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Palladium BALANCED SCORECARD COLLABORATIVE

Balanced Scorecard REPORT

THE STRATEGY EXECUTION SOURCE

ON BALANCE

Special Book Preview

Part II of a two-part series on strategy development, excerpted from Kaplan and Norton's forthcoming book, *The Execution Premium,* due out this June.

Formulating (and Revising) the Strategy

By Robert S. Kaplan and David P. Norton, with Edward A. Barrows Jr.

In Part I, Kaplan and Norton described the first set of steps in strategy development: crafting a mission, vision, and value statements; identifying strategic goals and critical issues; quantifying value gaps; and performing a battery of strategic analyses to define environmental factors, opportunities, and threats. Once completed, the organization reaches a new juncture: where the formal discipline of strategy development intersects with the art of strategy formulation.

The literature on strategy development and formulation can be overwhelming, with its many approaches and different schools of thought. Some of the more prominent approaches include positioning (or "competitive advantage," credited to Michael Porter), the resource-based view, core competencies, value-based management, profiting from the core, blue ocean strategy, emergent strategy, experience co-creation, and disruptive innovation. Complementing these strategic approaches are such operational improvement methodologies as total quality management, Six Sigma, ISO standards, lean manufacturing, and the learning organization. Supplementing both strategic and operational approaches are methodologies designed to minimize risk, including enterprise risk management, COSO (for financial institutions),[1] and internal controls such as those required by Section 404 of the Sarbanes-Oxley Act.

Our work on strategy execution is agnostic with respect to approaches, methodologies, and tools. We have seen many companies use different ones effectively to formulate their strategies. And whatever strategic, operational, and risk management priorities a company establishes during the strategy formulation process, any of them can be translated into a strategy map and made operational through a Balanced Scorecard.

In fact, *Figure 1* shows how many of these strategic, operational, and risk management approaches can be visualized on a strategy map. Starting at the top, most organizations will have some form of financial-portfolio approach to frame their corporate strategy. Portfolios profile the financial characteristics of each business unit to achieve the desired balance of growth, cash flow, and risk. Value-based management approaches, such as economic value added, focus intensively on selecting objectives consistent with long-term shareholder value creation. Enterprise risk management, including COSO and internal controls, focuses on reducing the financial, operating, technological, and market risks that can impair a company's ability to execute its strategy. Typically, however, these financial-strategy and risk-management approaches do not account for customer value propositions, key business processes, or an investment in the intangible assets that are critical for sustained value creation.

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Leveraging Information Assets to Execute Strategy

When it comes to adding technology to support management processes, decision makers often overlook the most critical question: how prepared is the organization to implement the new solution? A mismatch between process maturity and technology maturity means the technology, no matter how robust, won't deliver. This article offers preliminary insights on an important study under way by Palladium Group and Microsoft with an ultimate goal of helping organizations evaluate how they leverage information assets to execute strategy.

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Moving from Performance Measurement to Strategy Management at Brigham and Women's/Faulkner Hospitals

Radical changes in its performance measurement approach and systems helped one of the world's most prestigious medical centers (and a 2006 BSC Hall of Fame winner) achieve ambitious service and financial goals. Its president and CEO recounts the transformation.

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Strategy or Stakeholders: Which Comes First?

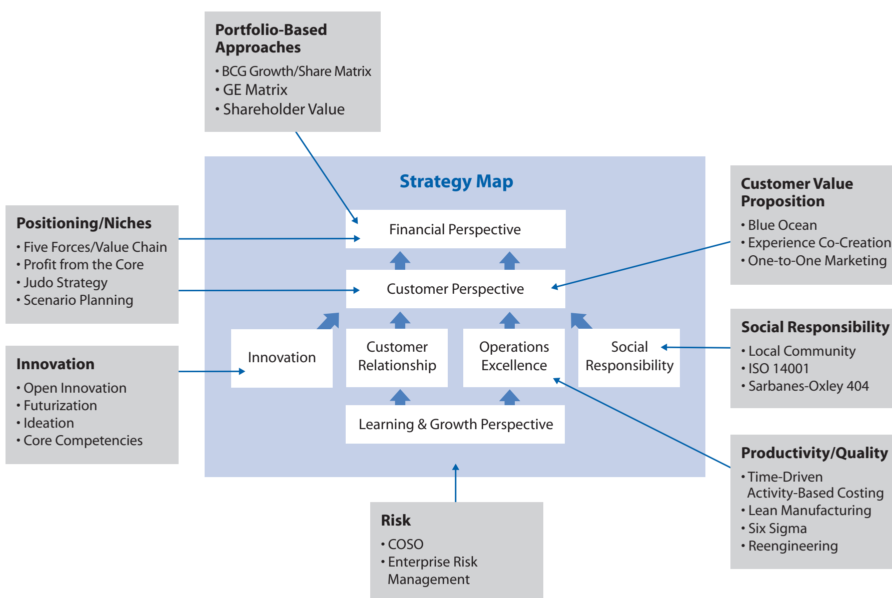
Stakeholder theory is no way to build strategy, argues Robert Kaplan. This theory, bolstered by the corporate social responsibility movement, puts stakeholder considerations first, as a foundation for strategy. Clearly, an organization's stakeholders may have conflicting interests, and some of those interests may also conflict with sound business management. As Kaplan notes, the interests of stakeholders who are strategically relevant are already accounted for in the strategy map. Strategy, he insists, must precede stakeholders, for philosophical as well as practical reasons.

Stimulating Creative Strategies

The most well-known strategy formulation approaches focus on customers. Porter's competitive advantage framework emphasizes zeroing in on market and customer segments and deciding whether to win in the chosen segment using either a low-cost or differentiated strategy. *Profit from the Core* author and consultant Chris Zook argues that most successful companies build their business around core market niches in which they have expertise, credibility, and deep knowledge about customer preferences. He observes how organizations like Gartner and Bausch & Lomb performed poorly after diluting their focus by entering new niches, and subsequently regained their success only after returning to their original niches. Kim and Mauborgne's blue ocean approach involves developing creative and sustainable new competitive positioning for a large customer base. Southwest Airlines, for example, created a new market segment by combining the low prices and on-time departures that had led people to use buses for intercity travel with the speed of airlines. Southwest's targeted customer base of price-sensitive travelers tolerates the lack of reserved seating, long queues to board planes, and absence of first-class options in return for low prices, convenient flights, and on-time arrivals. Through this innovative offering, the company changed the dynamics of its industry.

Experience co-creation, developed by Prahalad and Ramaswany, also focuses on the customer value proposition, but with a twist: companies develop the value proposition jointly with their customers. John Deere Company's Deer Trax system allows farmers to monitor the operation of their fleet of tractors and other vehicles. It also brings farmers together into various thematic communities to share knowledge and exchange experiences. Deere's product/service design is "co-created" with the customer, putting the farmer at the center of the process.

Figure 1. Leading Methodologies Used in Strategy Formulation



Most strategy formulation approaches focus on a particular performance dimension (e.g., financial, customer, internal process), as this strategy map representation shows. And the majority of approaches focus on customers.

Balanced Scorecard Report

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Yet another school of thought views strategy as a dynamic, competitive process. Scenario planning, first developed at Shell, is a widely used approach in which the organization creates responses to competitive and environmental developments. Companies such as LG.Philips LCD use "war game" simulations to identify likely competitor reactions to various strategies that they might introduce.

Whatever the methodology used, the outcome of any strategy formulation approach is to develop a direction that differentiates the company's market position and offering from its competitors so that it can create a sustainable competitive advantage that leads to superior financial performance (or, for nonprofits, demonstrably positive social impacts). The "creativity" of the strategy, then, becomes an important means to this end. Those involved in strategic planning can draw from the toolbox of methodologies illustrated in Figure 1 to develop their differentiating strategy. As executives become more knowledgeable about the range of strategy formulation tools available, they can use the approach that seems most appropriate to their company's circumstances, culture, and competencies.

The strategy map framework shown in Figure 1 may help guide the choice. If, for example, the company has low capital utilization, then a value-based management approach would help define a financial strategy. If the company lacks a distinctive brand or market presence, an approach that helps identify an attractive customer segment, such as positioning, the blue ocean approach, or experience co-creation, might prove most helpful. If the company has distinctive capabilities in important business processes—operations management, customer data mining, or innovation—that competitors lack, then the resource-based view and core competency approaches are effective. If the company has exceptional human capital, with skilled, experienced, and highly motivated employees, then creating a learning organization and encouraging employees to propose emergent strategies are useful ways to identify promising new strategies.

Launching the Strategy Formulation Process

Most organizations already have a strategy, which they typically review and fine-tune each year at a leadership offsite meeting. Ricoh Americas, for example, uses a systematic process for its annual strategy reviews. It conducts a major refresh of its strategy, called the Mid-Term Plan (MTP), every three years. In the two "off years," the strategy review is done for course correction—fine-tuning and executing the formulated strategy—not for determining new strategic direction.

Ricoh launched its 14th MTP in 2001, which called for developing a profitable new business and assimilating two major acquisitions. Chairman and CEO Kirk Yoshida emphasized the development of a new organizational culture. "We are creating a culture in our organization that is strategy-focused and aligns financial plans and compensation to the achievement of the strategy," he said in an internal company newsletter. "We are making strategy everyone's job." In 2004, the company's new chairman and CEO, Sam Ichioka, launched the 15th MTP. While reaffirming the foundations of the company's existing mission, vision, and values, the new MTP shifted the organization's focus to higher levels of growth. Executives updated the vision to "Becoming America's #1 document solutions company," which led to a stretch target for growth and its decomposition into four strategic themes, a process we described in Part I.

The fine-tuning Ricoh carries out in the two off years would be typical for companies that are delivering expected performance, not those experiencing major external or internal changes. Organizations tend to fine-tune the existing strategy until some trigger event causes them to search for a new strategy. Incremental changes in their strategy might be introduced, but the primary purpose of the annual review process is to reaffirm the established strategic direction—in other words, to execute, not develop, the strategy—communicate it to all employees, and align them to it.

Undertaking Transformational Strategies

But any strategy, good or bad, eventually runs its course. A company's competitors observe its successful strategy and eventually adapt to counter the advantages created by the first mover. Competitors' moves typically take three or more years to begin to affect a company's performance.

Our tentative conclusion from surveying dozens of companies is that the useful life of a new strategy is generally three to five years. During this time, incremental changes are usually sufficient (assuming the existing one is delivering successful performance). Only when the strategy has run its course or begins to fail, or the company experiences a major disruptive event, does it consider a new, transformational strategy. In other words, organizations require some kind of "trigger event" to initiate the search for a new and transformational strategy.

At HSBC Rail, a unit within the global financial services firm HSBC Corporation, CEO Peter Aldridge proactively launched a major strategy review amid the company's excellent financial performance. Aldridge could see

storm clouds approaching from different directions: parent HSBC Corporation was demanding major improvements in capital utilization from its units; the UK Department of Transportation, a key HSBC Rail stakeholder, sought to greatly reduce the subsidy the state would provide to HSBC's principal customers, the deregulated rail operating companies; and industry trends, such as the growth in passenger and freight traffic and environmental and climate concerns, threatened HSBC's existing strategy. Rather than wait for the storm to hit, Aldridge took action. He launched a series of 10 workshops with middle and senior managers to prepare for a new strategy that would be more suitable for the new circumstances he anticipated. The workshops helped managers understand—and accept—the mission, vision, and values of the organization. The consensus the workshops achieved set the stage for formulating a new strategy and making it actionable through a strategy map and Balanced Scorecard.

Triggers

One common trigger is the burning platform of a failed strategy. We observed this happening in the 1990s when several companies adopted the Balanced Scorecard to help them implement a radically different strategy after experiencing financial distress. CIGNA Property and Casualty had the largest losses in the industry, including a combined ratio (expenses to premiums) of 140; Mobil U.S. Marketing and Refining, with a $500 million negative cash flow year, was the most unprofitable company in its industry; and AT&T Canada lost Can$ 350 million in one year. Under the pressure of a burning platform, an organization is highly motivated to seek a new strategy rather than continue to be immolated by a failed one.

Another typical trigger for undertaking a transformational strategy is the appointment of a new leader, especially one from outside the organization. Clearly, new leaders are frequently brought in specifically to deal with a burning platform, but leadership change is common for many other reasons. In governmental organizations, leadership tenure is linked to the election cycle. Military appointments tend to be for three or four years. New leaders generally initiate a comprehensive review and sweeping analysis of the existing strategy, which often prompts a strategy overhaul.

Technological change can also be a trigger, as many retail and financial institutions learned in the 1990s with the emergence of the Internet as a powerful new sales channel. Then, many companies talked about being "Amazon'd." Wells Fargo saw the Internet as a catalyst for shifting its strategy from productivity enhancements and cost reduction in its traditional brick-and-mortar retail outlets to revenue growth and customer relationships cultivated through online banking.

The external trigger could be macroeconomic, such as a major increase in an input price (e.g., energy) or a foreign exchange revaluation. It could be a change in regulation, such as when new competition is allowed to enter a company's existing market, or when a company is allowed to enter new markets and business segments that were previously proscribed. The trigger could also be a radical, unexpected move by an existing or new competitor, or a major unexpected event. Consider what the 9/11 terrorist attacks represented for the U.S. Federal Bureau of Investigation (FBI). The agency's new leaders quickly saw the need for a completely new strategy—and for major changes in the organizational culture if the new strategy were to be successfully implemented. FBI Director Robert Mueller knew he would need to prepare all employees for the massive changes ahead. He relied on a widely used tool, the "from-

Figure 2. The FBI's "From-To" Chart

PAST	FUTURE
Domestic	Global
Law enforcement	National security and law enforcement
Case-driven	Threat-driven
Quantitative evaluation (case-based)	Qualitative evaluation (threat-based)
Contributor	Full partner
Tactical	Strategic
"Restrict; share what you must"	"Share; restrict what you must"
Ineffective communications	Effective, relevant, and timely communications
Operational silos	Integrated team approach
Ineffective and inefficient HR processes	Highly effective and efficient HR processes
Agents/support	Team of professionals
Antiquated and disparate IT systems	Mission-enhancing integrated IT systems; productivity tools
Applying developed S&T	Developing and applying optimal S&T
Budget drives strategy	Strategy drives budget

This widely used tool helps leaders communicate the desired future state of their organization to the entire workforce.

to" chart, to describe the scale and scope of the transformation (see *Figure 2*).

The senior management team develops the "from" in the "from-to" chart by examining the state of the enterprise today, especially the weaknesses exposed by a prior SWOT (strengths, weaknesses, opportunities, and threats) analysis. It then forecasts where the enterprise needs to be (the "to") to carry out its future mission, informed by the threats and opportunities identified in the SWOT analysis. For example, Figure 2 shows that the FBI had to change from being a case-driven organization—one that reacts to crimes already committed—to becoming a threat-driven organization, one that attempts to prevent incidents such as terrorist attacks from occurring. Instead of being siloed and secretive, the FBI had to learn to share information and work collaboratively with other agencies to prevent incidents that could harm U.S. citizens. Internally, agents had to work outside of their traditional operational silos and become active participants in integrated teams. These guidelines, which emerged from extensive dialogue conducted throughout the organization, engaged all levels of the FBI to participate in setting goals for the new strategic direction, and contributed to a widespread understanding and support for the new strategy that would emerge.

In summary, companies can introduce a new transformational strategy either on a regularly scheduled basis, as done by Ricoh every three years, or when the executive team recognizes that its existing strategy has run its course and a new approach is needed. For example, Andy Grove triggered Intel's transformational strategy shift in the 1980s from producing memory chips to making microprocessors when he asked his management team, "If we were starting the company today, would we be building capacity to produce commodity memory chips?" At organizations that don't overhaul strategy according to a schedule, it's essential that the tools and processes used to monitor the internal and external environment are reliable.

A company we'll call Horizon Real Estate learned this the hard way. Its strategy had been in place for five years. In each of the preceding four years, Horizon's annual review resulted in minor changes to the existing strategy, which seemed to be working fine. But in year five, performance dipped and the executive team realized that its existing strategy needed rethinking. In advance of the next annual strategy meeting, managers made a major investment in time and analysis to understand the new competitive environment. This set the stage for a new and transformative strategy to be developed at the meeting. On one hand, the annual update process had worked, with a new strategy introduced to offset the decline in performance that surfaced the previous year. But as one senior officer stated, "I'm not happy with the planning process that we used a year ago. If we had done a better job with our environmental scan and been more disciplined in analyzing the data we had on hand at the prior annual strategy update meeting, we could have seen the problems coming a year earlier and dramatically improved our reaction time. The value of moving a year earlier in our business is enormous!"[2]

Refreshing via Strategic Theme

Fine-tuning the existing strategy or overhauling it are not the only possibilities for strategic change. A strategy, after all, usually consists of several coexistent strategic themes. One theme may require dramatic revision while others require little or no change. For example, Chase Bank, while assimilating major acquisitions in the 1990s, learned that its stated goal of "100% customer retention" was misguided; many customers, especially those with low asset balances, were unprofitable. So Chase changed the goal of its customer relationship strategic theme to "retaining assets" rather than "retaining customers," striving to keep only profitable customers. Its strategic themes for corporate branding, operational excellence, and developing employee capabilities remained unchanged.

There are many schools of thought and methodologies for strategy formulation. Whichever one an organization chooses, it should serve to create a strategic direction that will differentiate the organization in its market. The strategy map framework, which decomposes performance into perspectives and identifies strategic themes, can help an organization choose an approach or approaches that are most relevant to its goals, value gaps, or capabilities.

Through regular strategy reviews, an organization can fine-tune its strategy, making incremental changes, and transform it when the strategy is either no longer relevant—or is failing outright. Whether major overhauls are performed on a regular schedule or on an as-needed basis, it's critical that executives rely on the most accurate analytic tools and data available so they respond in a timely way to the triggers that warrant transformational change. ■

Authors' note: We would like to recognize the important efforts of Ed Barrows in developing this work.

1. COSO, the Committee of Sponsoring Organizations of the Treadway Commission, was established by five accounting and finance professional associations to create standards for internal controls.

2. Comments made at Palladium Group's March 2007 conference, "Putting Your People Where Your Strategy Is: Creating a High-Performance Organization."

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