The Value Market

CREATING PROFITABLE GROWTH THROUGH CONSISTENT STRATEGY EXECUTION

BY DEAN SORENSEN

When Hewlett and Packard started their business, they posted the following Rules of the Garage:

"Believe you can change the world. Work quickly, keep the tools unlocked, and work whenever. Know when to work alone and when to work together. Share—tools, ideas. Trust your colleagues. No politics, no bureaucracy. (These are ridiculous in a garage.) The customer defines a job well done. Radical ideas are not bad ideas. Invent different ways of working. Make a contribution every day. If it doesn't contribute, it doesn't leave the garage. Believe that together we can do anything."

Most executives still aspire to run their companies in this way. They understand the need to be more flexible and responsive, not only to attract and retain loyal customers but to maintain competitive cost structures that will sustain profitable growth as well. Yet with growth comes complexity. It becomes increasingly difficult to manage the many competing and constantly changing priorities being driven by evolving customer demands.

But there is one constant. Customers demand "red carpet" service at "deep discount" prices. Delivering exceptional service and value to customers while minimizing costs is essential. Virtually every aspect of organization performance is governed by such conflicting objectives—tradeoffs—between cost and service. Expressed another way, between customer and shareholder value.

Most organizations, however, are ill-equipped to manage these tradeoffs. The result: strategies that fail to meet their objectives, leading to suboptimal performance. The evidence: many of the management challenges (Figure 1) organizations face today.

A Value Market (VM) is a powerful new management system that enables organizations to address these challenges. It leverages emerging management system software (MSS) that integrates universally accepted management tools, such as the balanced scorecard and activity-based costing (ABC), as well as planning, budgeting, and forecasting, to provide this one capability that such applications can't provide individually—the ability to manage tradeoffs.

A VM provides the basis to deploy and operationalize strategy across functional boundaries into the processes, activities, and experiences that deliver value to customers. In this context, it represents a significant step change in an organization's ability to execute strategy and create profitable growth.

In affording these capabilities, a VM also provides the means to answer questions many finance professionals are asking: What lies beyond budgeting? How can tactics (budgets) and strategy (balanced scorecard) be integrated more effectively?

But a VM isn't just about management tools and software. It's also about fundamentally changing how organizations engage employees in managing a business. The objective: Create a more agile and customer-focused organization where people make the "right decisions" because they think and act more like "business owners." Appreciating this objective starts with an understanding of the fundamental issue it addresses: consistent strategy execution.

MANAGEMENT SYSTEMS AND STRATEGY EXECUTION

Strategies fail to achieve their objectives for many reasons. The strategy itself was flawed. The right people weren't in place. But the problem often lies in deployment. Numerous organizations lack effective management systems—the processes, frameworks, tools, and economic models that enable them to define, adapt, and deploy strategy.

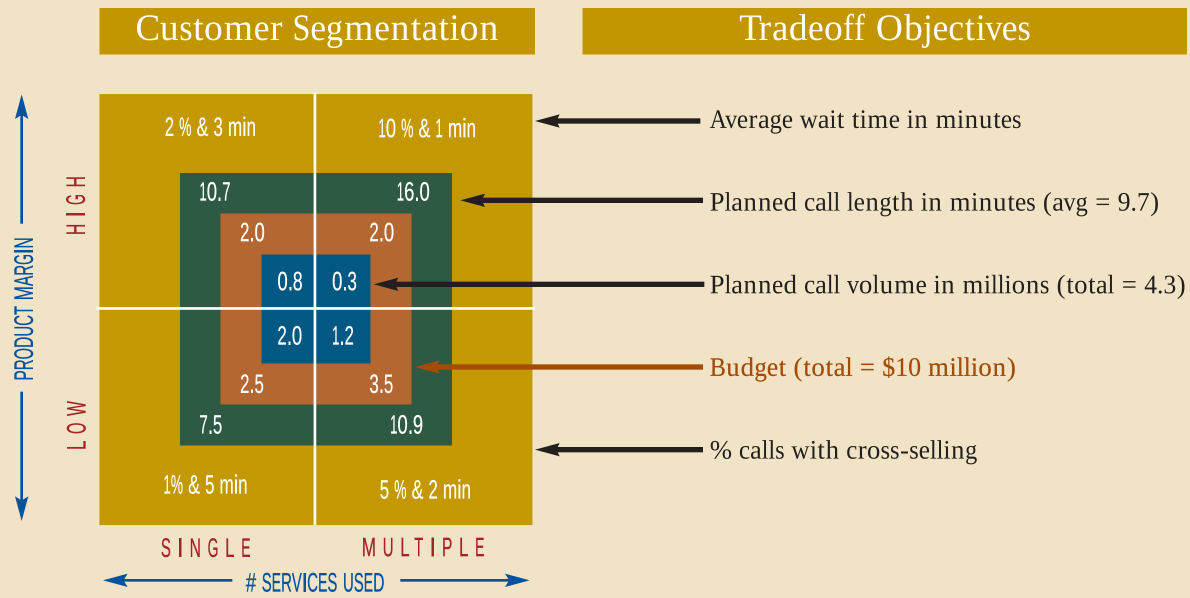
For many companies, management systems are ill-suited to meet the needs of today's competitive environment, often being described as cumbersome, inefficient, and ineffective—particularly budgeting. In a time when organizations are eager to exploit synergies across their business units, traditional management systems do little to support this. Instead, they often encourage a defend-your-own-turf attitude that's reinforced by recognition and rewards that are linked to achieving the budgeted numbers. The result: strategies that don't meet their objectives.

The evidence is abundant. Research shows that most organizations fail to consistently achieve strategic objectives and create profitable growth. For them, initiatives often fall short of meeting their objectives. Enterprise resource planning (ERP), customer relationship management (CRM), business process reengineering (BPR), and knowledge management are common examples.

Figure 1: STRATEGIC IMPERATIVES AND MANAGEMENT CHALLENGES

Strategic Imperatives		Management Challenges
Attract and retain loyal customers	TRADEOFF	While maintaining profitable product and customer portfolios
Increase top-line growth from new products	TRADEOFF	While increasing bottom-line growth
Reduce costs and maintain a competitive cost structure	TRADEOFF	While delivering superior service that meets/exceeds customer expectations
Become more innovative, flexible, and responsive to customers	TRADEOFF	While leveraging economies of scale and minimizing risk to the organization
Attract the right people and leverage their skills	TRADEOFF	While investing the right amount to keep them

Figure 2: EXECUTABLE OBJECTIVES



The above graphic relates to an example of a financial institution seeking to increase cross-selling (during customer interactions in its call center) as a means to increase revenue from its existing customer base. It depicts how this strategic objective would be deployed to four customer segments served by the call center. Specifically, it shows how planned:

- Call lengths and cost per call vary in light of how the $10 million budget is allocated to four customer segments—16-minute calls for high-profit customers and 5-minute calls for low-profit customers.
- Service levels vary by customer segment in light of budgetary constraints, where shorter wait times equate to higher levels of service—1 minute for high-profit customers and 5 minutes for low-profit customers.
- Cross-selling sales targets vary in light of planned call lengths for each customer segment—10% target for high-profit customers and 1% for low-profit customers.

What's important to note is that this example provides a framework for integrating activity-based costing, the balanced scorecard, and planning and budgeting. The key—expressing all financial and nonfinancial metrics in terms of customer-specific outputs.

At the heart of this execution challenge lies one single issue: a lack of clear integration between strategy and tactics. Strategic objectives are typically expressed in terms of initiatives and key performance indicators, while tactically based budgets are typically expressed in terms of general ledger line items. The result: strategic objectives that aren't always executable.

EXECUTABLE OBJECTIVES

What constitutes an executable objective? Three characteristics define them. They must be realistic and achievable, adequately funded and resourced, and customer specific. The problem for many organizations is that their objectives lack these characteristics.

Call centers often provide classic examples. Many employ high-level objectives, such as average time/cost per call and wait time. While these metrics provide useful information for monitoring performance trends, by definition they aren't typically executable because they don't have all three characteristics. Figure 2 illustrates what would constitute executable objectives.

What happens when organizations don't manage at this level of detail? Confusion about how strategic objectives should be interpreted and how resources should be allocated to achieve them. This can lead to behaviors and decisions that are in direct conflict with the strategy, such as prematurely ending calls to meet objectives. The result: internal and external customer expectations that aren't met and, ultimately, lost sales and profits.

Managing expectations in this manner is a capability lacking in most organizations. In fact, this capability gap permeates virtually every aspect of organization performance and lies at the heart of many of the aforementioned management challenges. Why do organizations have such difficulty in managing expectations? Stated simply, a lack of practical tools.

WHAT'S NEW? MANAGING TRADEOFFS

So what has changed to address this? As technologies have evolved, the transmission, circulation, and processing of high volumes of data have become spectacularly fast, accurate, and cheap. These logistical advances have coincided with breakthrough developments in management system software to overcome the obstacles that have prevented organizations from addressing this expectation management problem.

Management system applications are undergoing three key changes. Web technology has significantly enhanced their ability to quickly collect and disseminate information—a problem limiting the effectiveness of management systems in many organizations. No surprise here. But as Figure 3 illustrates, the other two aren't as obvious. Software vendors are beginning to provide solutions that:

◆ Integrate balanced scorecards with activity-based costing and/or planning and budgeting.

◆ Incorporate broader capabilities beyond traditional business intelligence, including strategy development, process, and knowledge management.

Why are these trends significant? Because they provide the means to integrate these aforementioned management tools into a powerful management system. The result: the ability to continuously plan, measure costs, and manage performance around processes and outputs. In turn, this provides one capability that these tools/applications can't provide individually—the ability to manage tradeoffs. This is the central role of a Value Market.

THE VALUE MARKET—INSTITUTIONALIZING CUSTOMER FOCUS

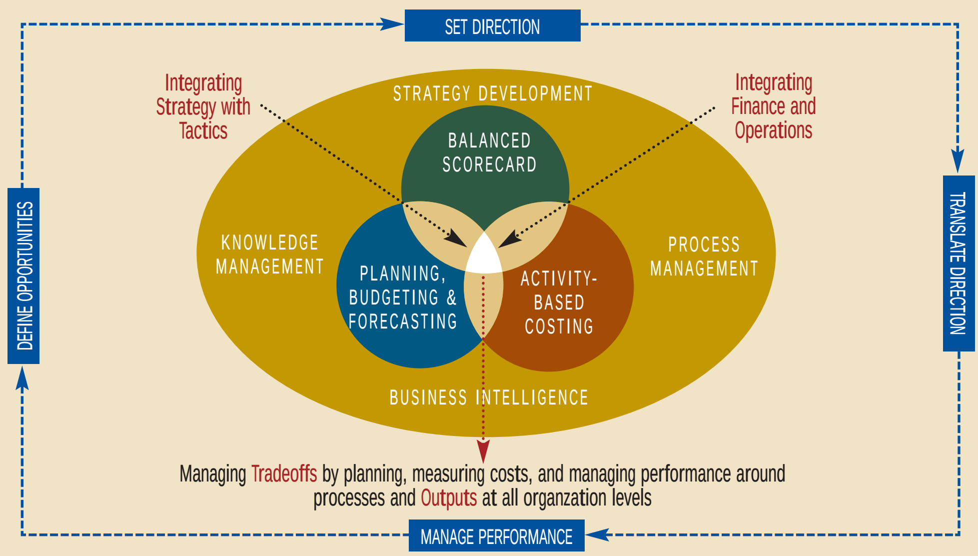
A VM is an output-based management system that institutionalizes customer focus. How? By integrating internal customer and supplier relationships into the management system. The notion of using such relationships to create customer focus isn't new. What's new, however, is the means to really manage the tradeoff objectives associated with these relationships. Without this capability, such relationships tend to break down and become ineffective because there's no mechanism to resolve conflict between the service levels being demanded by internal customers and the budgetary constraints imposed on internal suppliers.

A VM, on the other hand, provides the basis to manage these conflicting objectives to the level of detail illustrated in Figure 2. It does so by translating high-level tradeoffs into those for the outputs that comprise the products and services customers buy, as shown in Figure 4. This process enables organizations to achieve four things that most can't with traditional management systems:

◆ Manage customer expectations by enabling specific dialogues with internal and external customers about service levels that can be achieved in light of budgetary constraints.

◆ Maintain competitive cost structures by translating what customers are demanding and willing to pay into objectives for the activities comprising the products and services they buy.

Figure 3: MANAGEMENT SYSTEM SOFTWARE CHANGES ENABLING THE VALUE MARKET

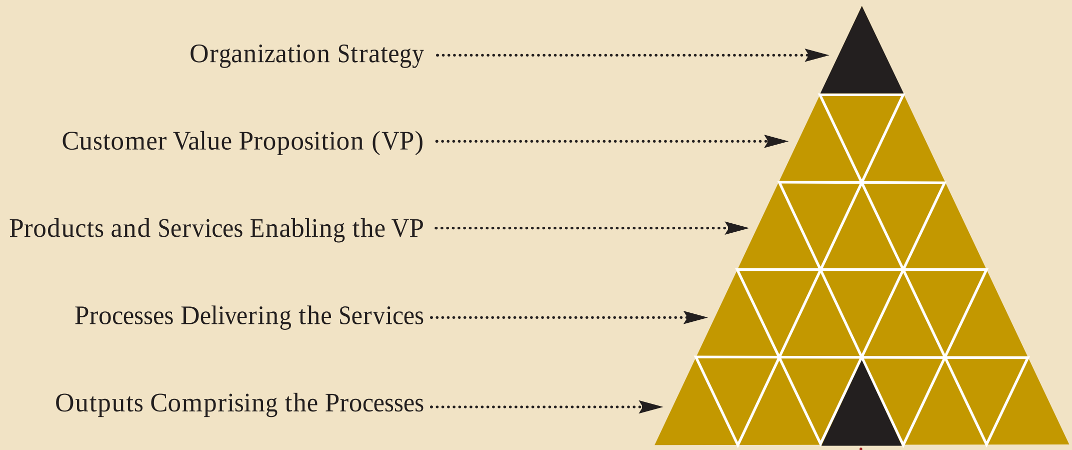


Conclusions about the trend toward integrated management system software is based on a research report that was jointly published by Bywater and Financial Executives International (www.fei.org) in July 2002. The report covered approximately 50 software vendors providing balanced scorecard, activity-based costing, and planning and budgeting solutions.

Figure 4: VALUE MARKET FRAMEWORK

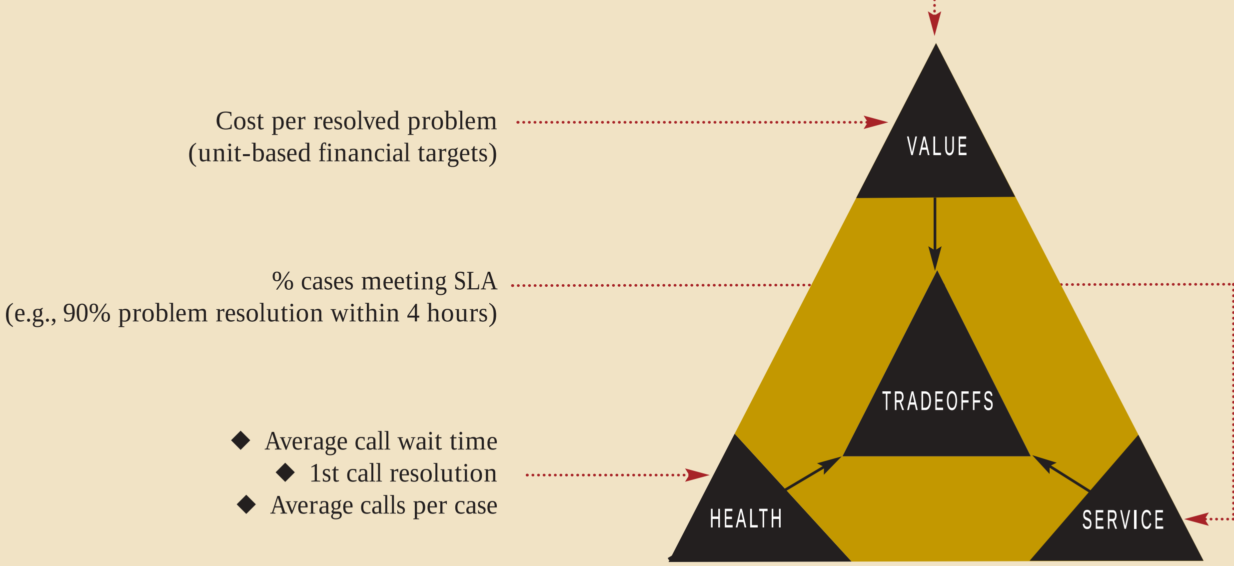
Tradeoff Hierarchy

A tool expressing the relationship between organization strategy and the tradeoff objectives associated with the outputs that comprise the underlying customer value propositions.



Tradeoff Objectives

The set of metrics defining the conflicting "Value" (or cost) and "Service" objectives that are associated with specific outputs, together with key underlying assumptions, expressed in the form of "Health" objectives. The following is an example of a tradeoff objective for the output of "Resolved Customer Problems," in a call center.



◆ Focus people on achieving broader organizational and customer objectives rather than those of individual functions.

◆ Translate strategy into specific tradeoff objectives that are explicitly linked to clearly defined customer experiences that the organization intends to create.

These capabilities promote more market-like actions, enabling companies to become more responsive and agile. They bring a level of direction and insight that provides a significant step change in an organization's ability to execute strategy. From this perspective, they provide the basis to fundamentally transform how organizations manage performance.

TRANSFORMING HOW ORGANIZATIONS MANAGE PERFORMANCE

Clear communication across an organization lies at the heart of this transformation. People start talking the same language because there's an explicit link between financial and operational objectives, which makes them better equipped to manage expectations. And the same capabilities that enable managers to better handle expectations of internal and external customers are the same ones that will allow CFOs to do likewise with market analysts about earnings.

But the benefits of framing objectives in this context go beyond just better communication. When people are accountable for managing tradeoffs, they start to think and act differently—more like business owners. They start to exhibit behaviors and make decisions in a manner depicted in Table 1. Why is this? Because a VM enables effective delegation and employee empowerment while fostering ownership of objectives through a more meaningful planning dialogue.

Effective Delegation and Employee Empowerment

Using outputs as the basis for delegating authority provides the means to effectively empower employees. They understand the tradeoff objectives. They know what constitutes a "right decision." As new situations arise, it's up to them to make decisions within these defined constraints. In this context, a VM provides the means to empower employees without abdicating control.

Fostering Ownership of Objectives

A VM provides the basis to change the tone of the management process. Budgets become more of a funding mechanism rather than a control device. Planning and performance management become less about controlling resource allocation and more about coordinating it. Between *organization* units, it forms the basis for establishing service levels in light of cost constraints. Between *management* levels, it provides the basis for an explicit two-way dialogue about the impact of planned spending on key performance indicators.

For example, when managers are faced with budget cuts, planning dialogues become focused on three levers affecting spending: reducing the volume of work, reducing service levels, and increasing productivity by way of capital expenditures. The idea here is that managers are the experts. You tell them what you want, and they will tell you how much it will cost, together with the detailed assumptions. In other words, it enables them to more effectively manage expectations—of both internal and external customers. It's this type of dialogue that gets people committed to achieving the objectives for which they are accountable.

This type of process is in stark contrast to those most organizations use today. Many still cling to traditional budgeting processes despite growing evidence that, in its traditional form, it often drives behaviors that are inconsistent with strategic objectives. The VM provides the means to address this—not by abandoning budgeting, as some might advocate, but by fundamentally changing its role. VM provides the basis to answer the question, "What lies beyond budgeting?"

This type of empowerment and commitment is essential for executing customer-focused strategies. Better decisions and customer experiences don't come from greater control—they come from better coordination. These enterprises accept that they can't tell employees what to do in all circumstances. Conditions change too fast for that! Direction must be given in terms of broader guidelines. And it's this form of direction that lies at the center of the VM's strategic value.

THE VALUE OPPORTUNITY

As organizations become more complex, it grows increasingly difficult to coordinate activities horizontally across functional and organizational boundaries, especially in larger enterprises that must constantly respond to market shifts. The result: Resources aren't always allocated to the right places, process cycle times rise, and strategic objectives aren't achieved because they aren't clear. A Value Market provides the means to cope with this level of complexity.

Depending on the coordination capabilities within an organization's existing management systems, a VM has the potential to create value from three related sources:

◆ Increasing the success rate of strategic initiatives by at least 100% (assuming that, on average, only one-third of the organization's change programs achieve their objectives) by enabling organizations to deploy them horizontally across business processes to specific activities and outputs.

◆ Permanently reducing overhead cost structures by up to 10% by allocating resources based on what customers are willing to pay.

◆ Decreasing process cycle times by up to 740%, thereby increasing the ability to attract and retain loyal customers with superior responsiveness.

This last point is particularly important. Research published in *Harvard Business Review* shows that a collective sense of responsibility for meeting customer needs can lead to cycle times up to 7.4 times faster than functionally based organizations. Establishing joint accountability for outputs and their related tradeoffs provides the founda-

Table 1: BUSINESS OWNER MENTALITY AND RIGHT DECISIONS

Business Owner Mentality	Right Decisions
OWNERSHIP: People feel ownership of the objectives for which they are accountable.	BALANCED: Optimize value for all stakeholders—shareholders, customers, and employees alike.
STEWARDSHIP: People manage the organization's resources as if they owned them.	CONSISTENT: Made consistently across the organization, given similar circumstances and facts.
INNOVATIVE: People are innovative in creating value for both customers and shareholders.	FACT-BASED: Leverage the collective experience and knowledge of the organization.
MOTIVATED: People stretch themselves and welcome challenges.	HOLISTIC: Made from an organizational perspective so that one function does not benefit from a decision at the expense of another.
COMMITTED: People live up to their commitments.	EXPEDIENT: Made quickly and are not hampered by a lack of information, fear of failure, or excessive organizational politics.
CUSTOMER ORIENTED: People treat customers as their own.	BOLD: Incorporate calculated risk taking where people "play to win" rather than "play not to lose."
INTEGRITY: Dominates how people work and interact with one another.	

tion for achieving this. It gets people to make decisions on a more holistic basis—decisions that are focused on profitably serving customers and creating value for the organization as a whole.

IMPLICATIONS FOR THE CFO

As organizations face the challenges of today's economic environment, the role of the CFO is becoming increasingly prominent. CEOs, shareholders, and market analysts expect them to become more of a strategic business partner—one that is focused on value creation rather than cost control. This entails playing a more significant role in shaping and executing strategy that creates value for all stakeholders—customers, employees, and shareholders.

Providing capabilities that foster good decision making is central to this evolving role as a value creator. For most organizations, management system software is essential. In fact, research shows that organizations will invest heavily in MSS over the coming years. Yet many are investing in tools that simply "pave the cow path"—perpetuating processes that do little to enhance the ability to execute strategy and create value.

CFOs need to be aware of this since their ability to assume a "business partner role" will likely be governed to a large extent by the MSS in which they choose to invest. In this context, they must be aware of the conscious or unconscious decision being made as the MSS is selected—the future of their finance function and the role it will play in the organization.

THE ROAD LESS TRAVELED

Today's complexities require a different type of management system—one that provides the basis to channel the collective organization intelligence and emotion into executing customer-focused strategies. The Value Market provides the means to achieve this by integrating universally accepted tools and practices into a powerful management system. Realizing its potential value, though, will require finance leaders with vision—ones who are comfortable taking "the road less traveled." They will see it as an opportunity to help their organizations become more innovative, flexible, and responsive and, in so doing, separate themselves from competitors through consistent strategy execution that sustains profitable growth. ■

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