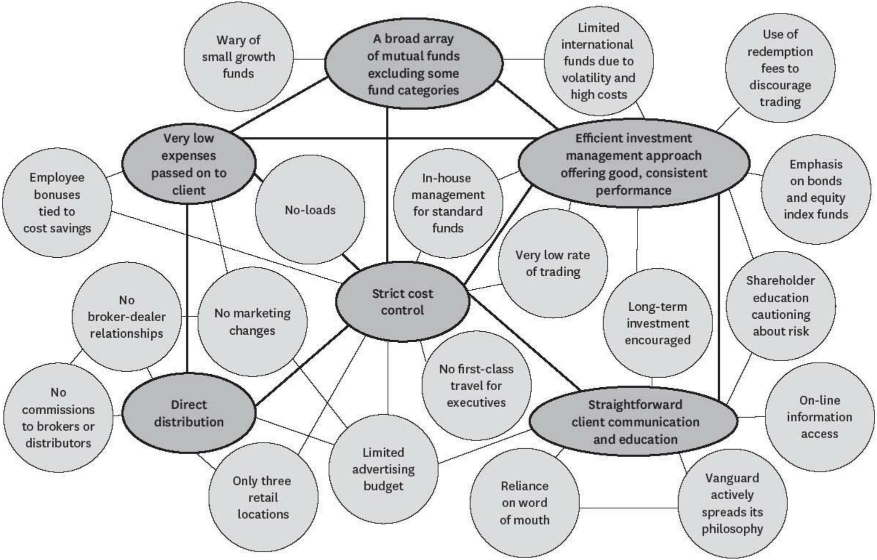
Mapping activity systems

Activity-system maps, such as this one for lkea, show how a company's strategic position is contained in a set of tailored activities designed to deliver it. In companies with a clear strategic position, a number of higher-order strategic themes (in dark grey) can be identified and implemented through clusters of tightly linked activities (in light grey).

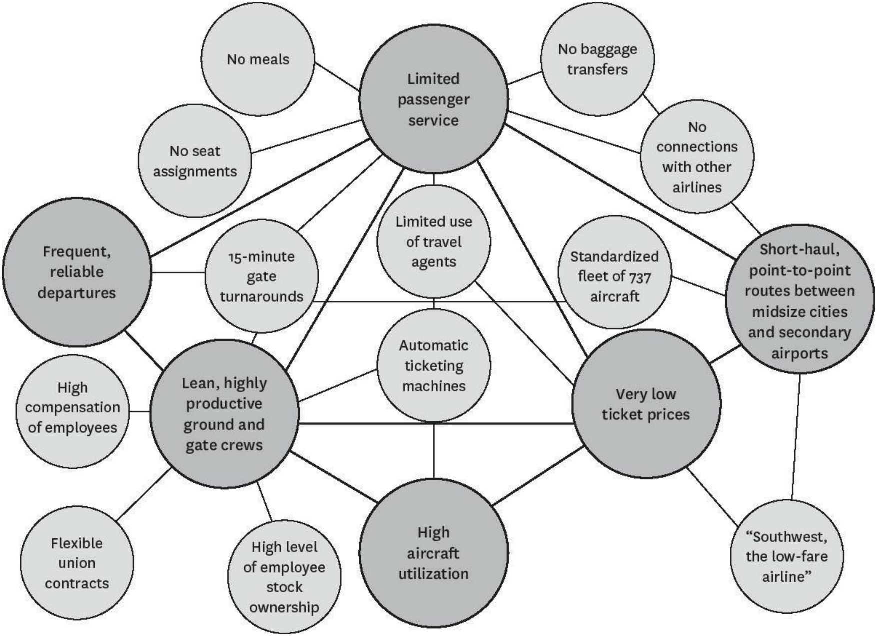

Explanatory catalogues, informative displays and labels
Self-transport by customers
Suburban locations with ample parking
High-traffic store layout
More impulse buying
Limited customer service
Self-selection by customers
Ease of transport and assembly
Limited sales staffing
Most items in inventory
Self-assembly by customers
Ample inventory on site
"Knock-down" kit packaging
Increased likelihood of future purchase
Year-round stocking
Modular furniture design
Low manufacturing cost
Wide variety with ease of manufacturing
In-house design focused on cost of manufacturing
100% sourcing from long-term suppliers

Vanguard's activity system

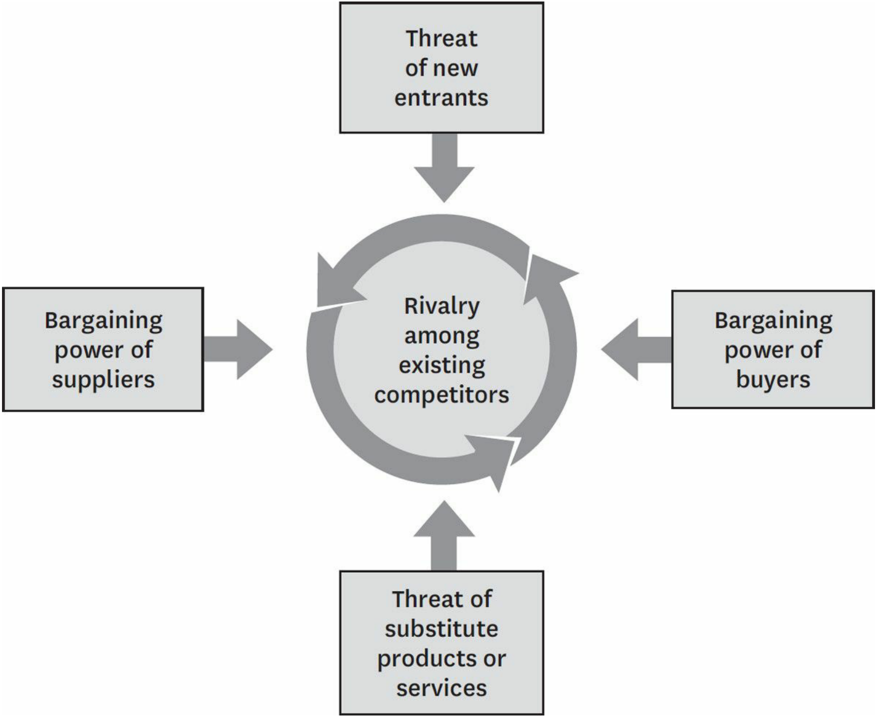
Activity-system maps can be useful for examining and strengthening strategic fit. A set of basic questions should guide the process. First, is each activity consistent with the overall positioning–the varieties produced, the needs served, and the type of customers accessed? Ask those responsible for each activity to identify how other activities within the company improve or detract from their performance. Second, are there ways to strengthen how activities and groups of activities reinforce one another? Finally, could changes in one activity eliminate the need to perform others?


A broad array of mutual funds excluding some fund categories
Wary of small growth funds
Limited international funds due to volatility and high costs
Use of redemption fees to discourage trading
Very low expenses passed on to client
Efficient investment management approach offering good, consistent performance
Employee bonuses tied to cost savings
No-loads
In-house management for standard funds
Emphasis on bonds and equity index funds
Very low rate of trading
Strict cost control
Long-term investment encouraged
Shareholder education cautioning about risk
No broker-dealer relationships
No marketing changes
No first-class travel for executives
Direct distribution
Straightforward client communication and education
On-line information access
No commissions to brokers or distributors
Only three retail locations
Limited advertising budget
Reliance on word of mouth
Vanguard actively spreads its philosophy

Southwest Airlines'activity system

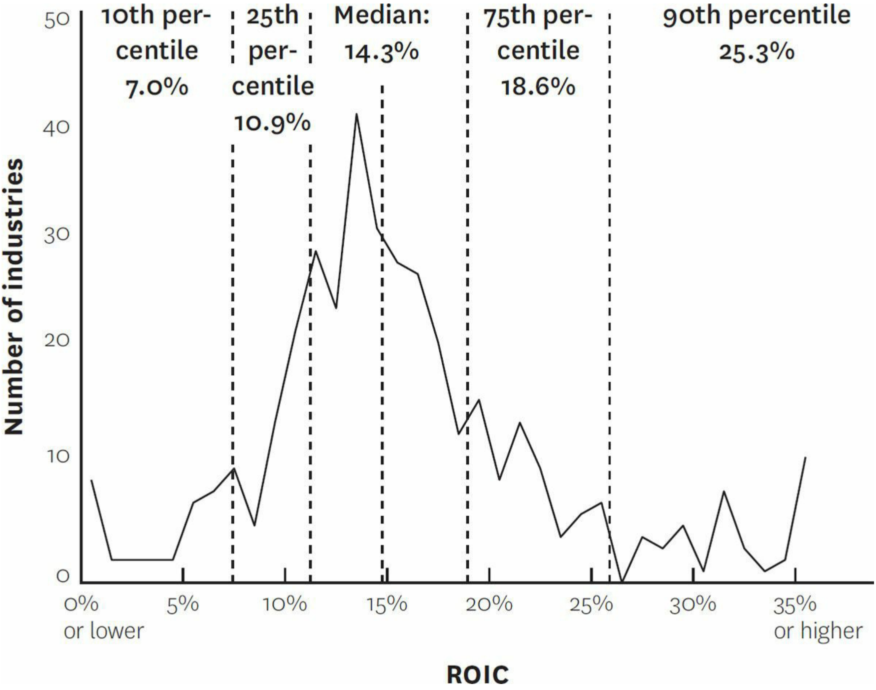

No meals
Limited passenger service
No baggage transfers
No seat assignments
No connections with other airlines
Frequent, reliable departures
15-minute gate turnarounds
Limited use of travel agents
Standardized fleet of 737 aircraft
Short-haul, point-to-point routes between midsize cities and secondary airports
Automatic ticketing machines
High compensation of employees
Lean, highly productive ground and gate crews
Very low ticket prices
Flexible union contracts
High level of employee stock ownership
High aircraft utilization
"Southwest, the low-fare airline"

The five forces that shape industry competition


Threat of new entrants
Bargaining power of suppliers
Rivalry among existing competitors
Bargaining power of buyers
Threat of substitute products or services

Average return on invested capital in U.S. industries, 1992-2006

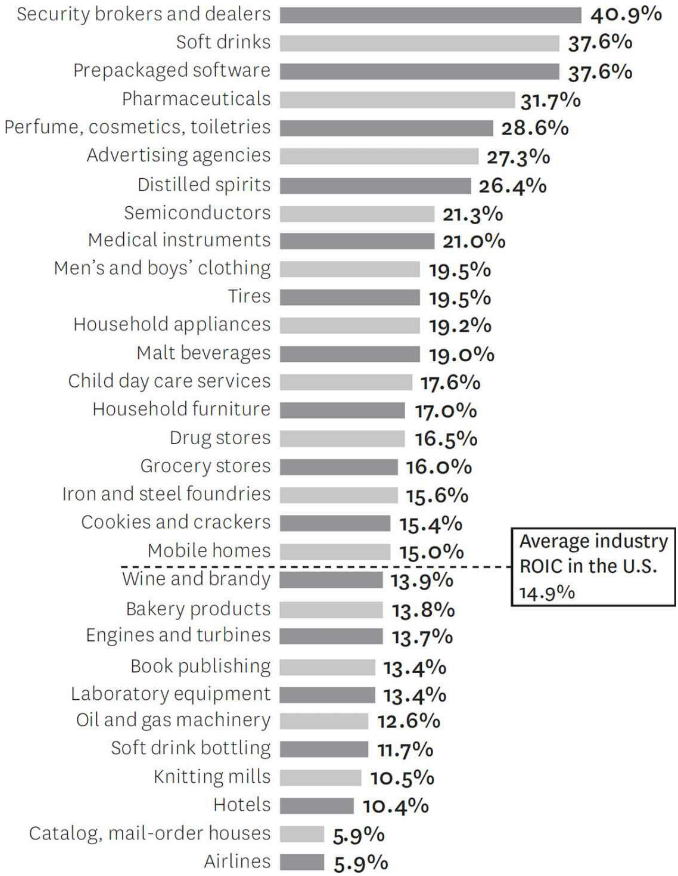
Return on invested capital (ROIC) *is the appropriate measure of profitability for strategy formulation, not to mention for equity investors. Return on sales or the growth rate of profits fail to account for the capital required to compete in the industry. Here, we utilize earnings before interest and taxes divided by average invested capital less excess cash as the measure of ROIC. This measure controls for idiosyncratic differences in capital structure and tax rates across companies and industries.*



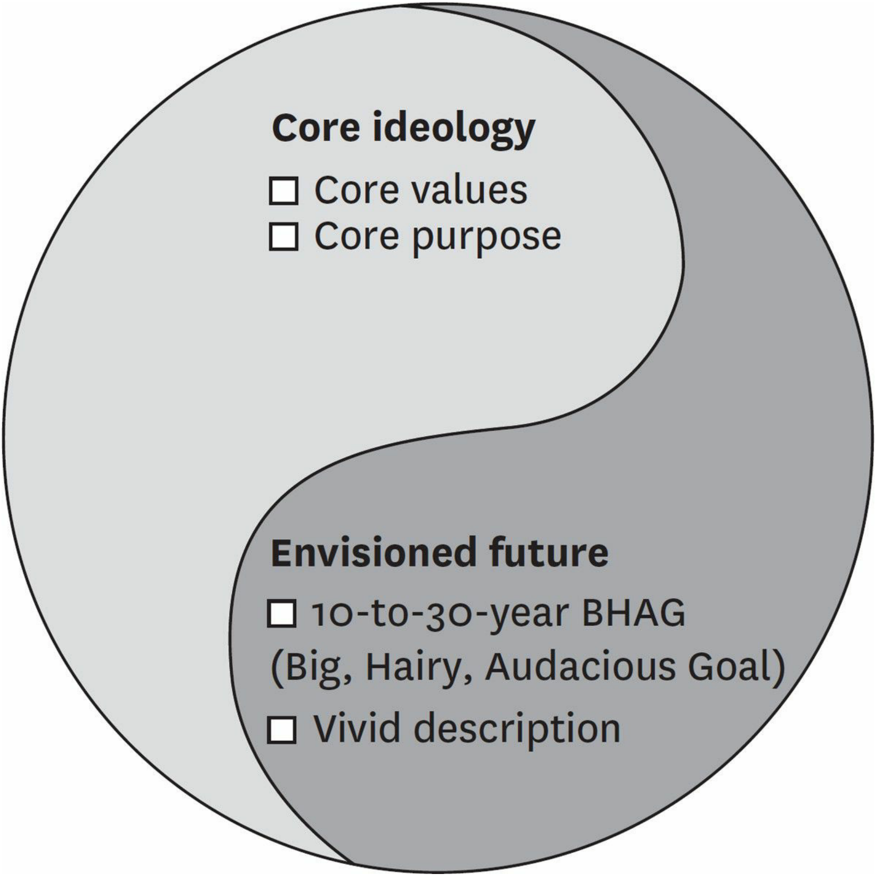
Source: Standard & Poor's, Compustat, and author's calculations

Profitability of selected U.S. industries

Average ROIC, 1992–2006



Articulating a vision


Core ideology
Core values
Core purpose
Envisioned future
10-to-30-year BHAG
(Big, Hairy, Audacious Goal)
Vivid description

The Elements of a Successful Business Model

EVERYSUCCESSFUL COMPANYALREADY operates according to an effective business model. By systematically identifying all of its constituent parts, executives can understand how the model fulfills a potent value proposition in a profitable way using certain key resources and key processes. With that understanding, they can then judge how well the same model could be used to fulfill a radically different CVP—and what they'd need to do to construct a new one, if need be, to capitalize on that opportunity.

Customer Value Proposition (CVP)

- **Target customer**
- **Job to be done** to solve an important problem or fulfill an important need for the target customer
- **Offering,** which satisfies the problem or fulfills the need. This is defined not only by what is sold but also by how it's sold.

PROFIT FORMULA

- **Revenue model** How much money can be made: price x volume. Volume can be thought of in terms of market size, purchase frequency, ancillary sales, etc.
- **Cost structure** How costs are allocated: includes cost of key assets, direct costs, indirect costs, economies of scale.
- **Margin model** How much each transaction should net to achieve desired profit levels.
- **Resource velocity** How quickly resources need to be used to support target volume. Includes lead times, throughput, inventory turns, asset utilization, and so on.

KEY RESOURCES needed to deliver the customer value proposition profitably. Might include:

- **People**
- **Technology, products**
- **Equipment**
- **Information**
- **Channels**
- **Partnerships, alliances**
- **Brand**

KEY PROCESSES, as well as rules, metrics, and norms, that make the profitable delivery of the customer value proposition repeatable and scalable. Might include:

- **Processes:** design, product development, sourcing, manufacturing, marketing, hiring and training, IT
- **Rules and metrics:** margin requirements for investment, credit terms, lead times, supplier terms
- **Norms:** opportunity size needed for investment, approach to customers and channels

Hilti Sidesteps Commoditization

HILTI IS CAPITALIZING ON a game-changing opportunity to increase profitability by turning products into a service. Rather than sell tools (at lower and lower prices), it's selling a "just-the-tool-you-need-when-you-need-it, no-repair-or-storage-hassles" service. Such a radical change in customer value proposition required a shift in all parts of its business model.

Traditional power tool company		Hilti's tool fleet management service
Sales of industrial and professional power tools and accessories	**Customer value proposition**	Leasing a comprehensive fleet of tools to increase contractors's on-site productivity
Low margins, high inventory turnover	**Profit formula**	Higher margins; asset heavy; monthly payments for tool maintenance, repair, and replacement
Distribution channel, low-cost manufacturing plants in developing countries, R&D	**Key resources and processes**	Strong direct-sales approach, contract management, IT systems for inventory management and repair, warehousing

Dow Corning Embraces the Low End

TRADITIONALLYHIGH-MARGIN DOW CORNING found new opportunities in low-margin offerings by setting up a separate business unit that operates in an entirely different way. By fundamentally differentiating its low-end and high-end offerings, the company avoided cannibalizing its traditional business even as it found new profits at the low end.

Established business		New business unit
Customized solutions, negotiated contracts	**Customer value proposition**	No frills, bulk prices, sold through the internet
High-margin, high-overhead retail prices pay for value-added services	**Profit formula**	Spot-market pricing, low overhead to accommodate lower margins, high throughput
R&D, sales, and services orientation	**Key resources and processes**	IT system, lowest-cost processes, maximum automation

A snapshot of blue ocean creation

This table identifies the strategic elements that were common to blue ocean creations in three different industries in different eras. It is not intended to be comprehensive in coverage or exhaustive in content. We chose to show American industries because they represented the largest and least-regulated market during our study period. The pattern of blue ocean creations exemplified by these three industries is consistent with what we observed in the other industries in our study.

Key blue ocean creations	Was the blue ocean created by a new entrant or an incumbent?	Was it driven by technology pioneering or value pioneering?	At the time of the blue ocean creation, was the industry attractive or unattractive?
Automobiles			
Ford Model T Unveiled in 1908, the Model T was the first mass-produced car, priced so that many Americans could afford it.	New entrant	Value pioneering* (mostly existing technologies)	Unattractive
GM's "car for every purse and purpose" GM created a blue ocean in 1924 by injecting fun and fashion into the car.	Incumbent	Value pioneering (some new technologies)	Attractive
Japanese fuel-efficient autos Japanese automakers created a blue ocean in the mid-1970s with small, reliable lines of cars.	Incumbent	Value pioneering (some new technologies)	Unattractive
Chrysler minivan With its 1984 minivan, Chrysler created a new class of automobile that was as easy to use as a car but had the passenger space of a van.	Incumbent	Value pioneering (mostly existing technologies)	Unattractive

Key blue ocean creations	Was the blue ocean created by a new entrant or an incumbent?	Was it driven by technology pioneering or value pioneering?	At the time of the blue ocean creation, was the industry attractive or unattractive?
Computers			
CTR's tabulating machine In 1914, CTR created the business machine industry by simplifying, modularizing, and leasing tabulating machines. CTR later changed its name to IBM.	Incumbent	Value pioneering (some new technologies)	Unattractive
IBM 650 electronic computer and System/360 In 1952, IBM created the business computer industry by simplifying and reducing the power and price of existing technology. And it exploded the blue ocean created by the 650 when in 1964 it unveiled the System/360, the first modularized computer system.	Incumbent	Value pioneering (650: mostly existing technologies) Value and technology pioneering (System/360: new and existing technologies)	Nonexistent
Apple personal computer Although it was not the first home computer, the all-in-one, simple-to-use Apple II was a blue ocean creation when it appeared in 1978.	New entrant	Value pioneering (mostly existing technologies)	Unattractive
Compaq PC servers Compaq created a blue ocean in 1992 with its ProSignia server, which gave buyers twice the file and print capability of the minicomputer at one-third the price.	Incumbent	Value pioneering (mostly existing technologies)	Nonexistent

(*continued*)

Key blue ocean creations	Was the blue ocean created by a new entrant or an incumbent?	Was it driven by technology pioneering or value pioneering?	At the time of the blue ocean creation, was the industry attractive or unattractive?
Dell built-to-order computers In the mid-1990s, Dell created a blue ocean in a highly competitive industry by creating a new purchase and delivery experience for buyers.	New entrant	Value pioneering (mostly existing technologies)	Unattractive
Movie theaters			
Nickelodeon The first Nickelodeon opened its doors in 1905, showing short films around-the-clock to working-class audiences for five cents.	New entrant	Value pioneering (mostly existing technologies)	Nonexistent
Palace theaters Created by Roxy Rothapfel in 1914, these theaters provided an operalike environment for cinema viewing at an affordable price.	Incumbent	Value pioneering (mostly existing technologies)	Attractive
AMC multiplex In the 1960s, the number of multiplexes in America's suburban shopping malls mushroomed. The multiplex gave viewers greater choice while reducing owners' costs.	Incumbent	Value pioneering (mostly existing technologies)	Unattractive
AMC megaplex Megaplexes, introduced in 1995, offered every current blockbuster and provided spectacular viewing experiences in theater complexes as big as stadiums, at a lower cost to theater owners.	Incumbent	Value pioneering (mostly existing technologies)	Unattractive

*Driven by value pioneering does not mean that technologies were not involved. Rather, it means that the defining technologies used had largely been in existence, whether in that industry or elsewhere.

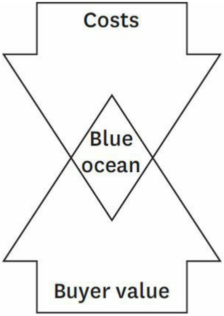
Red ocean versus blue ocean strategy

The imperatives for red ocean and blue ocean strategies are starkly different.

Red ocean strategy	Blue ocean strategy
Compete in existing market space.	Create uncontested market space.
Beat the competition.	Make the competition irrelevant.
Exploit existing demand.	Create and capture new demand.
Make the value/cost trade-off.	Break the value/cost trade-off.
Align the whole system of a company's activities with its strategic choice of differentiation *or* low cost.	Align the whole system of a company's activities in pursuit of differentiation *and* low cost.

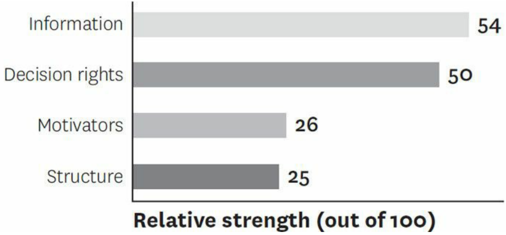
The simultaneous pursuit of differentiation and low cost

A blue ocean is created in the region where a company's actions favorably affect both its cost structure and its value proposition to buyers. Cost savings are made from eliminating and reducing the factors an industry competes on. Buyer value is lifted by raising and creating elements the industry has never offered. Over time, costs are reduced further as scale economies kick in, due to the high sales volumes that superior value generates.



What matters most to strategy execution

When a company fails to execute its strategy, the first thing managers often think to do is restructure. But our research shows that the fundamentals of good execution start with clarifying decision rights and making sure information flows where it needs to go. If you get those right, the correct structure and motivators often become obvious.


Information
54
Decision rights
50
Motivators
26
Structure
25
Relative strength (out of 100)

The 17 fundamental traits of organizational effectiveness

From our survey research drawn from more than 26,000 people in 31 companies, we have distilled the traits that make organizations effective at implementing strategy. Here they are, in order of importance.

Rank	Organization Trait	Strength Index (Out of 100)
1	Everyone has a good idea of the decisions and actions for which he or she is responsible.	81
2	Important information about the competitive environment gets to headquarters quickly.	68
3	Once made, decisions are rarely second-guessed.	58
4	Information flows freely across organizational boundaries.	58
5	Field and line employees usually have the information they need to understand the bottom-line impact of their day-to-day choices.	55
6	Line managers have access to the metrics they need to measure the key drivers of their business.	48
7	Managers up the line get involved in operating decisions.	32
8	Conflicting messages are rarely sent to the market.	32
9	The individual performance-appraisal process differentiates among high, adequate, and low performers.	32
10	The ability to deliver on performance commitments strongly influences career advancement and compensation.	32
11	It is more accurate to describe the culture of this organization as "persuade and cajole" than "command and control."	29
12	The primary role of corporate staff here is to support the business units rather than to audit them.	29
13	Promotions can be lateral moves (from one position to another on the same level in the hierarchy).	29
14	Fast-track employees here can expect promotions more frequently than every three years.	23
15	On average, middle managers here have five or more direct reports.	19
16	If the firm has a bad year, but a particular division has a good year, the division head would still get a bonus.	13
17	Besides pay, many other things motivate individuals to do a good job.	10

Building Blocks Decision rights Information Motivators Structure

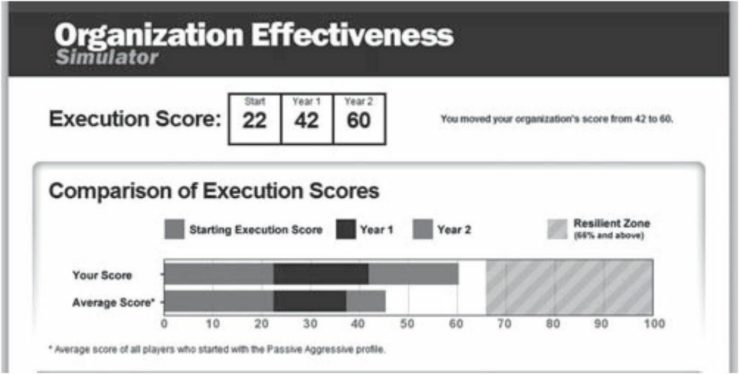
Within 18 months, the company was working in the new model. “This was a revolution that became a renaissance,” Owens recalls, “a spectacular transformation of a kind of sluggish company into one that actually has entrepreneurial zeal. And that transition was very quick because it was decisive and it was complete; it was thorough; it was universal, worldwide, all at one time.”

Mapping improvements to the building blocks: some sample tactics

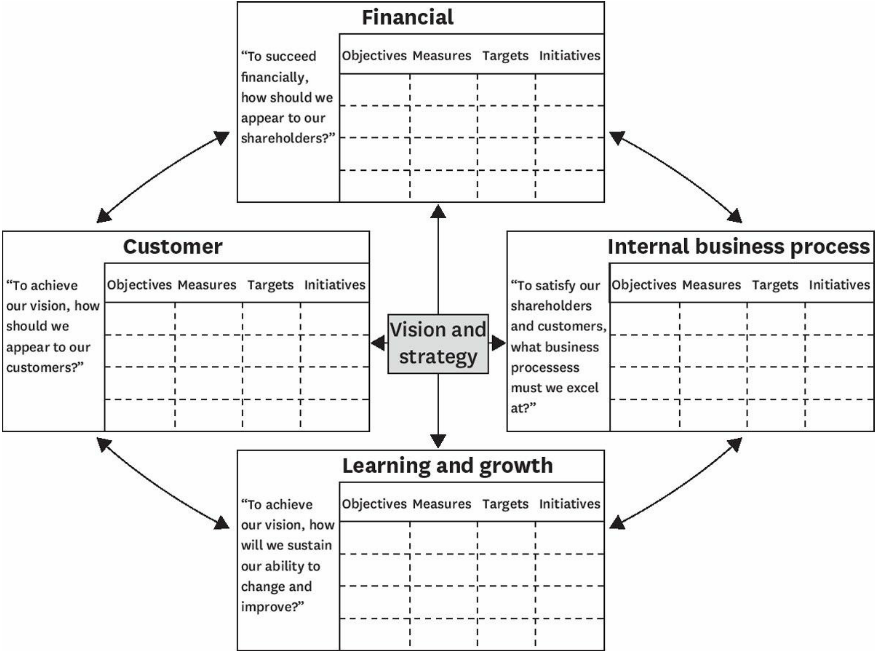
Companies can take a host of steps to improve their ability to execute strategy. The 15 here are only some of the possible examples. Every one strengthens one or more of the building blocks executives can use to improve their strategy-execution capability: clarifying decision rights, improving information, establishing the right motivators, and restructuring the organization.

- Focus corporate staff on supporting business-unit decision making.
- Clarify and streamline decision making at each operating level.
- Focus headquarters on important strategic questions.
- Create centers of excellence by consolidating similar functions into a single organizational unit.
- Assign process owners to coordinate activities that span organizational functions.
- Establish individual performance measures.
- Improve field-to-headquarters information flow.
- Define and distribute daily operating metrics to the field or line.
- Create cross-functional teams.
- Introduce differentiating performance awards.
- Expand nonmonetary rewards to recognize exceptional performers.
- Increase position tenure.
- Institute lateral moves and rotations.
- Broaden spans of control.

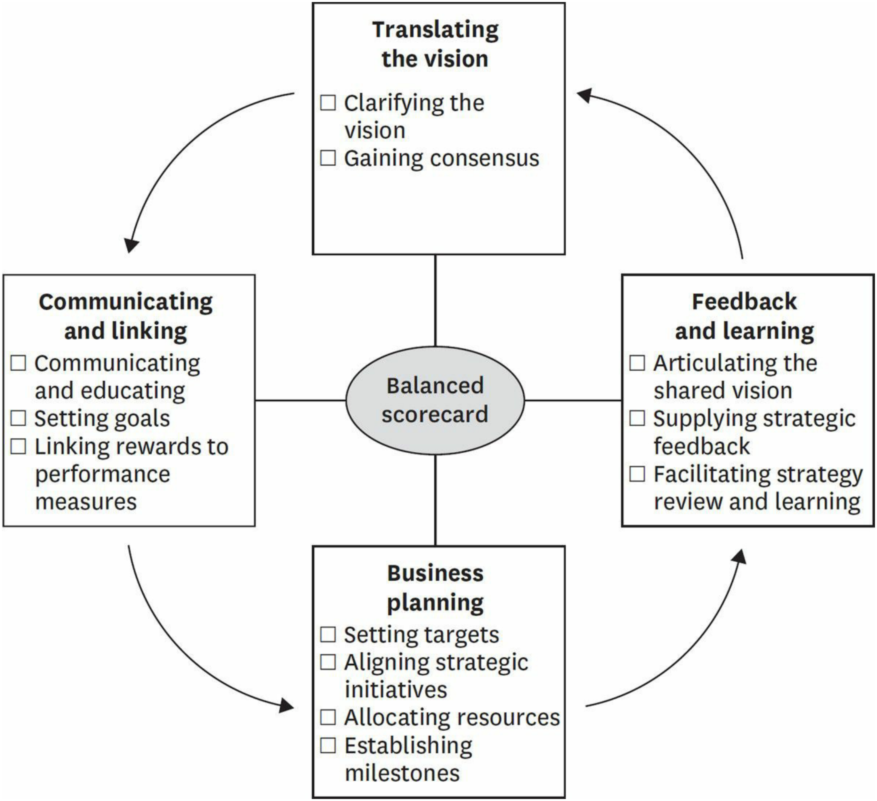
Building blocks Decision rights Information Motivators Structure


Organization Effectiveness
Simulator
Execution Score:
Start
22
Year 1
42
Year 2
60
You moved your organization's score from 42 to 60.
Comparison of Execution Scores
Starting Execution Score
Year 1
Year 2
Resilient Zone
(66% and above)
Your Score
Average Score*
0
10
20
30
40
50
60
70
80
90
100
* Average score of all players who started with the Passive Aggressive profile.

Translation vision and strategy: four perspectives


Financial
"To succeed financially, how should we appear to our shareholders?"
Objectives Measures Targets Initiatives
Customer
"To achieve our vision, how should we appear to our customers?"
Objectives Measures Targets Initiatives
Vision and strategy
Internal business process
"To satisfy our shareholders and customers, what business processess must we excel at?"
Objectives Measures Targets Initiatives
Learning and growth
"To achieve our vision, how will we sustain our ability to change and improve?"
Objectives Measures Targets Initiatives

Managing strategy: four processes


Translating the vision
Clarifying the vision
Gaining consensus
Communicating and linking
Communicating and educating
Setting goals
Linking rewards to performance measures
Balanced scorecard
Feedback and learning
Articulating the shared vision
Supplying strategic feedback
Facilitating strategy review and learning
Business planning
Setting targets
Aligning strategic initiatives
Allocating resources
Establishing milestones

How one company built a strategic management system . . .

2A *Communicate to middle managers*. The top three layers of management (100 people) are brought together to learn about and discuss the new strategy. The balanced scorecard is the communication vehicle. *(months 4–5)*

2B *Develop business unit scorecards*. Using the corporate scorecard as a template, each business unit translates its strategy into its own scorecard. *(months 6–9)*

5 *Refine the vision*. The review of business unit scorecards identifies several cross-business issues not initially included in the corporate strategy. The corporate scorecard is updated. *(month 12)*

Time frame *(in months)*

0	1	2	3	4	5	6	7	8	9	10	11	12

Actions:

1 *Clarify the vision*. Ten members of a newly formed executive team work together for three months. A balanced scorecard is developed to translate a generic vision into a strategy that is understood and can be communicated. The process helps build consensus and commitment to the strategy.

3A *Eliminate nonstrategic investments*. The corporate scorecard, by clarifying strategic priorities, identifies many active programs that are not contributing to the strategy. *(month 6)*

3B *Launch corporate change programs*. The corporate scorecard identifies the need for cross-business change programs. They are launched while the business units prepare their scorecards. *(month 6)*

4 *Review business unit scorecards*. The CEO and the executive team review the individual business units' scorecards. The review permits the CEO to participate knowledgeably in shaping business unit strategy. *(months 9–11)*

7 *Update long-range plan and budget*. Five-year goals are established for each measure. The investments required to meet those goals are identified and funded. The first year of the five-year plan becomes the annual budget. *(months 15–17)*

9 *Conduct annual strategy review*. At the start of the third year, the initial strategy has been achieved and the corporate strategy requires updating. The executive committee lists ten strategic issues. Each business unit is asked to develop a position on each issue as a prelude to updating its strategy and scorecard. *(months 25–26)*

13	14	15	16	17	18	19	20	21	22	23	24	25	26

6A *Communicate the balanced scorecard to the entire company*. At the end of one year, when the management teams are comfortable with the strategic approach, the scorecard is disseminated to the entire organization. *(month 12–ongoing)*

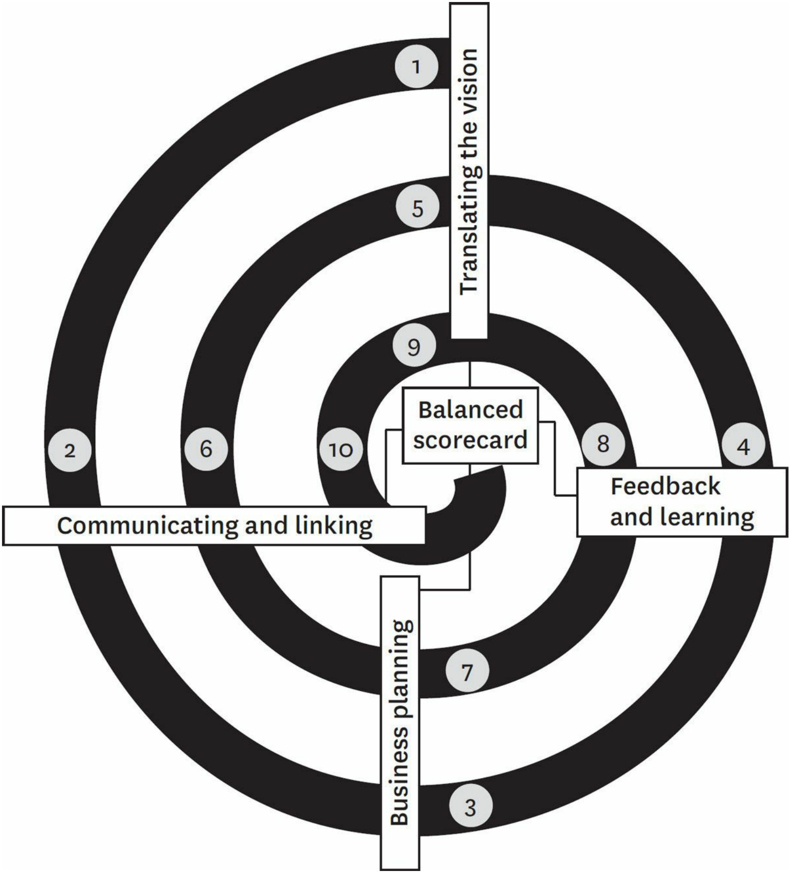
6B *Establish individual performance objectives*. The top three layers of management link their individual objectives and incentive compensation to their scorecards. *(months 13–14)*

8 *Conduct monthly and quarterly reviews*. After corporate approval of the business unit scorecards, a monthly review process, supplemented by quarterly reviews that focus more heavily on strategic issues, begins. *(month 18–ongoing)*

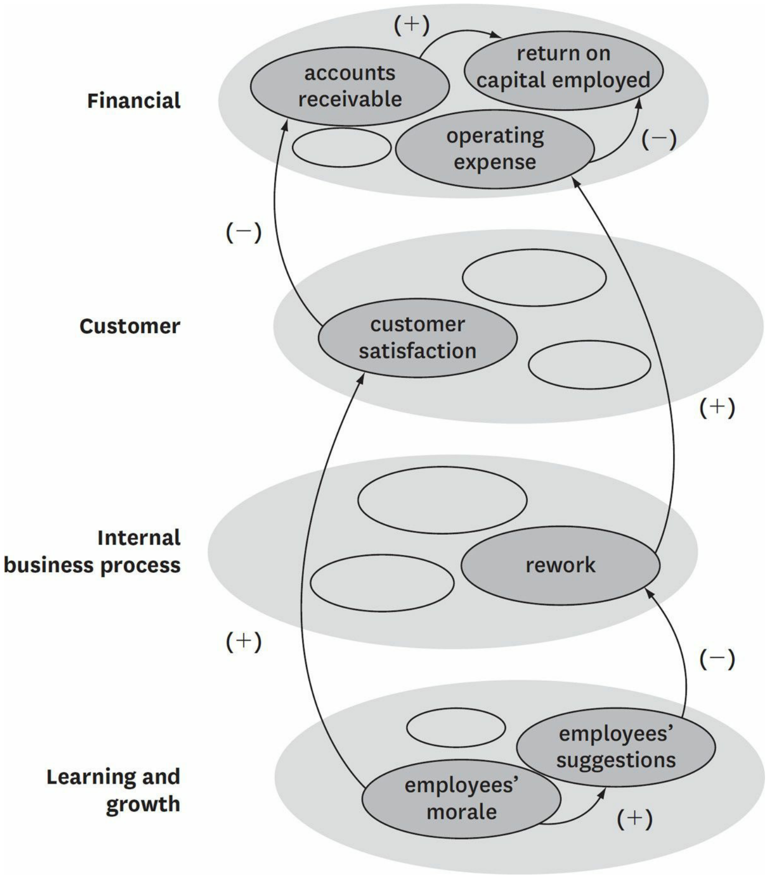
10 *Link everyone's performance to the balanced scorecard*. All employees are asked to link their individual objectives to the balanced scorecard. The entire organization's incentive compensation is linked to the scorecard. *(months 25–26)*

Note: Steps 7, 8, 9, and 10 are performed on a regular schedule. The balanced scorecard is now a routine part of the management process.

. . . around the balanced scorecard


Translating the vision
Balanced scorecard
Communicating and linking
Feedback and learning
Business planning
1
2
3
4
5
6
7
8
9
10

How one company linked measures from the four perspectives



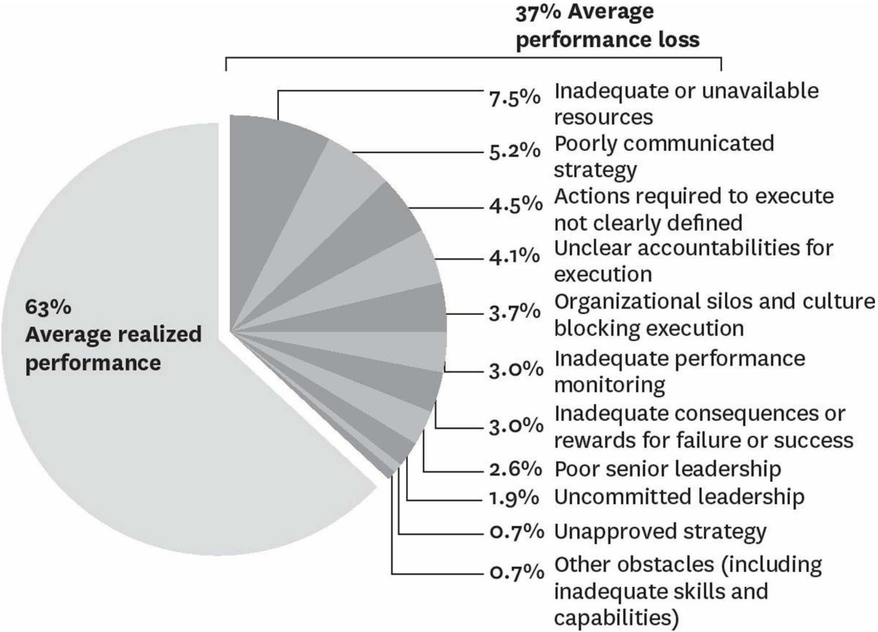
It's all in a phrase

A handful of companies have distilled their strategy into a phrase and have used it to drive consistent strategic action throughout their organizations.

Company	Strategic Principle
America Online	*Consumer connectivity first—anytime, anywhere*
Dell	*Be direct*
eBay	*Focus on trading communities*
General Electric	*Be number one or number two in every industry in which we compete, or get out*
Southwest Airlines	*Meet customers' short-haul travel needs at fares competitive with the cost of automobile travel*
Vanguard	*Unmatchable value for the investor-owner*
Wal-Mart	*Low prices, every day*

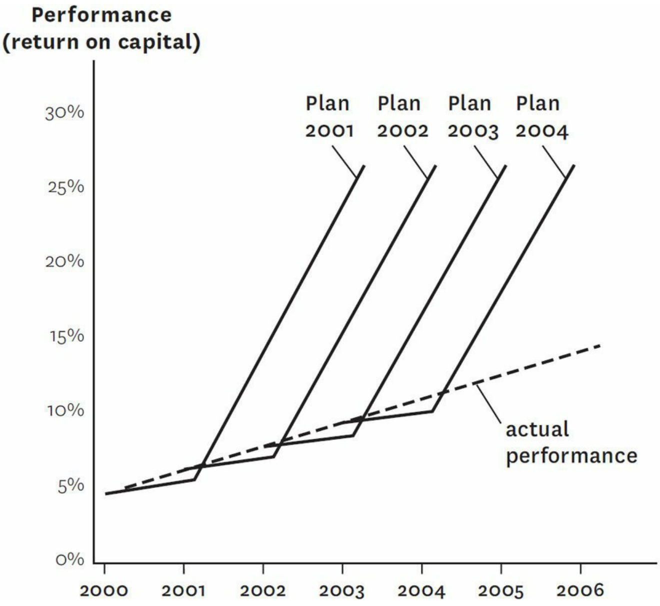
Where the performance goes

This chart shows the average performance loss implied by the importance ratings that managers in our survey gave to specific breakdowns in the planning and execution process.


37% Average performance loss
7.5% Inadequate or unavailable resources
5.2% Poorly communicated strategy
4.5% Actions required to execute not clearly defined
4.1% Unclear accountabilities for execution
3.7% Organizational silos and culture blocking execution
3.0% Inadequate performance monitoring
3.0% Inadequate consequences or rewards for failure or success
2.6% Poor senior leadership
1.9% Uncommitted leadership
0.7% Unapproved strategy
0.7% Other obstacles (including inadequate skills and capabilities)
63% Average realized performance

The venetian blinds of business

This figure illustrates a dynamic common to many companies. In January 2001, management approves a strategic plan (Plan 2001) that projects modest performance for the first year and a high rate of performance thereafter, as shown in the first solid line. For beating the first year's projection, the unit management is both commended and handsomely rewarded. A new plan is then prepared, projecting uninspiring results for the first year and once again promising a fast rate of performance improvement thereafter, as shown by the second solid line (Plan 2002). This, too, succeeds only partially, so another plan is drawn up, and so on. The actual rate of performance improvement can be seen by joining the start points of each plan (the dotted line).


Performance
(return on capital)
30%
25%
20%
15%
10%
5%
0%
Plan
2001
Plan
2002
Plan
2003
Plan
2004
actual
performance
2000
2001
2002
2003
2004
2005
2006