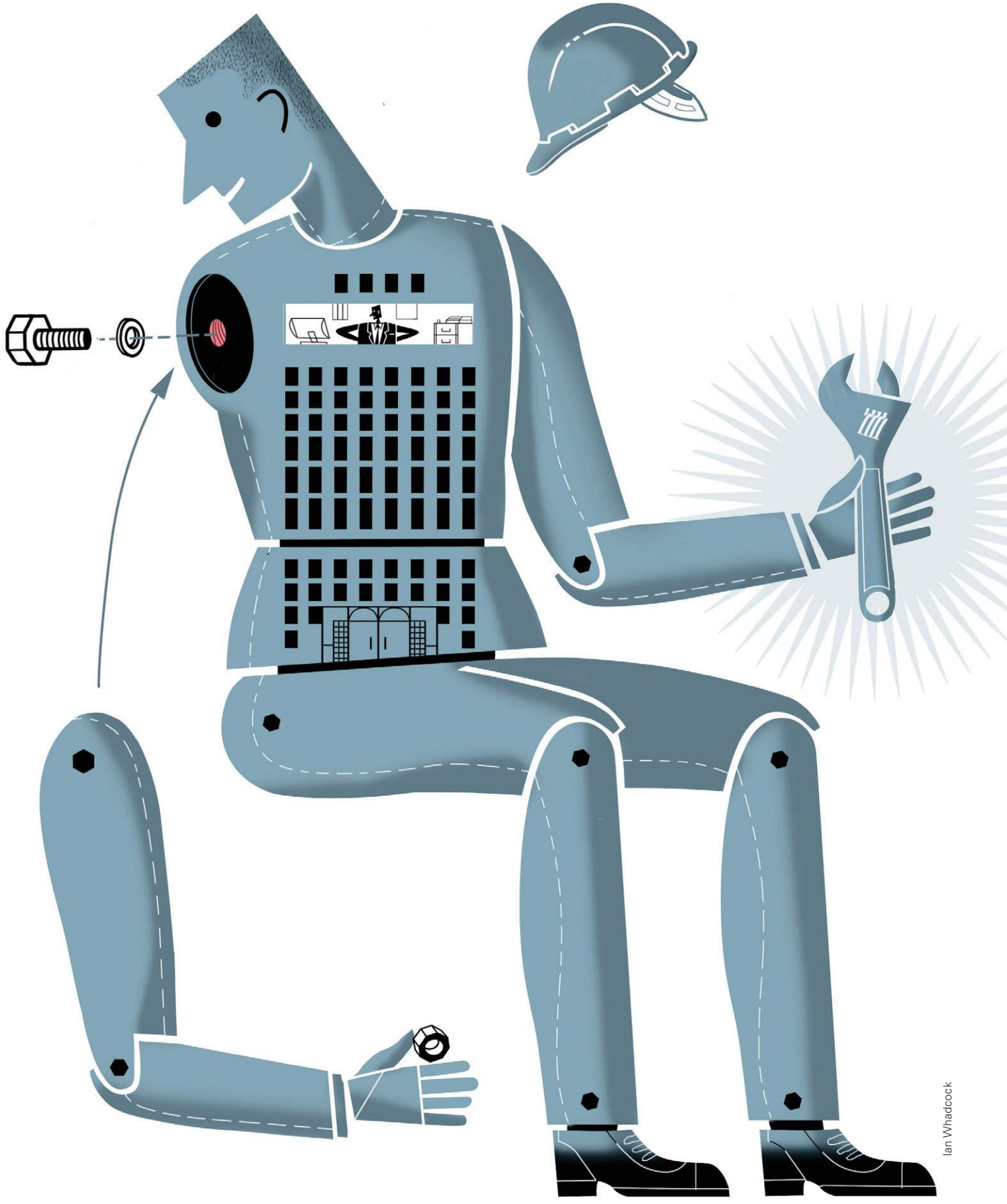

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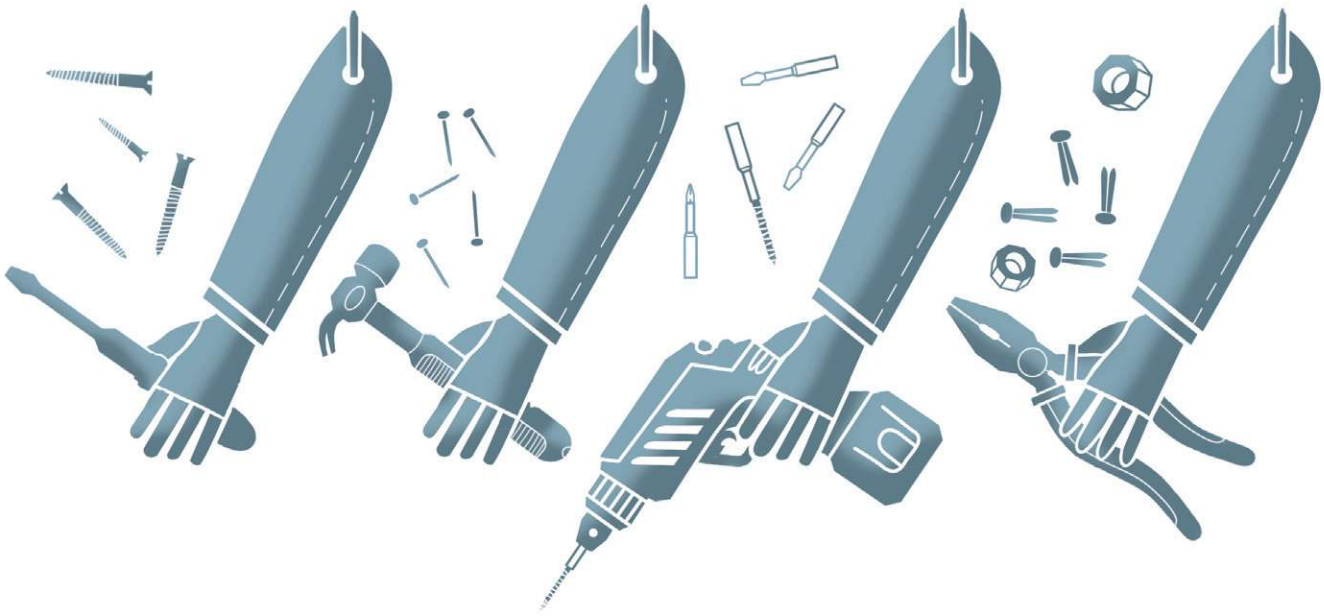

Successful strategy execution has two basic rules: understand the management cycle that links strategy and operations, and know what tools to apply at each stage of the cycle.

MASTERING the Management System

by Robert S. Kaplan and David P. Norton

NOT LONG AFTER ITS SUCCESSFUL IPO, the Conner Corporation (not its real name) began to lose its way. The company's senior executives continued their practice of holding monthly one-day management meetings, but their focus drifted.

The meetings' agenda called for a discussion of operational issues in the morning and strategic issues in the afternoon. But with the company under pressure to meet quarterly targets, operational items had started to crowd strategy out of the agenda. Inevitably, the review of actual monthly and forecast quarterly financial performance revealed revenues to be lower, and expenses to be higher, than targeted. The worried managers spent hours discussing how to close the gap through pricing initiatives, capacity downsizing, SG&A staff cuts, and sales

campaigns. One executive noted, "We have no time for strategy. If we miss our quarterly numbers, we might cease to exist. For us, the long term is the short term."

Like Conner, all too many companies – including some well-established public corporations – have learned how Gresham's Law applies to their management meetings: Discussions about bad operations inevitably drive out discussions about good strategy implementation. When companies fall into this trap, they soon find themselves limping along, making or closely missing their numbers each quarter but never examining how to modify their strategy to generate better growth opportunities or how to break the pattern of short-term financial shortfalls. Analysts, investors, and board members start to question the imagination and commitment of the companies' management.

In our experience, however, breakdowns in a company's management system, not managers' lack of ability or effort, are what cause a company's underperformance. By *management system,* we're referring to the integrated set of processes and tools that a company uses to develop its strategy, translate it into operational actions, and monitor and improve the effectiveness of both. The failure to balance the tensions between strategy and operations is pervasive: Various studies done in the past 25 years indicate that 60% to 80% of companies fall short of the success predicted from their new strategies.

By creating a closed-loop management system, companies can avoid such shortfalls. (See the exhibit "How the Closed-Loop Management System Links Strategy and Operations.") The loop comprises five stages, beginning with strategy development, which involves applying tools, processes, and concepts such as mission, vision, and value statements; SWOT analysis; shareholder value management; competitive positioning; and core competencies to formulate a strategy statement. That statement is then translated into specific objectives and initiatives, using other tools and processes, including strategy maps and balanced scorecards. Strategy implementation, in turn, links strategy to operations with a third set of tools and processes, including quality and process management, reengineering, process dashboards, rolling forecasts, activity-based costing, resource capacity planning, and dynamic budgeting. As implementation progresses, managers continually review internal operational data and external data on competitors and the business environment. Finally, managers periodically assess the strategy, updating it when they learn that the assumptions underlying it are obsolete or faulty, which starts another loop around the system.

A system such as this must be handled carefully. Often the breakdown occurs right at the beginning, with companies formulating grand strategies that they then fail to translate into goals and targets that their middle and lower managers understand and strive to achieve. Even when companies do formalize their strategic objectives, many still struggle because they do not link these objectives to tools that support the operational improvement processes that ultimately must deliver on the strategy's objectives. Or, like Conner, they decide to mix discussions of operations and strategy at the same meeting, causing a breakdown in the strategic-learning feedback loop.

In the following pages we draw upon our extensive research and experience advising companies, as well as nonprofit and public sector entities, to describe the design and implementation of a system for strategic planning, operational execution, and feedback and learning. We present a range of tools that managers can apply at the different stages, most developed by other management experts and some of our own design. (See "A Management System Tool Kit" on page 67 for further reading on the tools discussed.) We will show how these can all be integrated in a system that links the management of strategy and operations.

STAGE 1 Develop the Strategy

The management cycle begins with articulating the company's strategy. This usually takes place at an annual offsite meeting during which the management team either incrementally improves an existing strategy or, on occasion, introduces an entirely new one. (Our experience suggests that strategies generally have three to five years of useful life.) Developing an entirely new strategy may take two sets of meetings, each lasting two to three days. At the first, executives should reexamine the company's fundamental business assumptions and its competitive environment. After some homework and research, the executives will hold the second set of meetings and decide on the new strategy. Typically, the CEO, other corporate officers, heads of business and regional units, and senior functional staff attend these strategy sessions. The agenda should explore the following questions:

What business are we in and why? This question focuses managers on high-level strategy planning concepts. Before formulating a strategy, managers need to agree on their company's purpose *(mission),* its aspiration for future results *(vision),* and the internal compass that will guide its actions *(values).*

The *mission* is a brief statement, typically one or two sentences, that defines why the organization exists, especially what it offers to its customers and clients. The pharmaceutical firm Novartis presents a good example: "We want to discover, develop and successfully market innovative

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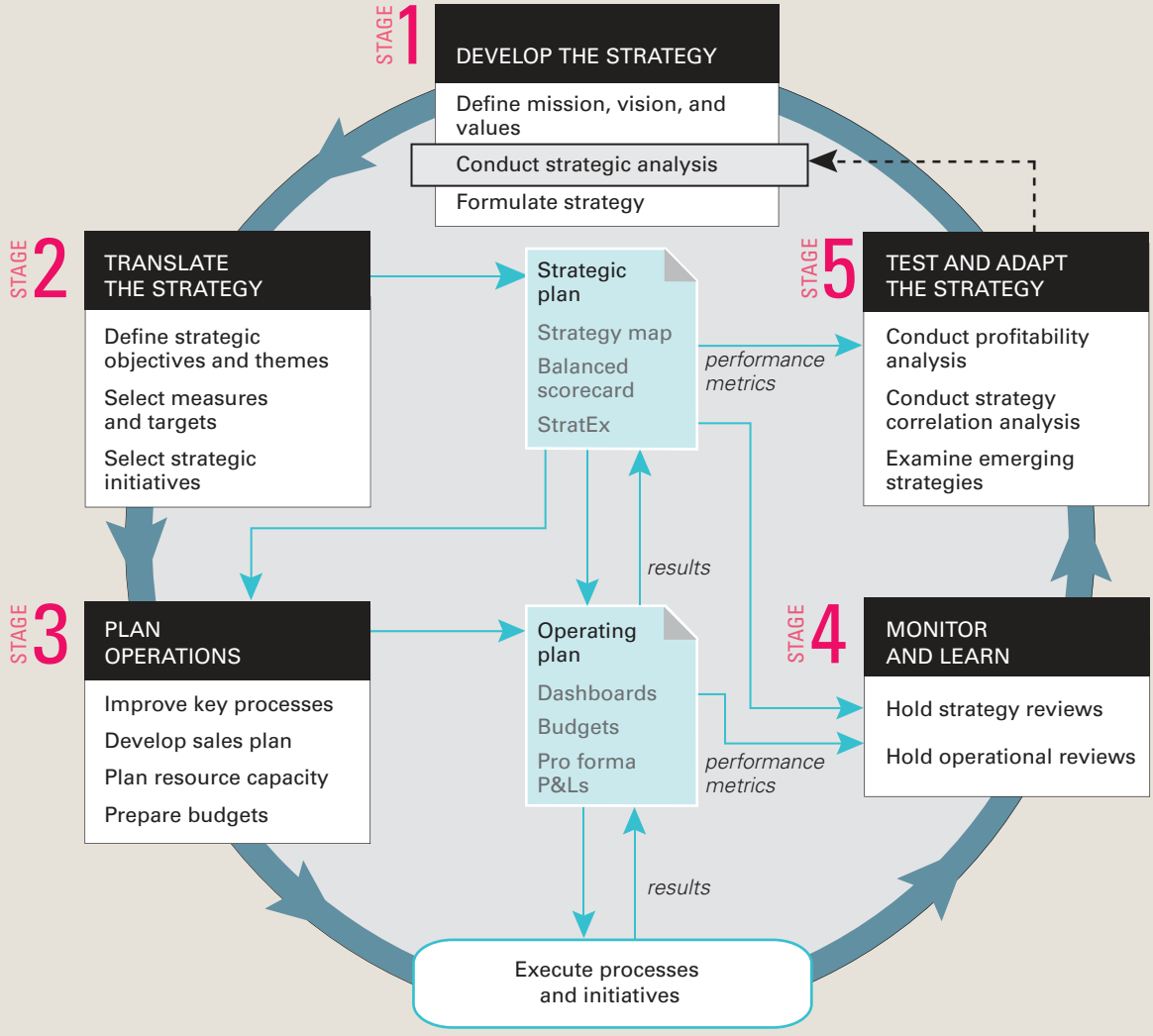
How the Closed-Loop Management System Links Strategy and Operations

Most companies' underperformance is due to breakdowns between strategy and operations. This diagram describes how to forge tight links between them in a five-stage system. A company begins by developing a strategy statement and then translates it into the specific objectives and initiatives of a strategic plan. Using the strategic plan as a guide, the company maps out the operational plans and resources needed to achieve its objectives. As managers execute the strategic and operational plans, they continually monitor and learn from internal results and external data on competitors and the business environment to see if the strategy is succeeding. Finally, they periodically reassess the strategy, updating it if they learn that the assumptions underlying it are out-of-date or faulty, starting another loop around the system.



products to prevent and cure diseases, to ease suffering and to enhance the quality of life. We also want to provide a shareholder return that reflects outstanding performance and to adequately reward those who invest ideas and work in our company."

The *vision* is a concise statement that defines the mid- to long-term (three- to 10-year) goals of the organization. Cigna Property and Casualty, an insurance company division we worked with in the 1990s, stated its goal this way: "to be a top-quartile specialist within 5 years." Though short, this vision statement contained three vital components:

- Stretch goal: "top quartile" in profitability (at the time, Cigna P&C was at the bottom of the fourth quartile).
- Definition of market focus: "a specialist," not a general-purpose underwriter, as it was at the time.
- A time line for execution: "5 years" (a heartbeat in the slow-moving insurance industry).

The stretch goal in the vision statement should truly be a difficult reach for the company in its present position. The CEO has to take the lead here; indeed, one of the principal roles of an effective leader, as Jim Collins and Jerry Porras noted in *Built to Last,* is to formulate a "big, hairy, audacious goal (BHAG)" that challenges even well-performing organizations to become much better. The classic example is Jack Welch's challenge for every GE business unit to become number one or two in its industry. In determining a stretch goal, it pays to look at the financial market's expectations as a benchmark, since the company's share price usually contains an implicit estimate of future profitable growth, which can be well beyond that achievable through incremental improvements to existing businesses. If a company is setting a new goal, rather than reaffirming an established goal, managers may need to undertake pre-offsite research and engage in extensive discussion at the meeting.

Finally, the *values* (often called core values) of a company prescribe the attitude, behavior, and character of an organization. Value statements, which are often lengthy, describe the desirable attitudes and behavior the company wants to promote as well as the forbidden conduct, such as bribery, harassment, and conflicts of interest, that employees should definitely avoid. These excerpts from the value statement of the internet service provider Earthlink illustrate the components of value statements:

- *We respect the individual, and believe that individuals who are treated with respect and given responsibility respond by giving their best.*
- *We are frugal. We guard and conserve the company's resources with at least the same vigilance that we would use to guard and conserve our own personal resources.*
- *We are believers in the Golden Rule. In all our dealings we will strive to be friendly and courteous, as well as fair and compassionate.*
- *We feel a sense of urgency on any matters related to our customers. We own problems and we are always responsive. We are customer-driven.*

The reaffirmation of mission, vision, and values puts executives in the right mind-set for considering the rest of the agenda and setting the company's fundamental guidelines.

What are the key issues we face in our business? With mission, vision, and values established, managers undertake a *strategic analysis* of the company's external and internal situation. The management team studies the industry's economics using frameworks such as Michael Porter's five forces model (bargaining power of buyers; bargaining power of suppliers; availability of substitutes; threat of new entrants; and industry rivalry). The team assesses the external macroeconomic environment of growth, interest rates, currency movements, input prices, regulations, and general expectations of the corporation's role in society. Often this is described as a PESTEL analysis, encompassing *political, economic, social, technological, environmental,* and *legal* factors. Managers can then dive into competitiveness data and consider the dynamics of the company's financial, technological, and market performance relative to its industry and competitors.

After the external analysis, managers should assess the company's internal capabilities and performance. One approach is to use Michael Porter's value chain model, categorizing capabilities used in the processes that create markets; develop, produce, and deliver products and services; and sell to customers. Or the internal analysis could identify the distinctive resources and capabilities that give the firm a competitive advantage. Finally, unless managers are introducing an entirely new strategy, they will want to assess the performance of the current strategy, a topic we discuss more later.

The next step is to summarize the conclusions from the external and internal analyses in a classic SWOT matrix, assessing the ability of internal attributes and external factors to help or hinder the company's achievement of its vision. The aim here is to ensure that the strategy leverages internal *strengths* to pursue external *opportunities,* while countering *weaknesses* and *threats* (internal and external factors that undermine successful strategy execution). This analysis will reveal a series of issues that the strategy must address: the best role for new products and services; whether new partners need to be acquired; what new market segments the company might enter; and which customer segments are contracting. These issues will become the focus of the strategy formulation process, which often takes place at a subsequent meeting.

How can we best compete? Finally, managers tackle the *strategy formulation* itself – the statement describing the strategy and how the company proposes to achieve it. In this step managers decide on a course of action that will create a sustainable competitive advantage by distinguishing the company's offering from competitors' and, ultimately, will

A Management System Tool Kit

Where to learn more about the concepts and frameworks described in this article

Develop the Strategy

Competitive Strategy

Michael E. Porter
Competitive Advantage: Creating and Sustaining Superior Performance
Free Press, 1985 (republished with a new introduction, 1998)

Michael E. Porter
Competitive Strategy: Techniques for Analyzing Industries and Competitors
Free Press, 1980 (republished with a new introduction, 1998)

Michael E. Porter
"What Is Strategy?"
Harvard Business Review
November–December 1996

Chris Zook and James Allen
Profit from the Core: Growth Strategy in an Era of Turbulence
Harvard Business School Press, 2001

Resource-Based Strategy

Jay B. Barney
Gaining and Sustaining Competitive Advantage – 3rd edition
Prentice-Hall, 2006

Jay B. Barney and Delwyn N. Clark
Resource-Based Theory: Creating and Sustaining Competitive Advantage
Oxford University Press, 2007

David J. Collis and Cynthia A. Montgomery
"Competing on Resources: Strategy in the 1990s"
Harvard Business Review
July–August 1995

Gary Hamel and C.K. Prahalad
Competing for the Future
Harvard Business School Press, 1994

Blue Ocean Strategy

W. Chan Kim and Renée Mauborgne
Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant
Harvard Business School Press, 2005

Disruptive Strategy

Clayton M. Christensen and Michael E. Raynor
The Innovator's Solution: Creating and Sustaining Successful Growth
Harvard Business School Press, 2003

Emergent Strategy

Gary Hamel
"Strategy Innovation and the Quest for Value"
Sloan Management Review
Winter 1998

Henry Mintzberg
"Crafting Strategy"
Harvard Business Review
July–August 1987

Translate the Strategy

Robert S. Kaplan and David P. Norton
The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment
Harvard Business School Press, 2000

Robert S. Kaplan and David P. Norton
Strategy Maps: Converting Intangible Assets into Tangible Outcomes
Harvard Business School Press, 2004

Robert S. Kaplan and David P. Norton
The Execution Premium: Linking Strategy to Operations for Competitive Advantage
Harvard Business School Press, 2008

Plan Operations

Process Improvement

Wayne W. Eckerson
Performance Dashboards: Measuring, Monitoring, and Managing Your Business
John Wiley & Sons, 2006

Michael Hammer
Beyond Reengineering: How the Process-Centered Organization Is Changing Our Work and Our Lives
HarperBusiness, 1996

Peter S. Pande, Robert P. Neuman, and Roland R. Cavanagh
The Six Sigma Way: How GE, Motorola, and Other Top Companies Are Honing Their Performance
McGraw-Hill, 2000

James P. Womack, Daniel T. Jones, and Daniel Roos
The Machine That Changed the World: The Story of Lean Production
Macmillan, 1990

Budgeting and Planning Resource Capacity

Jeremy Hope and Robin Fraser
Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap
Harvard Business School Press, 2003

Robert S. Kaplan and Steven R. Anderson
Time-Driven Activity-Based Costing: A Simpler and More Powerful Path to Higher Profits
Harvard Business School Press, 2007

Test and Adapt Strategy

Dennis Campbell, Srikant Datar, Susan L. Kulp, and V.G. Narayanan
"Testing Strategy Formulation and Implementation Using Strategically Linked Performance Measures"
HBS Working Paper, 2006

Thomas H. Davenport and Jeanne G. Harris
Competing on Analytics: The New Science of Winning
Harvard Business School Press, 2007

Anthony J. Rucci, Steven P. Kirn, and Richard T. Quinn
"The Employee-Customer-Profit Chain at Sears"
Harvard Business Review
January–February 1998

lead to superior financial performance. The strategy must respond, in some form, to the following questions:

- Which *customers* or *markets* will we target?
- What is the *value proposition* that distinguishes us?
- What *key processes* give us competitive advantage?
- What are the *human capital* capabilities required to excel at these key processes?
- What are the *technology enablers* of the strategy?
- What are the *organizational enablers* required for the strategy?

Managers can draw upon an abundance of models and frameworks as they formulate the strategy. Michael Porter's original competitive advantage framework, for example, presented the strategy decision as a choice between whether to provide generic low-cost products and services or more differentiated and customized ones for specific market and customer segments. The Blue Ocean approach, popularized by W. Chan Kim and Renée Mauborgne, helps companies search for new market positions by creating new value propositions for a large customer base. Resource-based strategists (including those in the core competencies school) emphasize critical processes – such as innovation or continual cost reduction – that the company does better than competitors and can leverage into multiple markets and segments. Clay Christensen has identified how new entrants can disrupt established markets by offering an initially less capable product or service at a much lower price to attract a large customer base not targeted by the market leaders.

We are agnostic with respect to these frameworks; we have seen each one we've described be highly successful. Which among them is the right choice probably depends on a company's circumstances and its competitive analysis. The Porter and resource-based frameworks help companies leverage existing competitive positions or internal capabilities, whereas the Blue Ocean and disruptive technology frameworks help them search for entirely new positions.

STAGE 2 Translate the Strategy

Once the strategy has been formulated, managers need to translate it into objectives and measures that can be clearly communicated to all units and employees. Our own work on developing strategy maps and balanced scorecards has contributed to this translation stage.

The strategy map provides a powerful tool for visualizing the strategy as a chain of cause-and-effect relationships among strategic objectives. The chain starts with the company's long-term financial objectives and then links down to objectives for customer loyalty and the company's value propositions. From there, it links to goals related to critical processes and, ultimately, to the people, the technology, and the organizational climate and culture required for successful strategy execution. Typically, a large corporation will create an overall corporate strategy map and then link it to strategy maps for each of its operating and functional units.

Even though a strategy map reduces a complex strategy statement to a single page, we have learned that many managers find the multiple objectives (typically, 15 to 25) on a map, along with their corresponding measures and targets, somewhat complex to understand and manage. Some of a map's objectives relate to short-term cost reduction and quality improvements while others reflect long-term innovation and relationship goals. Managers often find it challenging to balance these myriad objectives.

In our recent work, we've found that companies can simplify the structure and use of a strategy map by chunking it into three to five *strategic themes.* A strategic theme, typically a vertical slice within the map, consists of a distinct set of related strategic objectives. (For an example, see "Mapping Strategic Themes," a generic strategy map organized by three vertical strategic themes and a horizontal theme to cluster the learning and growth objectives.)

Strategic themes offer several advantages. At the business unit level, the theme structure allows unit managers to customize each theme to their local conditions and priorities, creating focus for their competitive situation while still keeping their objectives integrated with the overall strategy. Second, the vertical strategic themes typically deliver their benefits over different time periods, helping companies simultaneously manage short-, intermediate-, and long-term value-creating processes. Using themes, executives can plan and manage the key elements of the strategy separately but still have them operate coherently.

Once managers have developed the strategy map, they link it to another tool of our design: a balanced scorecard of performance metrics and targets for each strategic objective. We believe that if you don't measure progress toward an objective, you cannot manage and improve it. The balanced scorecard metrics allow executives to make better decisions about the strategy and quantitatively assess its execution.

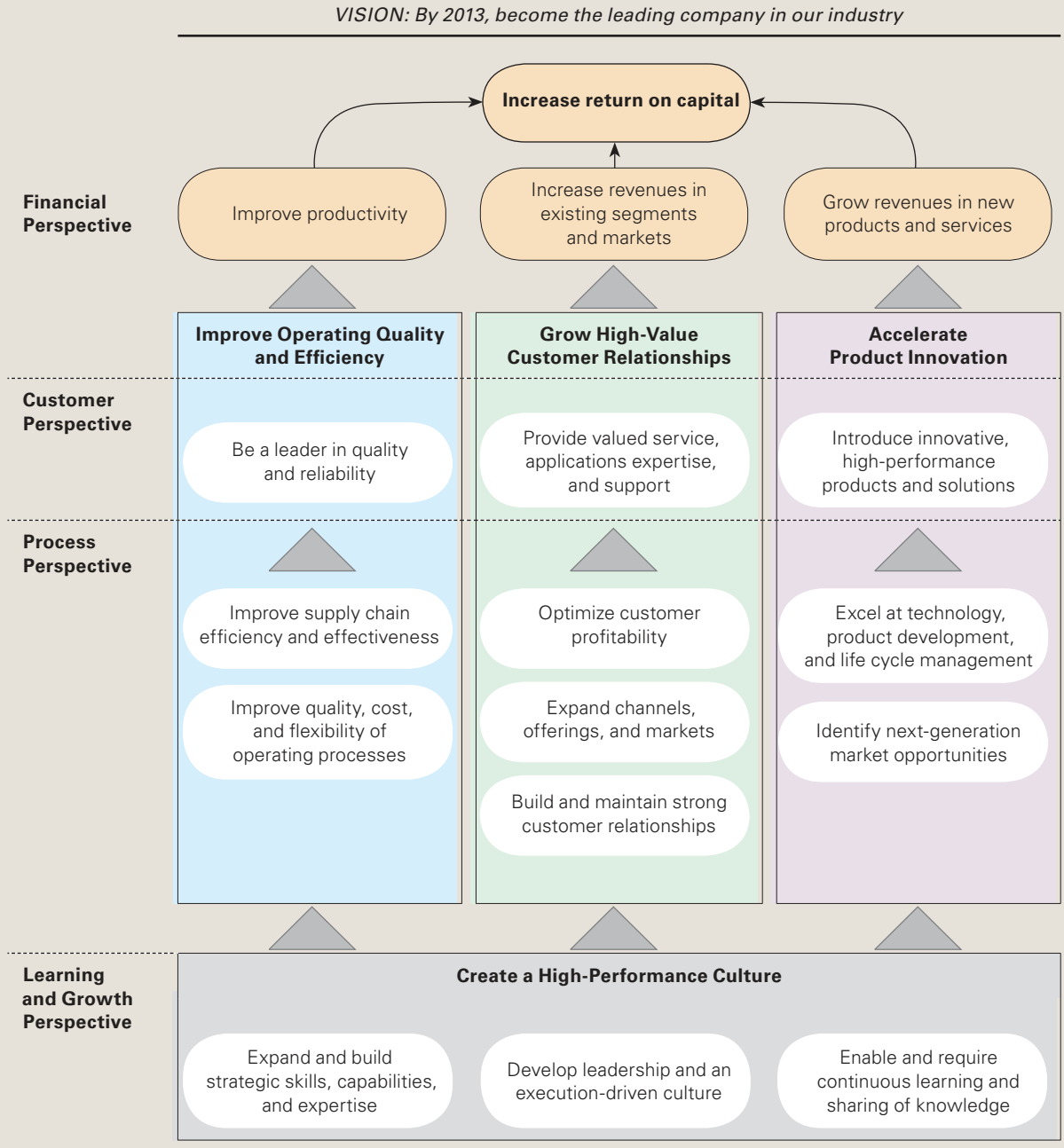
A third step at Stage 2 involves identifying, and authorizing resources for, a portfolio of strategic initiatives intended to help achieve the strategy's objectives. A strategic initiative is a discretionary project or program, of finite duration, designed to close a performance gap. It might focus on, say, developing a customer loyalty program or training all employees in Six Sigma quality management tools.

In our original conception of the strategy map and the balanced scorecard, we encouraged companies to select initiatives independently for each objective. We came to realize, however, that by doing so, companies would fail to benefit from the integrated and cumulative impact of multiple, related strategic initiatives. Achieving an objective in the customer or financial realm generally requires complementary initiatives from different parts of the organization, such as human resources, information technology, marketing,

Mapping Strategic Themes

This generic strategy map illustrates how a corporate strategy can be sliced into four themes, each with its own cause-and-effect relationships.

Real-life maps will be more complex but will still have the desirable property of making strategy much easier to understand and manage. The strategic themes provide a common structure that unit managers can use to develop their own maps within the big picture and a governance structure that assigns accountability for actions.



distribution, and operations. Also, stand-alone cross-unit initiatives often have no clear owner or home in the organization. Starved for resources and lacking clear accountability for execution, the strategic initiatives wither away, thwarting the strategy's execution.

Companies with theme-based strategy maps avoid these problems by assigning a senior executive to lead each strategic theme. In this way, the company gains an accountability and reporting structure even for cross-business and cross-functional-unit objectives. The executive assigned to own each theme assumes the responsibility for devising and executing an entire portfolio of initiatives selected to achieve the theme's performance targets. The executive team authorizes the resources required for the various portfolios; we call the designated funds strategic expenditures (or StratEx). Committing funds to StratEx is similar to budgeting for research and development: Both categories represent spending on near-term actions expected to deliver mid- to long-term performance, and both are separate from the operating and capital expenditures (OpEx and CapEx, described in the next stage) that support current operations.

STAGE 3 Plan Operations

With strategic metrics, targets, and initiative portfolios in place, the company next develops an operational plan that lays out the actions that will accomplish its strategic objectives. This stage starts with setting priorities for process improvement projects, followed by preparing a detailed sales plan, a resource capacity plan, and operating and capital budgets.

Process improvements. The strategic initiatives developed in Stage 2 consist of the short-term projects (lasting as long as 12 to 18 months) selected to help achieve the strategy map's objectives. However, to execute their strategies, companies generally must also enhance the performance of their ongoing processes – measured, for example, by their

What Resources Do You Need to Implement Your Strategy?

It's critical for companies to factor their strategic goals into their operational planning. Here's how one company broke its sales forecast down into figures for each of the activities required to achieve it and used those figures to estimate the personnel and computing resources it would need in the next period.

Breaking Down the Sales Target

Towerton Financial, a financial services company, broke down a monthly sales target of about $7.9 million into subtargets for its four product lines: stock trading, mutual fund trading, investment management, and financial planning. It then broke each line's forecast down into the volume and mix of transactions that the company's most expensive resources (people and computing) would be expected to handle each month. That information helped the company's managers calculate the resources needed to achieve their sales goals.

	Stock trading	Mutual fund trading	Investment management	Financial planning
Sales target	**$3,636,000**	**$2,031,000**	**$919,000**	**$1,323,000**
Number of transactions	275,000	49,000	5,500	6,300
Number of new accounts opened	750	400	130	100
Number of calls to customer service center	11,000	20,000	21,500	84,500
Number of meetings opening new accounts	750	400	130	100
Number of meetings servicing existing accounts	400	200	250	450
Computing MIPS utilized	419,690	56,212	60,835	11,457

responsiveness, speed, quality, and cost. Companies will get the biggest bang for their buck when they focus their business process management, total quality management, lean management, Six Sigma, and reengineering programs on processes directly related to the objectives on their strategy maps and scorecards. The goal is to align near-term process improvements with long-term strategic priorities.

Managers need to deconstruct each strategic process to identify the critical success factors and metrics that employees can focus on in their daily activities. Electronic and physical dashboards, displaying data on the key indicators of local process performance, will inform the actions of and provide feedback to employees attempting to achieve process performance targets. For example, one large pharmaceutical chain has a dashboard system that gives each store manager a customized, single page display of financial and operating metrics – those that a statistical analysis revealed have the highest correlation with aggregate store performance. The managers' dashboards also display monthly quartile rankings among comparable stores for six key metrics.

Sales plan. Managers also must identify the resources required to implement their strategic plan. Before they can do that, they need to deconstruct their overall sales target into the expected quantity, mix, and nature of individual sales orders, production runs, and transactions. (For an illustration, see the example of Towerton Financial in "Breaking Down the Sales Target." Towerton is a composite of various firms we've worked with.) Companies with well-functioning ERP systems will have a historical record of product and customer mix and transaction volumes they can draw upon to do this. A company can start by simply grossing up last period's distribution of order sizes by the desired percentage change in sales. Using this baseline, the company's planners can modify the distribution to reflect expected changes in sales and ordering patterns, such as an increase in minimum order sizes and the additional

Translating the Sales Plan into Resource Requirements

In this chart, Towerton Financial calculated the quantity of resources required to implement the sales plan at left, using a time-driven ABC model. The numbers under total hours show what Towerton would need from each kind of personnel or IT resource. (Note that the capacity of computing resources is measured by MIPS, not hours.) The next column indicates how many hours (or MIPS) are supplied monthly by one unit of each resource. The numbers for resource units required were obtained simply by dividing the total demand for each resource by the quantity supplied monthly by one unit of it. After examining the resource requirements under a range of assumptions, Towerton authorized the level of resource supply to be carried into the next period. In general, companies will want to supply somewhat more capacity than forecast, as shown in the column for resource units supplied; resource demands are not uniform throughout a period. As the final column shows, Towerton expects to operate at close to full capacity during the upcoming period. Knowing the cost of each resource unit, Towerton can quickly translate its operating plan into an overall profit plan and individual product line P&Ls.

Resource type	Total hours	Available hours/month per resource unit	Resource units required	Resource units supplied	Capacity utilization
Brokers	27,070	130	208.2	215	97%
Account managers	6,540	130	50.3	51	99%
Financial planners	7,300	130	56.2	59	95%
Principals	4,627	130	35.6	36	99%
Customer service representatives	14,654	140	104.7	110	95%
IT consultants	10,321	140	73.7	75	98%
Computing MIPS utilized	548,194	7,920	69.2	75	92%

sales from new lines of products or services or new markets. Finally, data-rich companies can easily embrace scenario planning to explore the sensitivity of their sales forecasts to alternative economic and competitive assumptions.

Resource capacity plan. Armed with data about productivity from process improvements and likely sales numbers, companies can now estimate what resources they will need in the year ahead to execute on their strategic goals. Our preferred tool for this step is time-driven activity-based costing (TDABC). Activity-based costing's original use was to measure the cost and profitability of processes, products, and customers (as we will describe in Stage 5). The time-driven version of ABC adds a new capability, the ability to easily translate future sales numbers into a forecast of required resource capacity. At the heart of the TDABC model is a set of equations, based on historical experience, that describe how various transactions and demands consume the capacity of resources such as people, equipment, and facilities. A company that has such a model in place can update these equations for any productivity gains that have occurred or are anticipated from process improvements (determined during the first step in this stage). Managers then feed the new detailed sales plans (from the second step) into the updated model, to produce estimates of the demand for resources implied by the sales forecast. (See "Translating the Sales Plan into Resource Requirements" for a simplified example.) The company, seeing the capacity required to deliver on its strategic plan, can then authorize the quantity of people, equipment, and other resources to be supplied, including any buffer capacity to handle fluctuations or short-term spikes in demand.

Dynamic operating and capital budgets. Once managers have determined the authorized level of resources for the future period, the financial implications become easy to calculate. In the Towerton Financial case used in the resource capacity exhibit, the company already knew the full monthly cost of each kind of personnel – brokers, account managers, financial planners, customer service representatives, and IT consultants – as well as the monthly cost for each server, the unit of computing capacity. To obtain the budget figures for each of the resources needed to meet the sales forecasts, Towerton's planners simply multiply the cost of each type of resource by the quantity it has decided to supply. Most of the resource capacity represents personnel costs and would be included in the OpEx budget. Increases in equipment resource capacity (such as Towerton's servers) would be reflected in the CapEx budget. The process quickly and analytically generates operating and capital budgets that grow logically and dynamically out of the sales and operating plans, rather than being imposed by fiat or through power negotiations. Since the company started with detailed revenue forecasts and now has the resource costs associated with delivering on them, simple subtraction will yield a detailed P&L for each product, customer, channel, and region. Companies that have shifted from an annual budgeting cycle to one with quarterly updates can use this process to obtain resource capacity plans for every period for which they have a sales forecast.

In a final budgeting step, the company authorizes the discretionary spending that does not have an immediate relationship with sales and operations, such as process improvement initiatives, advertising, promotion, research and development, training, and maintenance. The amount of such spending remains a judgment call for experienced executives and is not a decision that can yet be automated through an analytic model.

The company now has finished the integrated planning of strategy and operations, which encompasses the following steps: Formulate the strategy; translate it into linked objectives, measures, and targets; develop and fund the portfolio of strategic initiatives; identify the process improvement priorities; forecast sales consistent with the strategic plan; estimate the resource capacities required for those sales; authorize the spending on resources; and produce next period's pro forma income and detailed P&L statements. From here on, it is up to the managers to execute, learn, and adapt, moving the management cycle into its fourth stage.

STAGE 4 Monitor and Learn

As companies implement their strategic and operational plans, they need to hold three types of meetings to monitor and learn from their results. First, managers should convene meetings that review the performance of operating departments and business functions and address problems that have arisen or persist. They also should hold strategy management meetings that review balanced scorecard performance indicators and initiatives to assess progress and identify barriers to strategy execution. Those two meetings make up Stage 4 of the system. In Stage 5, managers meet to assess the performance of the strategy itself and adapt it if necessary. The three meetings have different subject matter, different frequencies, and, often, different sets of attendees. (See the exhibit "Management Meetings 101" for a comparison of the meetings.)

Operational review meetings. Management groups need to meet frequently – perhaps weekly, twice weekly, or even daily – to review their operating dashboards and reports on sales, bookings, and shipments, and to solve short-term issues that have recently arisen: complaints from important customers, late deliveries, defective production, mechanical breakdowns, the extended absence of a key employee, new sales opportunities. The speed at which new data are posted on operational dashboards is the central factor in determining meeting frequency: If the company has a short operations cycle, with new data posted hourly and daily,

then a daily review promotes rapid learning and problem solving. But for a product development group, progress against milestones and stage gates may be better evaluated monthly.

The people attending an operational review typically come from within a single department, function, or process. A unit's salespeople, for example, will meet (often via conference calls and webcasts) to discuss the sales pipeline, recent sales closings, and new customer opportunities and problems. Operations people review production problems, including defects, yields, bottlenecks, maintenance and repair schedules, equipment breakdowns, downtime, scheduling, expediting, supplier concerns, and distribution. Finance personnel address short-term cash flow issues, including collections on receivables, late payments to suppliers, treasury operations, and banking relationships. The top management group may meet monthly to review overall financial performance.

Smaller companies, without functional departments, may have only a single monthly operating meeting, corresponding to the frequency with which they close their books. In general, however, we recommend gearing operating review

Management Meetings 101

It's important to distinguish clearly among the various kinds of meetings that form the feedback and learning component of the management system. They require different frequencies and have very different agendas and informational requirements. Companies that try to double up these meetings in order to accommodate the availability of senior staff run the risk of having discussions of operational crises drive out consideration of strategic issues.

	MEETING TYPE		
	Operational review	**Strategy review**	**Strategy testing and adapting**
Information requirements	Dashboards for key performance indicators; weekly and monthly financial summaries	Strategy map and balanced scorecard reports	Strategy map, balanced scorecard, ABC profitability reports, analytic studies of strategy, external and competitive analyses
Frequency	Daily, twice weekly, weekly, or monthly, depending on business cycle	Monthly	Annually (perhaps quarterly for fast-moving industries)
Attendees	Departmental and functional personnel; senior management for financial reviews	Senior management team, strategic theme owners, strategy management officer	Senior management team, strategic theme owners, functional and planning specialists, business unit heads
Focus	Identify and solve operational problems (sales declines, late deliveries, equipment downtime, supplier problems)	Implement strategy	Test and adapt strategy based on causal analytics, product-line and channel profitability, changing external environment, emergent strategies, and new technology developments
Goal	Respond to short-term problems and promote continuous improvements	Fine-tune strategy; make midcourse adaptations	Incrementally improve or transform strategy; establish strategic and operational plans; set strategic targets; authorize spending for strategic initiatives and other major discretionary expenditures

meeting frequency to the operating cycle of the department and business, so management can respond to sales and operating data and to myriad other tactical issues in the most timely manner.

Ideally, operational meetings are short, highly focused, data driven, and action oriented. One company we've advised holds its operational reviews in a small room filled with whiteboards and flip charts but no chairs. Attendees post agenda topics and look over dashboards before the meeting, which lasts only as long as needed to discuss each issue, develop an action plan, and assign responsibility for carrying it out. Forcing everyone to stand signals that the meeting's purpose is not to spend time together, passively listening. It is to engage managers in active and brisk problem-solving discussions on the most pressing issues of the day.

One company holds its operational reviews in a room with no chairs. Forcing everyone to stand signals that the meeting is not about passive listening; it's about active and brisk problem solving.

Strategy review meetings. The leadership team of a business unit must meet periodically to review the progress of its strategy. Operational issues, unless they are particularly significant and cross-functional, should not be discussed at this meeting. Attendance at strategy reviews should be compulsory for the unit's CEO and all members of its executive committee.

There's no clear consensus around the optimal frequency for these meetings, though most companies hold a monthly two- to three-hour strategy review meeting, to ensure that strategy remains top of mind. That works well when a management team works in one central location. Some companies, especially those with dispersed teams, hold their strategy review meetings quarterly. Strategy is a long-term commitment, and strategic initiatives such as developing new workforce competencies, redefining the brand, innovating new products, building new customer relationships, and reengineering key business processes typically take more than a month to yield measurable results. Quarterly meetings will probably require at least an entire day for active discussion of all strategic objectives and themes.

Many company units hold their monthly operational financial review on the same day as the strategy review, since the same people attend both. If that's the situation, it's essential to set distinctly different agendas for the two meetings. Otherwise, as in our opening example of the Conner Corporation, short-term operational and tactical issues will drive out discussions of strategy implementation.

Like operational reviews, strategy management meetings should not be spent listening to report presentations. Managers should come to the meetings already familiar with the data to be discussed, thinking about the issues that the gaps in recent performance raise, and formulating solutions to problems. At the meetings themselves, executive committee members should discuss the issues, explore their implications, and propose action plans.

Executives have to make a trade-off between breadth and depth at these reviews. In the early years of balanced scorecard implementations, we encouraged a full discussion of BSC measures at each strategy management meeting. It soon became apparent that the normal time reserved for a monthly meeting did not permit a full discussion of all the objectives, measures, and initiatives on a strategy map and scorecard. The solution, we discovered, came from the practice of using strategic themes to organize strategy maps: devote most of the meeting to a deep dive into one or two of the strategic themes.

That is precisely what happens at HSBC Rail, an operating unit of the HSBC Group, which purchases, leases, and maintains the locomotives and cars for the UK and other nations' railroad systems. Its monthly two-and-a-half-hour meeting brings together its strategy council, consisting of the CEO, the head of Finance, the head of Customer Service–Operations, the head of Customer Relationship Management–Sales, the head of Learning and Development, and the strategy management officer, who coordinates the data on the strategic measures and initiatives for each strategic theme in advance of the meeting. The data go into a monthly report that has a section for each strategic theme. The section contains the theme's strategy map, objectives, targets, and initiatives, with each component color-coded green (if the objective's target has been achieved),

yellow (progress is slower than expected but doesn't require immediate senior management attention), or red (progress is off track *and* requires management attention to resolve critical issues). Each theme's section also contains evaluations and commentary from the theme owner about any performance gaps and proposed actions for addressing them.

The monthly meeting focuses on one (or at most two) strategic themes in depth. The agenda also allots time for one operational or strategic "hot topic" to ensure that urgent issues that fall outside the theme under discussion will be addressed. The February 2007 strategy council meeting was a typical HSBC Rail strategy review. (See the exhibit "A Model Strategy Review Agenda.") The strategy management officer started with an update on the action items from the previous month, indicating which had been accomplished and which were still under way. The CEO followed with a quick review of the unit's color-coded strategy map and offered his perspective on the business. Then, the attendees gave in-depth consideration for about 60 minutes to the Customer Relationship Management strategic theme. For the remaining themes, the council spent about five minutes each on any issues that had to be resolved before the scheduled deep dive on that theme. The meeting participants, who were already familiar with the data and ready to discuss the implications and to propose action plans, built constructively on the ideas presented during the meeting. The CEO questioned and probed, kept the meeting focused on the key issues, encouraged dialogue and debate, and ensured that the meeting stayed on schedule. The strategy management officer recorded each approved action item and the designated manager who would be accountable for following up on it.

HSBC's meetings – like all excellent strategy reviews – focus on whether strategy execution is on track, where problems are occurring in the implementation, why they're happening, what actions will correct them, and who will have responsibility for achieving targets. These meetings take the strategy as a given. They are not used, except in unusual circumstances, to question or adapt the strategy. That is what takes place in the final stage.

STAGE 5 Test and Adapt the Strategy

From time to time managers will discover that some of the assumptions underlying their strategy are flawed or obsolete. When that happens, managers need to rigorously reexamine their strategy and adapt it, deciding whether incremental improvements will suffice or whether they need a new, transformational strategy. This process closes the loop of the management system. It generally occurs at the strategy

A Model Strategy Review Agenda

Time	Item	Detail	Duration	Responsibility
10:10	Action Log	Review Status	5 minutes	Paul (Strategy Management Officer)
10:15	Overview	Review Strategy Map Highlight Key Issues Review Initiatives Review Measures	10 minutes	Peter (CEO)
10:25	Theme Assessment	Customer Relationship Management	60 minutes	Bob (Head of CRM–Sales)
11:25	Break		5 minutes	
11:30	Theme Summary	Learning and Growth	5 minutes	Nick (Head of Learning and Development)
11:35	Theme Summary	Capital Efficiency	5 minutes	David (Head of Finance)
11:40	Theme Summary	Operational Excellence	5 minutes	Robert (Head of Customer Service–Operations)
11:45	Hot Topic	Resourcing Challenge	30 minutes	David (Head of Finance)
12:15	Meeting Review	Communication Summary	10 minutes	Peter (CEO)
12:25	Meeting Review	Feedback	5 minutes	
12:30	Action Log	Review of New Items	5 minutes	Peter (CEO)
12:35	Any Other Business and Meeting Close			Paul (Strategy Management Officer)
	Next Meeting	18/04/07 – Theme Assessment: Capital Efficiency		

development offsite described under Stage 1 but could occur during the year if the company experiences a major disruption or a new strategic opportunity. The strategy testing and adapting process introduces new inputs to the offsite: an analysis of the current economics of existing products and customers, statistical analyses of correlations among the strategy's performance measures, and consideration of new strategy options that have emerged since the previous strategy development meeting.

Cost and profitability reports. Anytime a company reviews its strategy, it should first understand the current economics of its existing strategy by examining activity-based costing reports that show the profit and loss of each product line, customer, market segment, channel, and region. Executives will then see where the existing strategy has succeeded and failed, and can formulate approaches to turning around loss operations and expanding the scope and scale of profitable operations.

Consider the experience of a large New York City bank with an overall profitable product line of demand and time deposits. Information from its aggregate profitability measurement system showed that all customers with balances greater than $25,000 were profitable, so the bank launched a major initiative to retain those clients. During the initiative, however, the bank conducted a more detailed ABC study to calculate the cost to serve and the profitability of all accounts. It learned that 35% of the households targeted for retention were unprofitable, with cumulative losses totaling more than $2 million. Unprofitable customers could be found in every balance tier up to $1 million, in fact. Managers at first could not believe that high-deposit individuals could be unprofitable. Further analysis revealed that unprofitable customers did a large number of transactions in the branches, the most expensive service channel, and kept most of their deposits in accounts that yielded low margins to the bank. Fortunately, the bank discovered this error in its strategy before it was too far along in its client retention initiative.

Unprofitability doesn't mean that a company should simply drop a customer or product, however. In our experience, companies find multiple ways – process improvements, repricing, and redefining relationships – to reduce or eliminate the losses from unprofitable products and customers, once a credible costing system has identified them.

Statistical analyses. Companies, especially those with large numbers of similar operating units, can use statistical analysis to estimate correlations among strategy performance numbers. Such analysis will usually validate and quantify links between investments in, for example, employee skills or IT support systems, and customer loyalty and financial performance. Occasionally, however, the analysis can reveal that assumed linkages are not occurring, which should cause the executive team to question or reject at least part of the existing strategy. Companies that consistently measure strategy performance through tools such as the strategy map and balanced scorecard have ready access to the data needed for strategy validation and testing.

Take Store 24, one of New England's largest convenience store chains (now owned by Tedeschi Food Shops), which in 1998 implemented a new customer strategy called "Ban Boredom." Store 24's CEO believed that providing an entertaining shopping atmosphere, including frequent themes and promotions, would differentiate the shopping experience at the chain from its competitors'. The company created a strategy map and balanced scorecard to communicate and help implement the new strategy. Within two years, however, Store 24's executive team learned that the strategy was not working. Feedback from individual customers and focus groups led the chain to abandon the Ban Boredom strategy and replace it with an updated version of its previous strategy, which featured fast and efficient service.

A Harvard Business School faculty team (Dennis Campbell, Srikant Datar, Susan Kulp, and V.G. Narayanan) gained access to quarterly data from Store 24's 85 retail outlets and performed statistical analysis to see whether the company's executives could have recognized the flaws in the Ban

UNPROFITABILITY DOESN'T MEAN that a company should simply drop a customer or product. Companies can find multiple ways to reduce or eliminate losses, once a credible costing system has identified them.

Boredom strategy earlier. Looking at data from the first year of the strategy, the study found that better implementation of the Ban Boredom program was indeed negatively correlated with store performance, exactly the opposite of what the strategy had intended. The data also showed that differences in profits were best explained by variables not related to the strategy, including store managers' skills, local population, and local competition. By uncovering those (and several other) simple correlations, Store 24 management could have learned one year earlier than it actually did that the new strategy was not working. The managers would also have seen that the strategy would be successful only if all stores raised their crew skills to high levels, something that wasn't feasible given the 200% annual employee turnover rate typical of retail stores.

Emergent strategies. The strategy offsite, beyond examining the performance of existing strategy, provides executives with a great opportunity to consider new strategy proposals that managers and employees throughout the enterprise may have suggested. Henry Mintzberg and Gary Hamel, in fact, argue against top-down strategy implementation, contending that the most innovative strategies emerge from within the organization. Not all such strategies are worth pursuing, however, and even if several seem promising, the executive team still needs to decide which, if any, to adopt.

If the executive team decides, based on analyses of the internal data, the competitive environment, and emerging strategy ideas, to alter the existing strategy, it should follow up by modifying the organization's strategy map and scorecard. That will launch another cycle of strategy translation and operational execution, with new targets, new initiatives, a new sales and operating plan, revised process improvement priorities, changed resource capacity requirements, and an updated financial plan. The new strategic and operational plans set the stage and establish the information requirements for next period's schedule of operational reviews, strategy reviews, and strategy testing and adaptation meetings.

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Managers have always found it hard to balance near-term operational concerns with long-term strategic priorities. But such a balancing act comes with the job; it is an inherent tension that managers cannot avoid and must continually address. As a senior strategic planner at a *Fortune* 20 company told us, "You can have the best processes in the world, but if your governance processes don't provide the direction and course correction required to achieve your goals, success is a matter of luck." At the same time, a company can have the best strategy in the world, but it will get nowhere if managers cannot translate that strategy into operational plans and then execute the plans and achieve the performance targets.

Managers that carefully follow the recommendations we have laid out in this article will have a complete management system that helps them set clear strategic goals, allocate resources consistent with those goals, set priorities for operational action, quickly recognize the operational and strategic impact of those decisions, and, if necessary, update their strategic goals. The closed-loop management system enables executives to manage both strategy and operations, and to balance the tensions between them.

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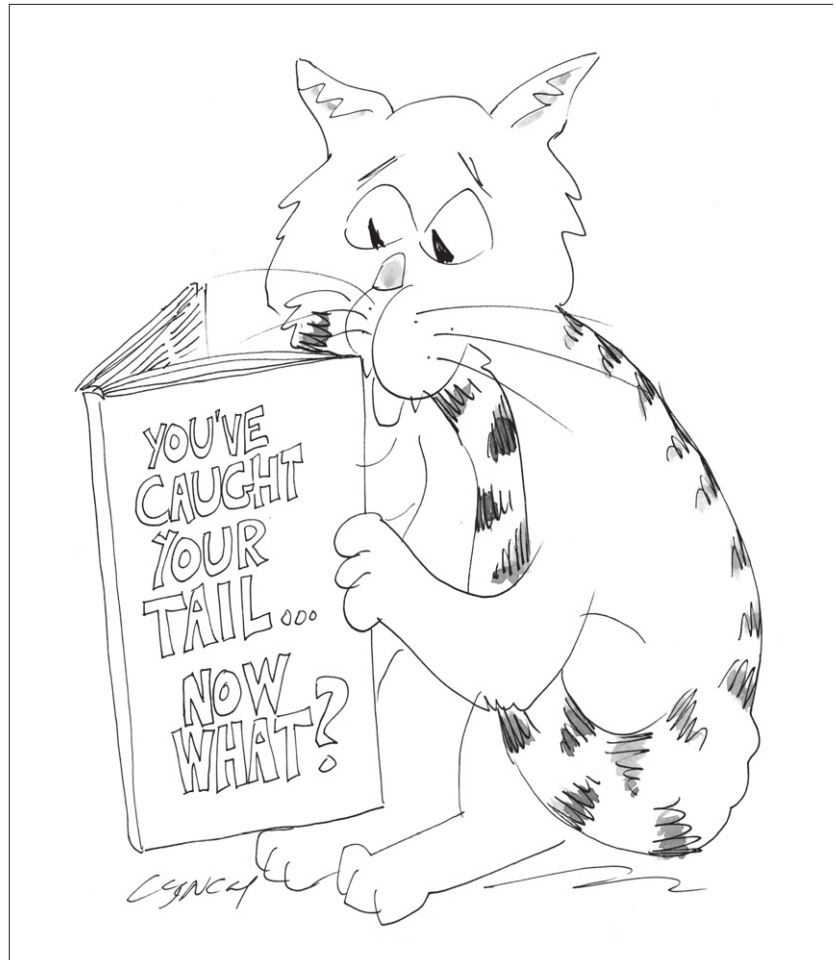

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