HARVARD | BUSINESS | SCHOOL
WORKING KNOWLEDGE
FOR BUSINESS LEADERS

The Execution Premium: Linking Strategy to Operations for Competitive Advantage

Q&A with HBS professor Robert S. Kaplan

by Martha Lagace

Companies often manage strategy in fits and starts. Though executives may formulate an excellent strategy, it easily fades from memory as the organization tackles day-to-day operations issues, doing what HBS professor Robert S. Kaplan calls "fighting fires."

A new book due in August by Kaplan and David P. Norton aims to make strategy a continual process. *The Execution Premium: Linking Strategy to Operations for Competitive Advantage* (HBS Press) shows managers how to weave organizational principles into a more effective management system that respects the differences between strategy and operations yet integrates them in a powerful way. Kaplan and Norton introduced the Balanced Scorecard, a performance measurement system, in 1992. *The Execution Premium* is their fifth book as coauthors.

Kaplan recently explained the ideas behind *The Execution Premium* and how they bridge the common divide between strategy and operations.

Q: What particular issues around execution need to be better addressed in business?

A: There are two key issues. First is leadership. Without strong visionary leadership, strategy will not be executed effectively.

The second key issue is to recognize that strategy and operations (or tactics) are both important but different. The normal course of events is for companies to focus on day-to-day operations and short-term problem solving. Management meetings focus on fighting fires and fixing problems. Often little time and few resources are committed to strategic issues.

We don’t advocate abandoning an intense focus on operations and their improvement. But we do advocate that planning strategy, not just describing it, is important. The senior management team needs to have regular, probably monthly, meetings that focus only on strategy. We describe in the book the different roles, frequencies, participants, and agendas for operational review meetings and strategy review meetings.

We open the book with a great quote often but perhaps inaccuratelyattributed to Sun Tzu in *The Art of War*: “Strategy without tactics is the long road to victory; tactics without strategy is the noise before defeat.” This quote highlights the importance of integrating strategy and operations, a central theme in our strategy execution system.

Q: What are typical challenges and pitfalls when linking strategy with operations? Why is a formal strategy execution system valuable?

A: One challenge or pitfall is that few companies align their operational improvement activities to strategic priorities.

Many companies today are practicing Total Quality Management, Six Sigma, or other continuous improvement activities. But these are done across the organization with no sense of priorities or impact from process improvements. Consequently, much effort does not show up in tangible results.

Companies need a formal process for using strategic objectives to set priorities for where operational improvements can have the largest impact on strategy execution. We note that quality and process improvement programs are like teaching people *how* to fish. Strategy maps and scorecards teach people *where* to fish.

Another pitfall occurs when budgeting and financial planning are done separately from strategic planning. We advocate that the operational plan and budget be driven from the revenue targets in the strategic plan. In *The Execution Premium*, we describe how a time-driven activity-based cost model provides the previously missing link between the revenue growth targets in a strategic plan and the authorization for spending to supply the quantities of resource capacity that are necessary to fulfill the sales and production needs of the strategic plan. Without this coupling, operational plans either provide too little or too much capacity for the strategic plan.

A third challenge is that most management meetings get consumed with discussions about short-term operational and tactical issues. It is important to meet to discuss and solve operational problems. But companies err when they devote all their time together for fire-fighting and coping with near-term issues. The formal strategy execution system schedules strategy review meetings at a different time from operational review meetings. In that way, each meeting has its own frequency, agenda, information system, and participation, as best meets the goals for that meeting.

Q: Given the proliferation of tools, how should management choose the right one to formulate strategy and improve operations?

A: We don't have a preferred position on strategy formulation methodologies. We have seen each approach lead to success in different circumstances. If, for example, the company has low capital utilization, then some use of a value-based management approach would help to define a financial strategy. If the company does not have a distinctive brand or market presence, a focus on identifying an attractive customer segment, such as through Harvard University professor Michael Porter's positioning framework, W. Chan Kim and Renee Mauborgne's Blue Ocean approach, or C. K. Prahalad and V. Ramaswany's customer co-creation process might prove most relevant.

If the company has distinctive capabilities in important business processes--operations management, customer data mining, or product features and innovation--that are superior to or not possessed by competitors, then the resource-based view and identification of core competencies are effective frameworks for strategy formulation. If the company has a great human capital base, with skilled, experienced, and highly motivated employees, then striving to create a learning organization and encouraging emergent strategies to be proposed can identify promising new strategic approaches.

While we are agnostic with respect to which strategy methodology a company uses to arrive at its strategy, we do believe that creating a strategy map and scorecard for that strategy is the logical and proven next step for putting the strategy into action. That is why we have placed strategy analysis and formulation as Stage 1 of our management system, with planning and translating the strategy as Stage 2.

We take the same position with the various operational improvement methodologies. We don't want to be caught debating the relative merits and shortcomings of TQM, Six Sigma, lean management, and reengineering. We do believe, however, that these methodologies are most effectively applied to the strategic processes identified in a company's strategy map and scorecard. That is why we place planning operations in Stage 4 of the management system, downstream from the Stage 2 processes of translating and planning the strategy.

You can't focus on the critical processes for improvement until they have been identified in the strategic planning and translation stage.

Q: What is an Office of Strategy Management, and why is it necessary in a company?

A: The OSM is analogous to a military general's chief of staff. The general is responsible and accountable for developing the strategy to win wars and battles. But a general almost always has a chief-of-staff, often several ranks junior, who leverages the general's time and attention. The chief-of-staff does not create strategy or operational tactics and has no authority or accountability for its execution. A chief-of-staff schedules the general's meetings, ensures that the appropriate people show up at the meeting, attends and takes notes at the meeting, and follows up after the meeting to ensure that the actions decided upon are carried out. The chief-of-staff leverages the general's time by making sure that all the information, people, and follow-up are in place for the general's strategy and tactics to be effectively executed. We recommend that a similar, but expanded, set of tasks be carried out by a small cadre of professionals to orchestrate the various strategy management processes for the executive team.

The Office of Strategy Management has multiple roles and responsibilities. First, as an architect, the OSM designs and embeds any missing strategy and operational management processes into the six-stage strategy execution system. The OSM ensures that all the planning, execution, and feedback processes are in place, and that they are linked together in a closed loop system.

The OSM also serves as the process owner for several strategy and operational management processes, such as those to develop the strategy, translate the strategy, and orchestrate the senior management strategy review meetings. Many of these processes are new to the organization. Since they cross existing business and functional organizational lines, it is natural for the OSM to be their owner. Assigning responsibilities for their execution to the OSM fills a gap in management practice without infringing on the current responsibilities of any existing department or function.

Finally, the OSM is the integrator of many existing activities. This aspect is challenging because organizational and functional units already have primary responsibility for processes such as budgeting, communications, human resources planning and performance management, IT planning, initiative management, and best practice sharing. The OSM must work with the existing owners of these processes to ensure they become aligned to the strategy.

Q: What is the role of leadership in sound execution?

A: While not an explicit part of any of the six strategy execution stages (described below), executive leadership pervades every stage of the management system. Throughout *The Execution Premium*, we describe organizations that have successfully implemented their strategies. They operate in varied regions and industries, including manufacturing, financial services, consumer services, nonprofit, educational, and public sector. Their strategies differ; some produce low-cost commodity products and services, others deliver complete solutions to their customer, and still others innovate with high-technology products. About the only common element all these diverse successful strategy implementers have in common is exceptional and visionary leadership. In every example, the unit's CEO led the case for change and understood the importance of communicating the vision and strategy to every employee. Without such strong leadership at the top, even the comprehensive management system we introduce in this book cannot deliver breakthrough performance.

In fact, leadership is so important to the strategy management system that we make a rather bold claim that leadership is both necessary and sufficient for successful strategy execution. The necessary condition comes from our experience with the more than one hundred enterprises around the world who have become members of the Balanced Scorecard Hall of Fame. In every instance, the CEO of the organizational unit implementing the new strategy management system led the processes to develop the strategy and oversee its implementation. No organization reporting success with the strategy management system had an unengaged or passive leader.

For Stage 1, the CEO leads the change agenda and drives it from the top to reinforce the mission, values and vision. Leadership sets the ambitious vision and stretch targets. In Stage 2, the executive leader validates the strategy map as an expression of the strategy articulated in Stage 1 and challenges the organization with stretch targets that take all employees outside their comfort zones. In Stage 3, leadership drives alignment of organizational units and is essential for communicating vision, values, and strategy to all employees. Leadership, in Stage 4, supports the cross-organizational unit process improvements. In Stage 5, the leader's openness and skill in running the strategy management review meeting determines its effectiveness for fine-tuning the strategy throughout the year. And in

Stage 6 the leader must allow even a well-formulated and executed strategy to be challenged in light of new external circumstances, data collected about the performance of the existing strategy, and new suggestions from employees throughout the organization. Being willing to welcome and subject existing business strategies to fact-based challenges is one of the hallmarks of effective leadership.

Our sufficiency claim, however, is even bolder. The management processes we describe in *The Execution Premium* give an effective leader a framework for effective strategy execution. None of the six stages in the management system is simple or brief. But collectively, the management processes in the six stages provide leaders with a comprehensive, proven system for managing the development, planning, implementation, review, and adaptation of their strategies.

We believe that our 18 years of observation and work with enterprises in all sectors and regions of the world has led to an emerging science of strategy execution. Each of the six stages in the strategy management system is doable, especially when guided by a senior strategy management office. The one component we cannot provide a blueprint for is visionary and effective leadership. That is why we have come to believe that executive leadership is now both necessary and sufficient for successful strategy implementation.

Q: You have written four other books touching on the Balanced Scorecard (BSC). How has your thinking and your work with this innovation evolved along the way?

A: Our thinking has really evolved from performance measurement, the focus of our first *Harvard Business Review* article and the first half of the original *Balanced Scorecard* book, to using the BSC as the cornerstone of a comprehensive management system to help enterprises execute their strategies. We learned early that the BSC was much more than just a better performance measurement system; it can become the basis for a new strategy management system.

Our second book, *The Strategy-Focused Organization*, identified the five principles we saw successful companies using with the BSC for strategy management: Mobilize, Translate, Align, Motivate, and Govern. In the next three books, including our most recent book, *The Execution Premium*, we went into more depth in these principles. *Strategy Maps* focused on principle #2, translate. We described and illustrated how strategy maps and scorecards could be customized to many different strategies. The fourth book, *Alignment*, described principle #3, how to create and capture corporate synergies through vertical and horizontal alignment of business and support units. The fourth book also contained material on principle #4, aligning and motivating employees for strategy execution in their business or support units.

Our most recent book started out as an in-depth articulation of principle #5, governing to make strategy a continual process." But along the way, my coauthor Dave Norton and I realized that this book was really a synthesis of all our prior work. It encapsulates the latest development in the other four strategy-focused organization principles and integrates them into a comprehensive closed-loop management system that links strategy and operations. Beyond integrating all our prior work, the new book also integrates a wide range of other proven management tools, including mission and vision statements, strategy formulation, target-setting, dynamic budgeting and resource allocation, process improvement, quality methodologies (Six Sigma, lean management, catchball), dashboards, the learning organization, analytics, and emergent strategies.

Q: What's next for you?

A: I have recently become sensitive to a gap in our strategy map/BSC framework by not paying sufficient attention to enterprise risk management (ERM). Obviously, many large financial institutions, despite having risk management departments, have suffered massive losses from failure to understand the risks they took on. All companies, not just financial ones, need to have better methods to assess and monitor their risks. Quantifying financial, operating, technological, and strategic risk is far from trivial, and much needs to be learned to make enterprise risk management more effective. Risk management also requires effective systems for internal control, management control, and governance.

ERM objectives and metrics could certainly have a home in the financial BSC perspective for increasing and sustain shareholder value, along with the traditional objectives of revenue growth and productivity improvements. And companies should have objectives in the process perspective to manage and mitigate the risks associated with their strategies. I am persuaded that embedding risk management objectives in strategy maps and scorecards should be a high priority for where increases in knowledge and professional expertise could add substantial value to an organization. And reviews of a company's risk position should be part of the monthly strategy review meetings. I plan to spend some time in the next few years exploring this issue and hoping to make some progress.