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Special excerpt from the forthcoming book, *The Execution Premium,* due out in June.

Integrating Strategy Planning and Operational Execution: A Six-Stage System

By Robert S. Kaplan and David P. Norton

This article, their January *Harvard Business Review* article, and their new book mark the next milestone in the evolution of Robert Kaplan and David Norton's strategy execution movement: a comprehensive management model that solves one of the greatest management challenges—linking strategy and operations. This powerful six-stage model incorporates the Balanced Scorecard, theme-based strategy maps, and the five Strategy-Focused Organization principles and practices. But it now also includes the most effective strategy development, planning, and management tools developed by leading experts. Collectively, these tools help companies not only plan and execute, but also monitor, learn, test, and adapt their strategic assumptions and practices to achieve sustainable success.

Experts from Michael Porter to Michael Hammer concur: without excellent operational and governance processes, strategy—even the most visionary strategy—cannot be implemented. Conversely, without strategic vision and guidance, operational excellence is not sufficient to achieve, let alone sustain, success.[1]

A survey we conducted in 1996 revealed that few organizations link their systems and align their employees to strategy. But a survey conducted in 2006 showed that 54% of respondents were now using a formal strategy execution management process. Of these, nearly 75% were outperforming their peer group. Conversely, among the organizations without a formal strategy execution process in place, 75% were underperforming or, at most, matching the average performance of their peers. Having a formal strategy execution system apparently makes strategic success up to three times more likely.

A Six-Stage Management System

We have now formulated the architecture for a comprehensive and integrated management system that explicitly links strategy formulation and planning with operational execution. (See *Figure 1,* page 4.)

Stage 1: Develop the strategy using an array of strategy tools such as mission, values, and vision (MVV) statements; external competitive, economic, and environmental analyses; methodologies such as Michael Porter's five forces and competitive positioning framework, the resource-based view of strategy, and blue ocean strategies, as well as scenario planning, dynamic simulations, and war-gaming.

Stage 2: Plan the strategy using such tools as strategy maps and Balanced Scorecards, along with targets and strategic initiatives.

Stage 3: Align the organization with the strategy by cascading strategy maps and Balanced Scorecards to all organizational units, by aligning employees through a formal communications process, and by linking employees' personal objectives and incentives to strategic objectives.

Stage 4: Plan operations using tools such as quality and process management, reengineering, process dashboards, rolling forecasts, activity-based costing, resource capacity planning, and dynamic budgeting.

Stage 5: Monitor and learn about problems, barriers, and challenges. This process integrates information about operations and strategy into a carefully designed structure of management review meetings.

Stage 6: Test and adapt the strategy, using internal operational data and new external environmental and competitive data—thus launching a new cycle of integrated strategy planning and operational execution.

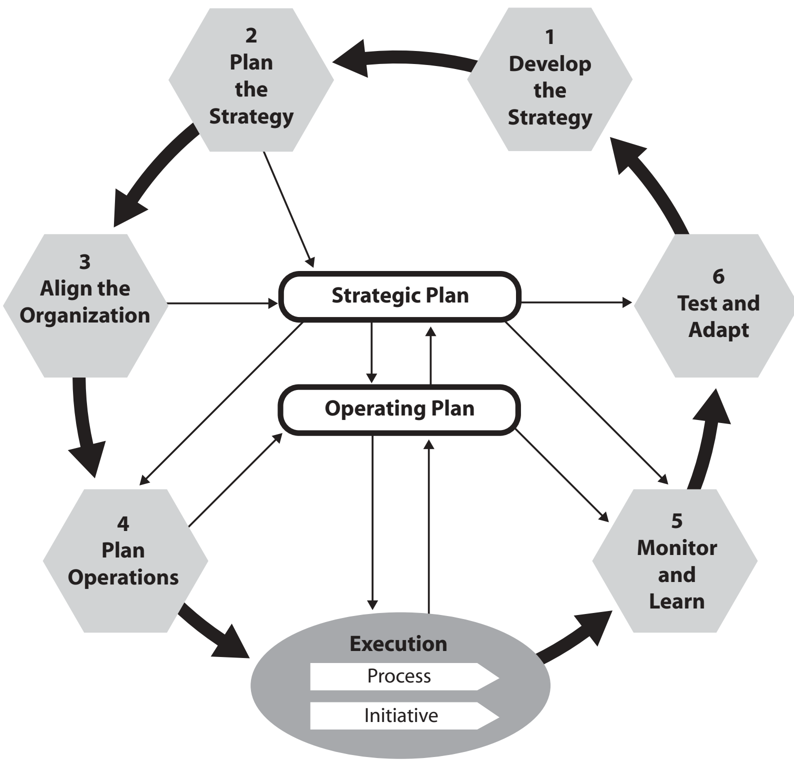
Stage 1: Develop the Strategy

The integrated management system begins when executives develop the strategy. In this process, described at length in the January–February and March–April issues,[2] companies address three questions:

1. What business are we in, and why? Executives begin strategy development by affirming the organization's purpose (mission), the internal compass that guides its actions (values), and its aspiration for future results (vision). These statements establish guidelines for formulating and executing the strategy.

2. What are the key issues we face? Managers conduct strategic analysis of their competitive and operating environments, especially major changes that have occurred since they last crafted their strategy, using input from three sources: external environment analysis (PESTEL analysis—political, economic, social, technological,

Figure 1. A Closed-Loop Management System Linking Strategy and Operations



This six-stage management system, which incorporates the principles of the Strategy-Focused Organization, provides a comprehensive system that integrates all the processes and tools needed to develop and operationalize strategy, and to monitor and improve the effectiveness of strategy and operations. Constant review and dynamic updating of information is built into the system, providing a closed loop of feedback and learning—and the ability to update the strategy when underlying assumptions prove outdated or flawed.

environmental, and legal or regulatory factors); the internal environment (key processes, such as the state of human capital, operations, innovation, and technology deployment); and the progress of the existing strategy (from BSC metrics). This environmental assessment is summarized in a SWOT table of strengths, opportunities, weaknesses, and threats, which identifies a set of strategic issues that must be addressed by the strategy.

From the outputs from questions (1) and (2), the executive team develops and communicates a strategic change agenda that explains the need for the changes in the strategy.

3. How can we best compete? In the final step, executives formulate a strategy by addressing these issues:

- In what niches will we compete?
- What customer value proposition will differentiate us in those niches?
- What key processes will create our differentiation?
- What direction does the strategy require we take in human capital?
- What are the technology enablers of the strategy?

Stage 2: Plan the Strategy

Managers plan the strategy by developing strategic objectives, measures, targets, initiatives, and budgets that guide action and resource allocation. Companies typically address five questions in this stage:

1. How do we describe our strategy? A strategy encompasses various dimensions of organizational change, from short-term productivity improvements to long-term innovation. Companies create a strategy map to depict all their strategic dimensions. Because of the difficulty in managing the simultaneous performance of the 15 to 25 objectives on a typical strategy map, companies now cluster related objectives into four to six strategic themes, each a set of related strategic objectives, that represent the major components of the strategy. (Example: "Improve Operational Quality and Efficiency.") By building a strategy map around strategic themes, executives can separately plan and manage each key component of the strategy but still have it operate coherently. Themes transcend functional lines and business units, thus supporting the boundaryless approach necessary for successful strategy execution.

2. How do we measure our plan? In this step, managers convert the objectives defined in the strategy maps into a Balanced Scorecard of measures, targets, and gaps. The overall "value gap"—typically defined by the vision statement crafted during the strategy development process—is split into gaps that each strategic theme must close over three to five years.

3. What action programs does our strategy need? Managers choose strategic initiatives—action programs of finite duration aimed at achieving targeted performance for the strategy map objectives. Initiatives must be viewed as a portfolio of complementary actions with a cumulative effect, each of which must be implemented successfully if the company is to achieve its theme targets and its vision objective.

4. How do we fund our initiatives? Executing strategy requires that initiatives be executed simultaneously in a coordinated manner. This requires explicit funding for the initiative portfolios. The traditional budgeting system focuses on the resources for existing organizational functions and business units. Strategic investments for initiatives that cross functions and business units must be removed from operational budgets and managed separately by the executive team. Companies facilitate this process by creating a special budget category called STRATEX (strategic expenditures).

5. Who will lead strategy execution? Some companies are establishing theme teams, a new accountability structure for executing strategy through strategic themes. This is important, since by definition strategic themes cross unit and functional lines and typical lines of responsibility. Companies assign executives to become theme owners, provide them STRATEX funding, and support them with theme teams drawn from across the organization. The theme owners and teams provide accountability for and feedback on the execution of the strategy within each theme.[3] (See Reprint #B0805B.)

Stage 3: Align the Organization with the Strategy

To capture the full benefits of operating a multibusiness, multifunction organization, executives must link company strategy to the strategies of their business and functional units, and must align and motivate employees. In this stage, they address three questions:

1. How do we ensure that all business units are aligned? Strategy is usually defined at the individual business-unit level. But companies typically consist of multiple business or operating units. Corporate-level strategy defines how the strategies of individual business units can be integrated to create synergies not available to business units that operate independently from each other. Corporate strategy is described by a strategy map that identifies the specific sources of synergies. Managers then cascade this map vertically to business units, whose own strategy maps can then reflect objectives related to their local strategies as well as those objectives that integrate with the corporate strategy and the strategies of other business units.

Whether developed annually or quarterly, the operating plan is launched from a sales forecast, a task facilitated by analytic approaches such as driver-based planning.

2. How do we align support units with business-unit and corporate strategies? Executives often treat support units and corporate staff functions as discretionary expense centers, that is, as overhead departments whose goals are to minimize their operating expenses. As a result, the strategies and operations of support units do not align well with those of the company and the business units they are supposed to support. Successful strategy execution requires that support units align their strategies to the value-creating strategies of the company and its business units. Support units should negotiate service-level agreements with business units to define the set of services they will provide. Creating support-unit strategy maps and scorecards based on the service-level agreements enables each unit to define and execute a strategy that enhances the strategies being implemented by business units.[4]

3. How do we motivate employees to help us execute the strategy? Ultimately, employees are the ones who improve the processes and run the projects, programs, and initiatives required by the strategy. They must know and understand the strategy if they are to successfully link their day-to-day work with the strategy. Formal communication programs help employees understand the strategy and motivate them to achieve it. Managers reinforce the communication program by aligning employees' personal objectives and incentives with business-unit and company strategic objectives. Also, training and career development programs help employees gain the competencies they need for successful strategy execution.

Stage 4: Plan Operations

How do companies link long-term strategy with day-to-day operations? Through an operational plan, which addresses these two key questions:

1. Which business process improvements are most critical for executing the strategy? The objectives in a strategy map's process perspective represent how strategy gets executed. Strategic themes originate in these key processes.[5] For example, a strategic theme to "Grow Through Innovation" requires outstanding performance from the new product development process; a theme to "Create Heightened Loyalty Among Targeted Customers" requires greatly improved customer management processes. Some process improvements are designed to deliver the financial perspective's cost reduction and productivity objectives, whereas others focus on excelling at regulatory and social objectives. These process improvements, distinct from the short-term strategic initiatives developed in Stage 2, represent improvements to existing, ongoing processes. Companies must focus their total quality management, Six Sigma, and reengineering programs on enhancing the performance of those processes directly related to the strategic objectives that will yield desired improvements in the strategy's customer and financial objectives. Customized dashboards containing key indicators of local process performance provide focus and feedback to employees' process improvement efforts.

2. How do we link strategy with operating plans and budgets? The process improvement plans and the BSC's high-level strategic measures and targets must be converted into an annual operating plan. An operating plan has three components: a detailed sales forecast, a resource capacity plan, and budgets for operating expenses and capital expenditures.

Sales forecast: Companies need to translate their strategic plan's revenue targets into a sales forecast. The Beyond Budgeting movement[6] advocates that companies continually respond to their dynamic environments by reforecasting quarterly sales on a rolling basis five to six quarters into the future. Whether developed annually or quarterly, the operating plan is launched from a sales forecast, a task facilitated by analytic approaches such as driver-based planning. To provide the detail necessary for the operating plan, the sales forecast should incorporate the expected quantity, mix, and nature of individual sales orders, production runs, and transactions.

Resource capacity plan: Companies can use time-driven activity-based costing (TDABC) to translate detailed sales forecasts into estimates of the resource capacity required for the forecast periods.[7] Activity-based costing is a tool for measuring the cost and profitability of processes, products, customers, channels, regions, and business units. But its "killer app" is for resource planning and budgeting. TDABC uses capacity drivers (typically time) to map resource expenses to the transactions, products, and customers handled by each process. It can easily map forecast sales and process improvements to the quantity of resources—people, equipment, and facilities—required to fulfill the plan.

Dynamic operating and capital budgets: Once managers have agreed on the quantity and mix of resources for a future period, they can easily calculate the financial implications of these resource commitments. The company knows the cost of supplying each unit of resource. It multiplies the cost of each resource type by the quantity of resources it has authorized, thereby obtaining the budgeted cost of supplying the resource capacity for the sales forecast and operating plan. Most of the resource capacity represents personnel costs and would be included in the operating expense (OPEX) budget. Increases in equipment resource capacity would be reflected in the capital budget (CAPEX). The outputs from this process are dynamic operating and capital budgets that have been derived quickly and analytically from the sales and operating plans.

Because the company starts with detailed revenue forecasts and now has the resource costs associated with delivering these forecasts, simple subtraction yields a forecast and detailed profit-and-loss statement for each product, customer, channel, and region. Companies that shift from an annual to a quarterly (rolling) budget process can follow this process to get resource capacity plans for every period in which they have a sales forecast. Discretionary spending—such as promotional and advertising costs, process improvement initiatives, and training—cannot yet be automated through a model. Planning for such costs is the last step in budgeting.

Stage 5: Monitor and Learn

Once the strategy has been determined, planned, and linked to a comprehensive operational plan, the company begins to execute its strategic and operational plans (represented by the oval between stages 4 and 5 in Figure 1), monitor the performance results, and act to improve operations and strategy based on new information and learning.

At operational review meetings, companies examine departmental and functional performance and address new or persistent problems. They conduct strategy review meetings to discuss the indicators and initiatives from the unit's BSC and assess the progress of and barriers to strategy execution.[8] By holding separate operational and strategy review meetings, companies avoid having short-term operational and tactical issues displace discussions of strategy implementation and adaptation. The two meetings address different questions:

1. Are our operations under control? At operational review meetings companies examine short-term performance and respond to newly identified problems that need immediate attention. Operational review meetings should correspond to the frequency with which operational data are generated and the speed at which management wants to respond to sales and operating data and the myriad other tactical issues that continually emerge. Many companies have weekly, twice-weekly, or even daily meetings to review operating dashboards of sales, bookings, and shipments and to solve such short-term problems as complaints from important customers, late deliveries, a near-term cash shortfall, or a new sales opportunity. Operational review meetings are typically departmental and function-based, bringing together the expertise and experience of employees to solve day-to-day issues in such areas as sales, purchasing, logistics, finance, and operations. These meetings should be short, highly focused, data-driven, and action-oriented.

2. Are we executing our strategy well? Typically, companies schedule strategy review meetings once a month to bring together the CEO and executive committee members to review the progress of the strategy. The leadership team discusses whether strategy execution is on track, tracks the source and causes of implementation problems, recommends corrective actions, and assigns responsibility for achieving the targeted performance. If one thinks of strategy and problem-solving through the lens of the plan-do-check-act (PDCA) cycle, strategy review meetings are the "check" and "act" portions of strategy execution. If some of the same people attend both review meetings, meetings should be held at different times and have different agendas.

Because in-depth discussion of every BSC objective, measure, and initiative would require too much time at each monthly meeting, many companies now organize their strategy review meetings by strategic themes, covering one or two in depth at each meeting. Theme owners circulate BSC report data on measures and initiatives in advance of the meeting so executives can come prepared with ideas and solutions. The meeting time focuses on devising action plans for new issues. (Meetings should also allow time for urgent "off theme" issues that cannot wait for the next meeting to be dealt with.)

Each theme and objective is thus examined carefully at least once per quarter.

Stage 6: Test and Adapt the Strategy

A separate meeting is needed to test whether fundamental strategic assumptions remain valid. Since the previous major strategy review and update, the company has collected additional data from its dashboards and monthly BSC metrics, information on changes in the competitive and regulatory environment, and new ideas (including new opportunities). The strategy testing and adapting meeting addresses the fundamental question: Do we have the right strategy?

In this meeting, the executive team assesses the performance of its strategy and considers the consequences of recent changes in the external environment. Testing and adapting the existing strategy should be part of the strategic analysis done as part of the first management system stage. We treat it separately because this process is designed for modifying an existing strategy rather than for introducing a new, transformational strategy. The test-and-adapt meeting closes the loop on the integrated system of strategy planning and operational execution.

We believe every company should conduct such a meeting at least annually, perhaps quarterly (if competitive, technological, and consumer dynamics warrant it), or whenever a major disruption or strategic opportunity arises.

This meeting should be informed by current external conditions (via PESTEL analysis) and the competitive environment, as previously described. But the company now has, in addition, multiple inputs that describe the actual performance of—the successes and failures of—the existing strategy. Activity-based profitability reports summarize profit-and-loss data by product line, customer, market segment, channel, and region. A second set of reports shows statistical analyses—summaries of the links among strategic metrics—that validate and quantify the hypothesized links on the company's strategy map and strategic themes; for example, the connection between employee training initiatives and customer loyalty and financial performance. When the correlations are zero or opposite expectations, the executive team questions or rejects components of the existing strategy. Incremental improvements may be needed, or perhaps it's time for a new, transformational strategy.

As the executive team updates its strategy, it also modifies the organization's strategy map and BSC and starts another cycle of strategy planning and operational execution: new targets, new initiatives, the next period's sales forecasts and operating plan, process improvement priorities, resource capacity requirements, and an updated financial plan. The strategic and operational plans set the stage and establish the information requirements for next period's schedule of operational review, strategy review, and strategy testing and adapting meetings.

Balancing the demands of near-term operations with long-term strategic goals and priorities has always been a major management challenge—and will remain so. But doing so is critical to successful strategy execution. This closed-loop system, which incorporates time-tested approaches, not only helps companies manage the two, but enables them to validate—and challenge—their strategic hypotheses, and, if necessary, modify and change in a timely, proactive way. ■

1. Porter has said, "Operational effectiveness and strategy are both essential to superior performance…but they work in very different ways." See M. Porter, "What Is Strategy?" *Harvard Business Review* (November–December 1996). Similarly, Hammer noted that, "High performance operating processes are necessary but not sufficient for enterprise success." See M. Hammer, "Redesigning the Practice of Management," at Management: The Last Process Frontier (Hammer & Company Conference, December 4, 2006).

2. See R. S. Kaplan and D. P. Norton, with E. A. Barrows, Jr., "Developing the Strategy: Vision, Value Gaps, and Analysis," *BSR* January–February 2008 (Reprint #B0801A); and R. S. Kaplan and D. P. Norton, with E. A. Barrows, Jr., "Formulating (and Revising) the Strategy," *BSR* March–April 2008 (Reprint #B0803A).

3. See R. S. Kaplan and C. Jackson, "Managing by Strategic Themes," *BSR* September–October 2007 (Reprint #B0709A).

4. See R. S. Kaplan, "The Demise of Cost and Profit Centers," *BSR* January–February 2007 (Reprint #B0701A).

5. Horizontal strategic themes, such as for a collection of learning and growth or finance objectives, or for an entire perspective, are exceptions and may not have originated within the process perspective.

6. A movement established by Jeremy Hope and Robin Fraser and an approach documented in their book *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap* (HBS Press, 2003) that calls for eliminating the static annual budget and replacing it with more dynamic tools such as rolling forecasts. Several BSC users, including Hall of Fame organizations Borealis (2001) and Statoil (2007) are advocates. See "New Tools for a New Corporate Culture: The Budget-less Revolution," about Borealis, *BSR* January–February 2002 (Reprint #B0201C); and "Statoil: Scorecard Success—the Second Time Around," *BSR* January–February 2008 (Reprint #B0801B).

7. R. S. Kaplan and S. P. Anderson, "Time-Driven Activity-Based Costing," *Harvard Business Review* (November 2004); and Kaplan and Anderson, *Time-Driven Activity-Based Costing: A Simpler and More Powerful Path to Higher Profits* (HBS Press, 2007).

8. See D. P. Norton and J. R. Weiser, "The Strategy Review Process," *BSR* November–December 2006 (Reprint #B0611A).

TO LEARN MORE

"Mastering the Management System," by Robert S. Kaplan and David P. Norton (Harvard Business Review, *January 2008; Reprint #R0801D*), *offers further details on the system described in this article, including a toolkit of concepts and frameworks related to each of the six stages.*

See also "Linking Strategy and Planning to Budgets," by David P. Norton (BSR *May–June 2006; Reprint #B0605A); and "Linking Operations to Strategy and Budgeting," by David P. Norton and Philip W. Peck* (BSR *September–October 2006; Reprint #B0609A*).