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Strategic Capabilities: Bridging Strategy and Impact

It's not surprising, perhaps, but it is discouraging: The high failure rate organizations experience in turning strategic plans into successful results has been noted by researchers for more than 30 years. Yet as recently as 2013, an *Economist* study reported "61% of respondents acknowledge that their firms often struggle to bridge the gap between strategy formulation and its day-to-day implementation. Moreover, in the last three years an average of just 56% of strategic initiatives have been successful."[1]

This stubbornly-high failure rate is not due to a lack of attention or advice. An internet search of "business strategy failure" yields more than 100,000 hits. But one source of failure that has not received the attention it should is the critical role that capabilities play in moving strategy from a plan to reality. Capabilities are, too often, the missing link between strategy and impact. When they are absent, weak or otherwise compromised, strategy execution invariably falters.

Companies can improve on this track record by paying far greater attention to the capabilities they need to successfully implement their strategy. Doing so starts with understanding exactly what "capabilities" are and what they are not, as well as determining which capabilities are strategic—i.e., are vital to the effective execution of a particular strategy—which are core to competitive performance, and which are foundational abilities that a company must have to be a viable competitor. It also involves defining these capabilities—especially strategic ones—at a much finer level of detail to make it clear what the organization is hoping to accomplish with them.

By approaching organizational capabilities in this way, companies can more effectively bridge strategy and impact—and, in the process, see their strategies live up to their potential.

Understanding organizational capabilities

If you asked 100 managers whether they knew what a "capability" was, in the context of their organization, 98 of them would likely say "yes." Unfortunately, in our experience, two-thirds of them would also probably be wrong. This widespread lack of a basic understanding of organizational capabilities is one of the biggest reasons more than half of all strategy initiatives fail.

Consider how organizations commonly describe capabilities, using language centered on a particular group—such as "Marketing," "Product Development," or "Human Resources." Such a high-level description can be problematic for two reasons. First, a new capability may not align with existing organizational units. Second, a given organizational unit may be responsible for a diverse set of capabilities. Marketing capabilities, for example, may include abilities related to pricing, advertising, customer research and so on. "World-class marketing" is a useful starting point, but greater specificity is needed if the organization seeks significant improvement or change. "World-class" is an example of the second failing many organizations exhibit in defining capabilities: They name a virtue rather than articulating clear abilities. "Customer-centric" and "responsive" join "world-class" as popular examples. These may be fine for an inspirational presentation, but they are too vague to guide useful action. When pressed for "world-class speed," one manager will work on sprints, another will train for a marathon, and a final department head will start shopping for race cars. All of these managers are committed to world-class speed, but their mismatched efforts will not get the organization as a whole anywhere any faster.

Thus, if companies want to improve their strategy execution success rate, the first place to start is to agree on what really constitutes an organization capability. A definition we have found to be accurate and useful is this:

Organizational capabilities are the abilities of an enterprise to operate its day-to-day business as well as to grow, adapt, and seek competitive advantage in the marketplace.

In this context, the distinction of *organizational* capabilities is key. While individual skills or competencies may be an important building block of an organizational capability, the two are not synonymous. Similarly, technology—on its own—does not constitute an organizational capability, though it may be an important, even vital, enabler of organizational capabilities. An enterprise's ability to perform is based on people, technology, and process coming together as an integrated whole to do what the organization requires in order to excel.

What *does* constitute an organizational capability? "Overnight delivery," "custom machining to .005mm tolerances," and "getting new product trials to the majority of the marketplace within the first six months" are all good examples. These descriptions are clear and precise enough that a company can discuss them in terms of performance—which, in turn, enables the organization to assess the strengths and weaknesses of current capabilities and what it needs to move forward. They also make it relatively easy to identify the relevant people, information, organizational units, processes, technologies, etc., that contribute to the capability described—and where the company is lacking.

Organizational units and competitive virtues can provide a useful starting point for assessing and improving capabilities. But greater specificity will be needed when the organization wants to move to action. This is particularly true for exploring capabilities that are new to the organization. In our experience, an initiative designed to strengthen or build capabilities has two critical dimensions: an explicit articulation of what the organization is trying to achieve (desired performance) and identification of the set of processes, activities, institutional assets, types of people, and other elements that will likely be needed to deliver that performance. When put into practice, this clarity forces an organization to move beyond platitudes to a clear, concrete and shared definition that provides the basis for a direct line of sight between future-state performance objectives and today's actions. In other words, organizational capabilities should be thought of as multi-dimensional.

Figure 1: The multi-dimensional building blocks of organizational capabilities

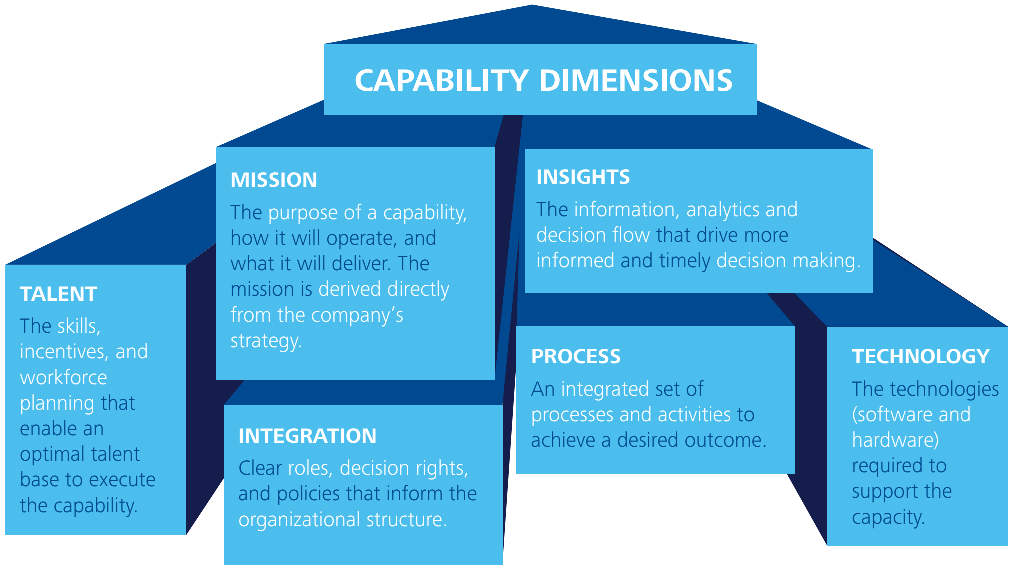


Figure 1 illustrates some of the building blocks that, as an integrated set, serve as the foundation of an organizational capability. These elements can be helpful for executives to keep in mind as they consider adapting or building the capabilities they need to support their company's strategy.

The importance of strategic capabilities

Once an organization has a common—and accurate—definition of capabilities, it can begin determining which capabilities will be needed to execute a given strategy. And that necessarily requires distinguishing among different types of capabilities according to their role in the organization.

In his landmark article "What Is Strategy?"[2] Michael Porter observed that "strategic position is contained in a set of tailored activities designed to deliver it," and competitive strategy "means deliberately choosing a different set of activities to deliver unique value." It is this unique set of tailored activities that enables a firm to perform in ways different from its competitors (note: Porter refers to "activities," but his examples include activities, assets, and talent attributes). This is where *strategic capabilities* come into play. When that "different set of activities" enables distinctive performance that means lower relative costs or better value along dimensions that matter to customers, it is the potential basis for successful competitive position.

This implies that a significant change in strategy will likely call for new levels or new dimensions of performance. This new performance will be rooted in new capabilities and their associated people, assets and activities. Yet often, strategies are decided upon solely in terms of the desired strategic outcomes and position without attention to the capabilities that will be needed to make that position a reality. The potential danger in this inattention to capabilities is that it may not be possible to appropriately execute the strategy using the organization's existing abilities. There are, of course, instances where implementation has failed because the organization did not understand or is resistant to the new strategy; but, too often, the organization simply lacks the capability to deliver on the new strategy. In one recent study, only a small minority of respondents said their existing operations are extremely well-aligned with strategy. This is true whether one looks at the business as a whole (12 percent), the cost structure (15 percent), markets served (18 percent), or other dimensions of the organization.[3]

The critical role that strategic capabilities play as a bridge between strategy and impact is highlighted in *Playing to Win*.[4] In this book, the authors—Procter & Gamble CEO A. G. Lafley and former Rotman School of Management dean, Roger Martin—use P&G as a case study on how to apply an integrated cascade of strategic choices. They argue that "a strategy is a coordinated and integrated set of five choices" and that these "five essential choices"[5] can be framed as the answers to these critical questions:

- What is our winning aspiration?
- Where will we play?
- How will we win?
- What capabilities must be in place? *(emphasis added)*
- What management systems are required?

Drawing on real-world experience, they highlight the critical role capabilities play and why it's necessary to explicitly define and create capabilities that will "enable the organization to bring its where-to-play and how-to-win choices to life."[6] When describing strategy positioning, the where-to-play and how-to-win questions are key. When enacting a new strategy, the capabilities that must be in place define the gaps between the current organization and the organization that successfully achieves its strategic positioning. (For more on the choice and action framework that embodies these five questions, see "The Strategic Choice Cascade" box on page 6.)

Lafley and Martin illustrate strategic capabilities using their experience with P&G as an example.

The specific set of strategic capabilities will vary from strategy to strategy and company to company. Wal-Mart's positioning in groceries calls for very-low-cost operations, while Whole Foods' ability to deliver a selection perceived as healthier is key to its positioning. But the point is universal. A small number of strategic capabilities enable successful competitive positioning. The implication of this is central to the problem of failed strategies: An enterprise can do almost everything it does well, but if it fails to prioritize and build these strategic capabilities, its strategy will fail. Strategic capabilities underpin advantage and are always a priority. They represent an innovative challenge to those who wish to find new ways to successfully compete.

"Companies can be good at a lot of things. But there are a smaller number … that together create distinctiveness, underpinning specific where-to-play and how-to-win choices. P&G certainly needs to be good at manufacturing, but not distinctively good at it to win. On the other hand, P&G does need to be distinctively good at understanding consumers, at innovation, and at branding its products."[7]

The Strategic Choice Cascade

In their recent book *Playing To Win*, A.G. Lafley and Roger Martin set out a clear and pragmatic strategic framework based on the Strategic Choice Cascade (figure 2), which was developed over 20 years by strategy consulting firm Monitor and used by hundreds of organizations—including, notably, P&G. It provides a powerful approach to thinking about strategic choice and action.

The Strategic Choice Cascade is addressed by every major enterprise, whether by design or accident. The higher-order sets of choices in this cascade—those that relate to overall longer-term "goals and aspirations" (mission, purpose, vision, etc.), followed by clear definitions of "where to play" (markets, geographies, customer segments, etc.) and "how to win" (a coherent proposition that encompasses both winning and sustainable value for customers and economic success for the organization)—are enterprise-level imperatives that stake out a competitive position. The lower-two boxes are focused on the activation of that position: In effect, they identify what it will take for the organization to be able to win in the fashion described. These final two boxes—"What capabilities must be in place?" and "What management systems are required?"—are not just important to understand for implementation purposes. They are the articulation needed to guarantee the strategy can be operationalized.

It is the clarity of choice and the connecting of the "position" boxes to the "activation" boxes that ensure the strategy bridges to impactful action. In this way, figure 2's arrows are as important as the boxes. Note that the arrows flow both ways. In many instances, recognition of a new growth opportunity leads an organization to identify new Play/Win choices followed by a focus on what capabilities they must build or partner for. This is a left-to-right flow through the cascade. In other instances, the flow is right to left. For example, the development of a new technology properly leveraged by the organization into a distinctive capability begs the questions "how does this create significant value for some customers?" and "where can I find them?"

Although the language of the cascade may reflect the language of business, the Strategic Choice Cascade has been successfully deployed in government and non-profit organizations as well. Ensuring an integrated, aligned and reinforcing set of prioritized choices is important for any organization whose mission is difficult and resources are constrained.

Figure 2: The Strategic Choice Cascade: A proven approach to addressing strategy as a set of 5 inter-related questions

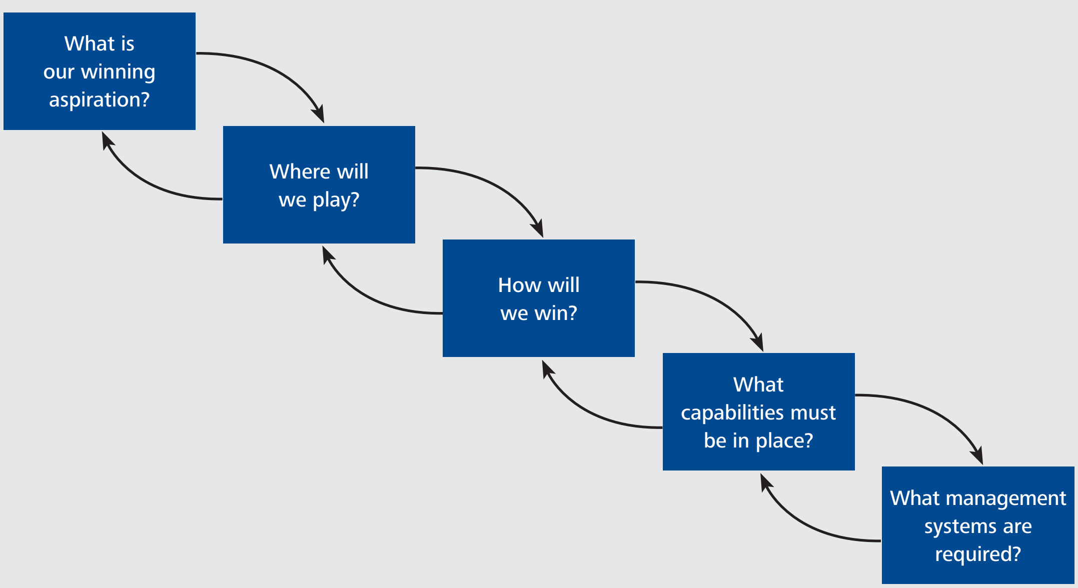
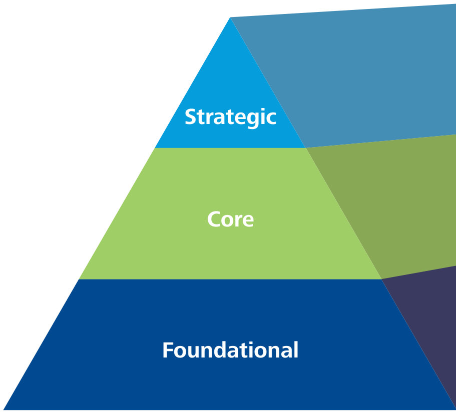


Figure 3: Three types of organizational capabilities



Definition
Strategic capabilities serve as the **basis for competitive advantage**; they are required to win. Must be distinctive versus competitors and either meaningful to customers or a source of economic advantage. There are two types: those which help the organization in the present, and adaptive capabilities which help the organization learn, adapt, and thrive over time.
Core capabilities impact customer choice and/or shape the economic profit proposition, but are not a defensible source of advantage; they **focus on effectiveness**. These represent customer relevant dimensions of performance through which competitors continually jockey for position.
Capabilities that represent **table stakes**, i.e., are not distinctive nor do they impact customer choice (when delivered correctly), but are required in order to be a viable competitor; focused on efficiency while maintaining threshold levels of performance. Can still become critically important to competition if they fall below industry thresholds.

Core and foundational capabilities

Of course, not all capabilities are a source of competitive advantage. As illustrated in figure 3, there are two other types of capabilities in addition to strategic ones: core and foundational.

Core capabilities are contested dimensions of competition and should be vigilantly honed, refined and strengthened as competitive performance requirements rise over time. These are the abilities that drive the rough-and-tumble world of day-to-day competition. A given company may get a leg up on competitors with a new feature or an improved cost position, but others will soon follow. Core capabilities are under constant pressure to improve.

Foundational capabilities represent threshold abilities a company must have to be a viable competitor. However, performance in these areas beyond threshold levels is not really valued by customers or a significant driver of enterprise economics. Handling accurate and timely payroll is an oft-cited example. It has to be done, but it's hard to find an industry in which it serves as an important competitive differentiator. This doesn't mean foundational capabilities can be ignored. Failure to meet the industry's minimum performance thresholds can quickly undermine competitive position. And industry performance standards have a way of rising over time. It doesn't matter how advantaged a product may be if the warehouse can't ship it to customers in the time they require it.

When understanding capabilities in this way, it's tempting to envision a capability lifecycle: New capabilities emerge as strategic for one industry leader, then become core as they are eventually replicated by others and ultimately become foundational as customers expect everyone to provide them. Capabilities in cell phone performance have, in fact, followed this pattern on relatively short cycles in recent years. But that's not always the case. Think back to the past few decades in the auto industry. U.S. auto producers in the 1960s and early 1970s considered "quality" and its related capabilities to be foundational in nature. Virtually all new cars were taken back to the dealer to "get the little things fixed." Customers perceived that all producers were about the same and customer buying behavior wasn't really affected unless they encountered a real lemon. Then along came the Japanese producers, most noticeably Toyota, which demonstrated that truly differentiated capabilities in high-quality manufacturing could create competitive advantage. To U.S. producers, it seemed as if almost overnight "quality" went from foundational to strategic. It took years for them to build their manufacturing and sourcing capabilities to where "quality" would become the highly contested core capability battleground it is today.[8] The pattern may be in the process of repeating, as automakers now view such issues as mileage and sustainability as areas in which they can achieve some sort of advantage.

As the P&G and automotive examples suggest, different industries and different times experience different patterns regarding which capabilities are strategic, core and foundational. But while there are commonalities within an industry, enterprise-specific choices about mission and aspirations, where to play, and how to win ultimately determine which is which.

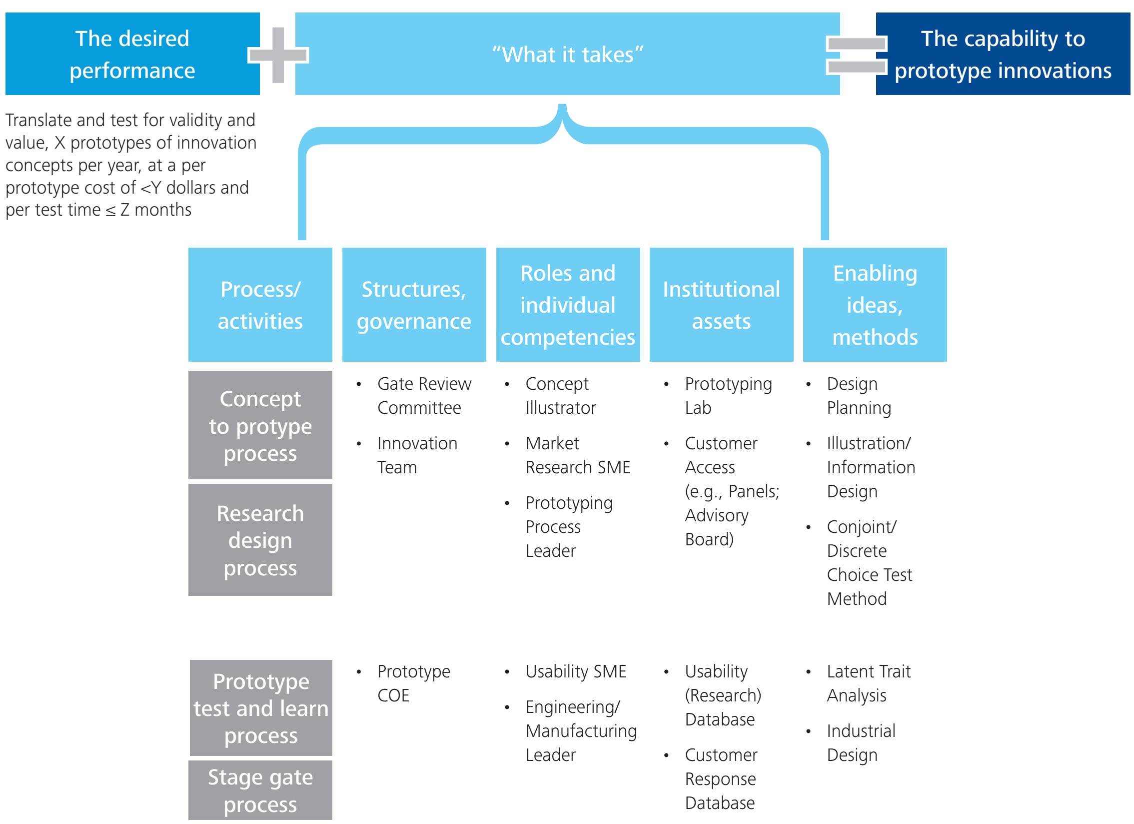
Meeting a higher standard of definition for capabilities

When considering the three types of capabilities it needs to compete, an organization also should keep in mind an important distinction in how capabilities are defined. For instance, standard definitions may be enough to act as a useful guide for foundational capabilities. But when it comes to core and strategic capabilities, a higher standard of definition helps illuminate how specific positioning choices can drive distinctive results. This is especially true when a new strategy calls for strategic capabilities that don't exist in the organization.

Figure 4 shows one firm's effort to meet this higher standard. The industrial products company began by identifying innovation broadly as an area in which it needed to develop breakthrough strategic capabilities that would distinguish it from competitors. When it came time to articulate the specific strategic capabilities the company would develop, one area of focus was prototyping. The firm had, of course, prototyped products before, but had never thought in terms of prototyping capabilities. Figure 4 shows this firm's attempt to provide a meaningful, measurable and actionable definition in the form of a "Strategic Capability Blueprint."[9]

In this instance, by defining the capability at a finer level of detail, the company could articulate a clear and measurable mission (shown as "desired performance" in the figure). It also could communicate a well-defined set of actionable, addressable building blocks from across the spectrum of insight, process, technology, talent and governance elements we discussed in figure 1. The early creation of this and other similar capability blueprints helped managers at that organization comprehend and meaningfully commit to the level of change that "becoming more innovative" would truly require.

Figure 4: An example of a strategic capability blueprint



The value of such definitional rigor is apparent when an organization is focused on strategic capabilities. In the case of a company that is changing its strategy, these capabilities are certainly new to the firm, likely to be new to the industry, and may be new to the world. Thus, the organization should be clear upfront about precisely what it is trying to accomplish. But this early rigor and clarity also serves the enterprise well when considering core and foundational capabilities. Small differences in core capabilities between competitors can translate into significant financial gains. For instance, being even slightly faster or better at things known to be important to customers and profits can mean the difference between a good year and a bad year in competitive marketplaces. Similar clarity about the mission and critical elements of foundational capabilities can ensure a company achieves necessary levels of performance while avoiding over-investment—thus freeing up resources to more effectively pursue strategic and core capabilities.

Many senior managers agree that such specificity and detail is needed at some point in the process; however, they argue that being so detailed so early is ill-advised. They worry that it would disempower their organization, or that they as managers don't know enough themselves about specifics (i.e., this kind of definition is a "technical matter"). Experience suggests otherwise. When the process is handled properly, a concrete capabilities blueprint lets each manager see clearly what is being asked of him or her and enables them to engage meaningfully in the conversation, asking questions and suggesting improvements. Such a blueprint does not lay out in advance all the changes that will be necessary, nor does it delineate program phases and timing. Instead, the focus is on helping the organization begin building a shared understanding of and enduring commitment to what likely will be needed if high-level strategic thinking is to yield competitive results.

For many organizations, the detail of the Strategic Capabilities Blueprint seems daunting as a part of the strategy process. But its development is relatively straightforward. A company can transform strategic aspirations into focused, well-defined capabilities by iteratively asking and answering a set of simple yet practical questions:

- What does "good" look like?
- How good do we need to be?
- How would we know if we were getting better?
- What would have to change in the way we operate?

A company that answers these questions, informed by knowledge of best practices in its industry and beyond, can develop clear, meaningful, measurable and actionable definitions that lay the groundwork for building capabilities that are critical to bridging strategy and impact.

Facing the challenges of distinctive capabilities

Yet while vital, defining strategic capabilities is not enough. An organization must also build those capabilities, which creates a particular kind of challenge for leadership. A full discussion of best practices in building strategic capabilities is beyond the scope of this paper, but we can highlight some of the important implementation implications.

First, it is axiomatic that an *off-the-shelf solution on its own won't create a defensible competitive position*. Building strategic capabilities, whether they are new to the world or just new to an industry, is akin to an act of innovation and should be managed as such. Companies should be prepared to make discoveries and have to adapt along the way.[10]

Second, because of their novelty to the organization, *new strategic capabilities* often do not map cleanly to the existing organization. Thus, a company may require an integrated approach to change management, one that precludes simple decomposition and allocation of the problem through existing organizational channels.

Third, *enabling distinctive positioning through capabilities often involves entirely new ways of thinking*, not just the speeding up or scaling up of old approaches. New ways of thinking can be difficult for the organization to communicate and track as well as for individuals to absorb. This is one of the reasons clarity of definition is so critical to effective communication early on. This also means people will need to practice and get feedback to master new approaches to their jobs and work.

Finally, while the focus may be on a single new strategic capability, organizational *performance is the result of an integrated system*. New strategic capabilities may require changes from related processes and people associated with foundational or core capabilities. For example, one firm had built a unique ability to rapidly deliver replacement components to customers. But as long as customers continued to stock high levels of parts in inventory, they did not see value in the firm's distinctive speed. It required a new and persuasive sales message to build trust and reduce customer inventories to translate the firm's strategic capability into competitive advantage.

The preceding factors suggest that strategic capability building is an integrative exercise designed to push the organization to new levels of performance that may not come easily. Indeed, building strategic capabilities is more an act of *creation* than *installation*. This creative act, coupled with the fact that the whole is so much more than the sum of the parts, is what simultaneously makes new capabilities powerful, difficult to achieve, and so tough for others to copy. To be sure, companies will face challenges in identifying, classifying, defining, communicating, and implementing capabilities. It's hard. But as Tom Hanks' character in "A League of Their Own" says, "The hard is what makes it great."[11]

[1] "Why Good Strategies Fail: Lessons for the C-Suite," *Economist Intelligence Unit*, 2013, http://www.pmi.org/~/media/PDF/Publications/WhyGoodStrategiesFail_Report_EIU_PMI.ashx.

[2] Michael Porter, "What is Strategy?" *Harvard Business Review*, Nov-Dec 1996 http://weaddvalue2.web12.hubspot.com/Portals/188908/docs/hbr.what%20is%20strategy.pdf.

[3] "Why Good Strategies Fail: Lessons for the C-Suite," *Economist Intelligence Unit*, 2013, http://www.pmi.org/~/media/PDF/Publications/WhyGoodStrategiesFail_Report_EIU_PMI.ashx.

[4] A.G. Lafley and Roger Martin, *Playing to Win: How Strategy Really Works*, Harvard Business Review Press; First Edition (February 5, 2013).

[5] Ibid., page 5

[6] Ibid., page 112

[7] Ibid., page 114

[8] James Womack, Daniel Jones, and Daniel Roos. *The Machine that Changed the World*, Free Press, 2007.

[9] For more on building innovation capabilities, see Keeley et al, *Ten Types of Innovation: The Discipline of Building Breakthroughs*, Wiley, First Edition (April 15, 2013).

[10] For more on the need to adapt during the implementation of strategy, see Amelia Dunlop, Vincent Firth, and Robert Lurie, "Dynamic Strategy Implementation," *Deloitte University Press*, December 3, 2013, http://dupress.com/articles/dynamic-strategy-implementation-delivering-on-your-strategic-ambition/.

[11] "A League of Their Own," Directed by Penny Marshall (1992; USA: Columbia Pictures.), Video.

About the authors

Erin Clark is a principal at Monitor Deloitte, Deloitte Consulting LLP's strategy consulting practice. Erin's work focuses on capability building and human capital. She has served clients in a variety of industries, including agriculture, automotive, biotech, consumer goods, government, industrials, manufacturing, medical devices and pharmaceuticals.

Bruce Chew is a director at Monitor Deloitte, Deloitte Consulting LLP's strategy consulting practice. His work focuses on strategy development and implementation and the building of strategic organizational capabilities. Over the past twenty years, Bruce has worked on those issues with government agencies and firms across a broad range of industries.

Robert Lurie is a former director with Deloitte's strategy practice, Monitor Deloitte. He recently joined Eastman Chemical as vice president of strategy.