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Performance Anxiety

Is it me or my business design?

By Adrian Slywotzky, Richard Balaban, and Phyllis Rothschild

Globalization and complexity have made it tough to untangle whether your greatest leverage lies in strategy or execution. A process called the *business design audit* cuts through the fog by examining all the business design choices and performance drivers within a company to determine which are out of alignment and what the highest-priority moves should be—while there's still time to act.

How well do you know your business? Do your biggest problems and opportunities lie in the realm of strategy or execution?

Virtually all large companies have faced the challenges of flawed strategy and flawed execution at some point. Some have faced both at the same time. Yet few have a process to untangle how much their current challenges stem from one or the other and what their highest-priority next moves should be.

Consider Sony and Gateway, which have been disappointing investors for years as they struggle to maintain profit margins and find new sources of growth in very competitive PC and consumer electronics markets. Their predicaments might seem similar, but they're actually quite different.

Gateway had a good business design idea that emphasized capturing profit from the services associated with owning the PC—leasing and financing, training classes, software and accessories, Internet access, and a trade-in program designed to keep customers coming back. But Gateway has had difficulties in executing this business design well. Sony, on the other hand, has demonstrated excellent execution of a business design that is becoming obsolete—introducing new consumer electronics products with incremental feature improvements that are sold through traditional retail channels.

This question of how to untangle strategy from execution does not surface in traditional strategic planning exercises or process improvement programs, which tend to be backward-looking, internally focused, and incremental in nature. As a result, managers often wind up tackling the wrong problem.

For example, WordPerfect (now owned by Corel) used to be one of the most successful companies in software, paying close attention to continuously improving customer service. Senior management did not anticipate the flaws in their business design as more and more customers bought PCs bundled with Microsoft Windows software. Even the highest levels of customer service performance could not stem the tide of WordPerfect users shifting to Microsoft's Word application, which was part of an "installed base" business design better suited to consumers' actual purchasing behavior.

Understanding one's business has become more difficult in recent years, for several reasons. Companies made many mergers and acquisitions starting in the 1990s not just to increase scale but also to acquire complementary products, channels, and customer segments. That created hard-to-digest inconsistencies within many firms. In addition, accelerated globalization has been destroying the assumptions on which many businesses

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are built, causing more mismatches between the design of the business and the requirements of local markets and supply systems.

In short, large companies have become so complex that few people understand how all the pieces work together. A global integrated oil company might have 20 business designs, including five or six that really matter in terms of revenues and profits. Some of the business designs need to be fixed and others are performing well but are limited by their nature and need to be reinvented. Senior managers may think they're running one business design when they actually have several and are comingling resources in a way that has become dysfunctional. They need to get a clear line of sight into their business so that they can understand which 20 moves they *could* make and which few moves they *should* make in order to grow profits on a sustained basis.

Having worked with executives in dozens of companies around the world and in many

industries, from paper to energy, from food products to insurance, we have developed a process that cuts through the fog of complexity by examining all the business design choices and performance drivers within a company to determine which are out of alignment. We call this disciplined process a business design audit. (See sidebar “The Components of Business Design.”)

The business design audit addresses several key questions for managers:

- How many different business designs are we running?
- Are these the right business designs, but in need of performance improvement?
- Or are they obsolete and need reinvention to create a unique position?
- How far away is each business design from its performance frontier?

■ The Components of Business Design

- *Customer selection.* Which customers do you and should you serve? Which are the most profitable segments, now and in the future?
- *Value proposition.* What is your unique value proposition, and how is it modified by segment?
- *Value capture.* How do you make money in each customer segment? Are there new profit models available? How many different profit models will you need to manage?
- *Strategic control.* What is the full repertoire of mechanisms to protect your business position, customer relationships, and profits from being poached by competitors?
- *Scope.* What activities should you do yourself? What should you outsource to others—and do you understand the hidden risks involved? When and why do you go offshore? Whom do you partner with? What collaborations do you want to join or catalyze?
- *Organizational architecture.* How should you hire, train, and assemble the right mix of people? What elements of the organization (talent, leadership, systems, processes, structure, governance, and culture) will best drive the choices you have made? Which organization mechanisms will allow you to adapt to new developments in markets, technological innovation, and globalization? What new mechanisms are necessary?



- What are the major risks that our business designs face?

Like a financial audit, a business design audit is sequential and objective. What's different is that the audit examines both design (the choices for each component) and engineering (whether the components work together as a finely tuned operating system), and it looks ahead. It shows how misalignment between or within the design and the engineering system erodes future value creation, and it helps set the agenda by showing executives the most fruitful course of action (Exhibit 1).

Of course, improving the businesses you have and building the businesses you need are linked activities. If you have poor operating performance, it will be difficult to fund growth with the necessary cash and earnings-per-share flexibility. And if you can't grow, it will be difficult to attract the talent, resources, and customers that can improve your performance.

An audit thus should address both areas. Management needs to make design choices that are internally consistent, and it needs an operating system (composed of activities, processes, and information) that will deliver on the design. (See sidebar "Tuning the Operating System" on page 23.)

Start with the Facts and the Homework

To see where the value is created, start by identifying the data points that would be most valuable to track, an exercise that should combine quantitative and qualitative measures. Even the relative strength or weakness of a business design can be tracked quantitatively by arraying the market-value-to-revenue ratio of all of the business designs in the industry.

A retailer, for example, can track not just the usual economic drivers such as inventory turns, but also what is happening to its customer base over time—which customers shop exclusively in its stores, which customers share their business with key competitors, who are the most profitable customers, what

Exhibit 1 X-raying the business

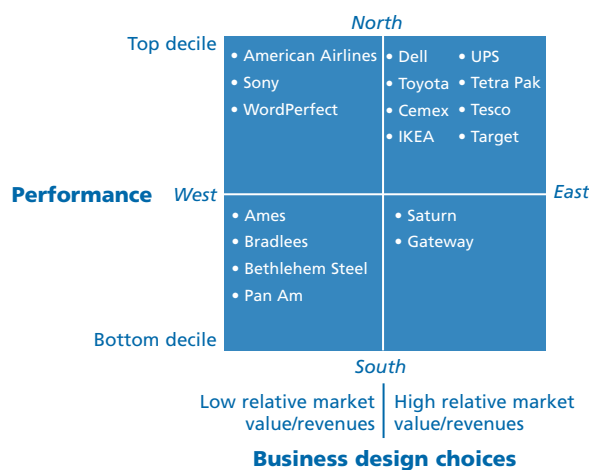
Traditional process improvement	Business design audit approach
• Inside out	• Outside in -Start with the customer
• Individual components	• System
• Single moves	• Combinations and sequence
• Cost reduction	• Cost reduction and revenue growth orientation -Upward spiral -Functional role
• Strategy separate	• Connects strategy and execution

is the retailer's share of their wallet, and so on. This database shows where value has been and will be created and what trends will drive economic profit in the future.

For each dimension of the business design and operating system, ask: How well aligned is that dimension with the overall design? How good is its relative performance? What is the breakthrough potential of that dimension?

You can then map both the business design and the operating performance dimensions on a simple grid (Exhibit 2). In the upper right or "northeast" quadrant of the grid, companies such as IKEA, Tetra Pak, UPS, Tesco, and Toyota have the best business designs in their industry and also have top-decile performance. But there is always room for improvement and these champions tend to audit themselves more frequently than most—well before their strong position begins to erode.

Exhibit 2 Charting the grid



In the upper left or northwest quadrant are the companies that have great performance in terms of cost, cycle time, logistics, and other operating measures, but the nature of their business design severely limits their returns. American Airlines and other “legacy” air carriers are good examples, with classic hub-and-spoke networks serving a wide variety of customer segments through a wide variety of assets. For these companies, the pressing challenge is how to revise or reinvent their business designs.

Another set of companies, in the southeast quadrant, have crafted superior business designs that can be effective against tough competitors, but their execution has failed to raise performance to a level that can yield great returns. Saturn and Gateway in the late 1990s fit this profile.

Finally, the lower left or southwest quadrant of the grid might be called the “bankruptcy waiting room,” where the business design is weak and the performance within the definition of that business design falls in the bottom decile of the industry. Ames and Bradlees department stores, Bethlehem Steel, and Pan Am were all in this position but did not act soon enough to make the necessary moves.

Companies that appear in each quadrant might not stay there for longer than a year or two, as the power of a business design and the quality of the operating system change over time. The business design audit can catch movement westward or southward early enough to give a company options to shift course.

Sifting Through the Portfolio of Business Designs

Large companies typically operate many business designs, and each should be mapped. For instance, one set of customers buys on a pure commodity basis; for them, the driving factor is lowest price. In this case, customer selection would be high-volume

purchasers and the value proposition is lowest delivered price, guaranteed. The value capture could be a long-term fixed contract or spot rates. Scope would include low-cost operations and outsourcing of non-critical functions to cheaper third parties. Strategic control would be the company’s low-cost systems and processes or an advantaged input source. Finally, the organization to support this business design would be no-frills and limited custom services. You might call this a “low-cost” business design.

At the same time, the company may also target higher-value customers with an offer that aims to solve their problems. The value capture here would be a function of the customer’s enhanced economics; higher levels of service and customer knowledge would be required to make the offer

credible. Switching costs would be high because of the firm’s access to customer operations. Organizationally, a skilled, high-touch sales force would be required to deliver on the value proposition. This is a “solutions” business design.

It’s important to determine which business designs drive the majority of revenue, which drive profitability and shareholder value, which represent future growth opportunities, which are threatened by their growing irrelevance, and which new business designs have yet to be developed.

To the Northeast

Once the metrics are collected and the map of the company’s recent positions laid out, management has to set its priorities for the best next moves. Although the ultimate goal is to reach the northeast quadrant, only a few companies can make that happen in one effort.

One that did advance north and east is Samsung, the Korea-based conglomerate. For many years, Samsung was a low-cost producer of appliances and semiconductors, focused on Korean markets with export to

Large companies have become very complex. More than ever, managers need a clear line of sight into all of their business designs.

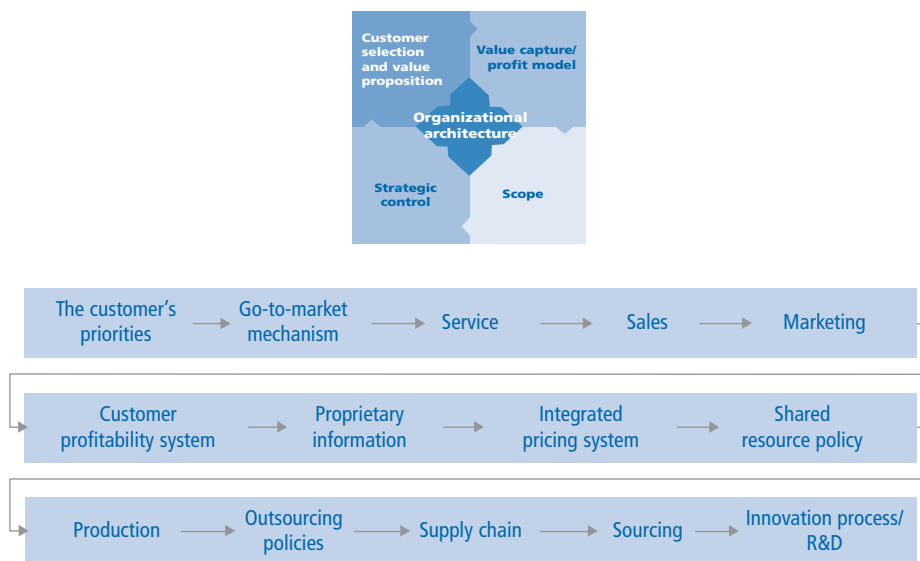
Tuning the Operating System

Moving north to improve operational performance involves delving into a firm's operating system. When diving into operations, it's easy to focus on the traditional value chain and ask, "How do I make stuff cheaper?" But that's just part of the equation.

You should also ask, "What kind of system do I need to respond to customers' priorities?" Start with customers, what they are willing to pay for, how they buy, how you service them, and work your way back to innovation and production. As shown in Exhibit 3, The operating system thus goes beyond the traditional value chain to include:

- The proprietary information chain (information about customers, suppliers, competitors, and so on)
- Processes that link different parts of the system (customer profitability system, integrated pricing system, etc.)
- Policies that determine how decisions get made on resource allocation, outsourcing versus doing in-house, and so on. Is the resource policy "everyone shares" or "the jungle rules"?
- Informal practices of "how we do things around here"

Exhibit 3 Every business design has a de facto operating system that supports its choices (or doesn't)



Keep in mind that the operating system is truly a system. Don't get seduced by the appeal of a point solution to a narrowly defined problem. You may think you have a sales force productivity problem, but the real problem may well be a customer selection problem and a pricing problem.

Looking simultaneously at the business design and how the operating system is engineered to support it helps get quickly to the issue of whether there are anomalies or areas of disconnect. A sales force trained and given incentives as product sellers will not be able to execute a key account strategy; the company will have to change its organizational system and skill set through training, reorganization, new hires, compensation changes, and other relevant moves. Similarly, a just-in-time production system will not function if it relies on untrained suppliers. ❖

developing countries. That business design started to flag in the early 1990s because Samsung faced competition from even lower-cost producers and had limited consumer awareness of its brand.

Starting in the late 1990s, Samsung set about shifting away from the low-cost, low-value business design (Exhibit 4). In appliances, consumer electronics, and mobile phones, the company targeted upwardly mobile consumers and corporate customers that valued leading technology. Innovation in product design, customer solutions, time-to-market, and branding would become much more important, so the company increased investment in marketing, R&D, and design.

On the branding front, Samsung trimmed the product portfolio and switched to selling all remaining products under the Samsung brand. It chose televisions and mobile phones—central to consumers' daily lives—for its most stylish designs and advanced technologies, backed by more marketing spend and non-traditional approaches such as a product placement agreement with New Line Cinema.

Samsung also decided that the primary go-to-market mechanism, which relied heavily on Wal-Mart, was not consistent with how Samsung's branding and value proposition were evolving to a high-style, high-value, premium-priced brand. Samsung pulled all of its products out of Wal-Mart and moved to retailers Best Buy and Circuit City—a tough but necessary decision.

Operational improvements supported this business design shift. Samsung outsourced non-essential Korean jobs and sourced low value-added components or products from low-cost countries, thus freeing up resources to focus on design and R&D. And it invested in more efficient merchandising and supply chain management practices that emphasized speed to market.

Samsung's six-year makeover has paid off in several ways. Samsung is one of the fastest-growing brands in the world and has overtaken in brand value venerable giants such as Sony, Philips, and Motorola. From 2000 through 2005, annual revenues have more than doubled from \$27 billion to \$59 billion, and on stock markets, Samsung has become the world's most valuable non-U.S. technology company.

One Step at a Time

The Samsung story, with concurrent moves both north to improve performance and east to change the business design, is unusual. Typically, a firm does best to sequence its moves.

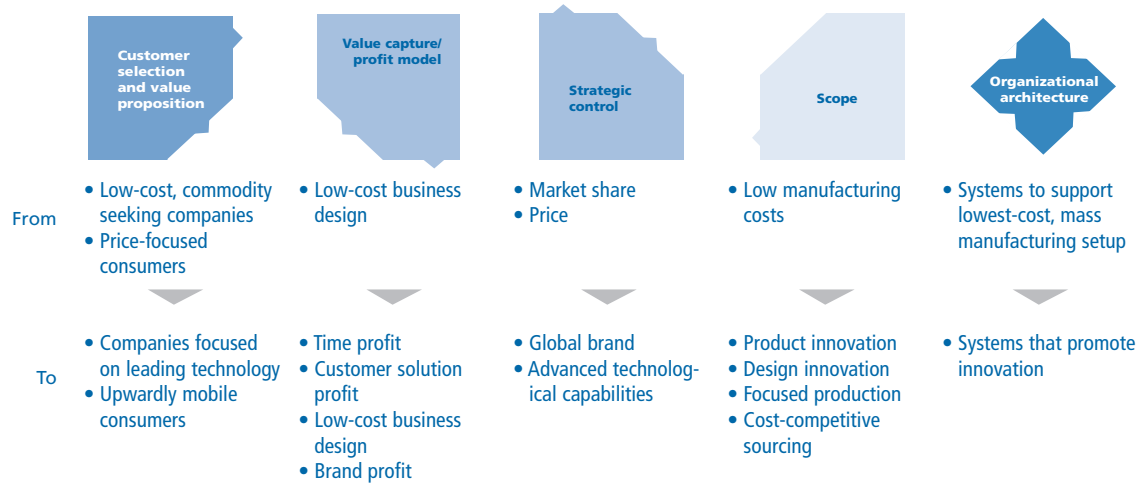
Sometimes, it becomes obvious that the firm should first move east.

Apple Computer's priority in the late 1990s was to refresh its business design, which had focused primarily on offering an alternative, proprietary computer to Wintel-based PCs. Apple decided to put a greater emphasis on appealing, sleek designs, which would resonate with graphic artists and other users in creative fields. Apple then branched out with its foray into consumer electronics and music distribution through the iPod music player and iTunes digital music store, which reached a far broader set of customers and generated interest for the core PC business as well.

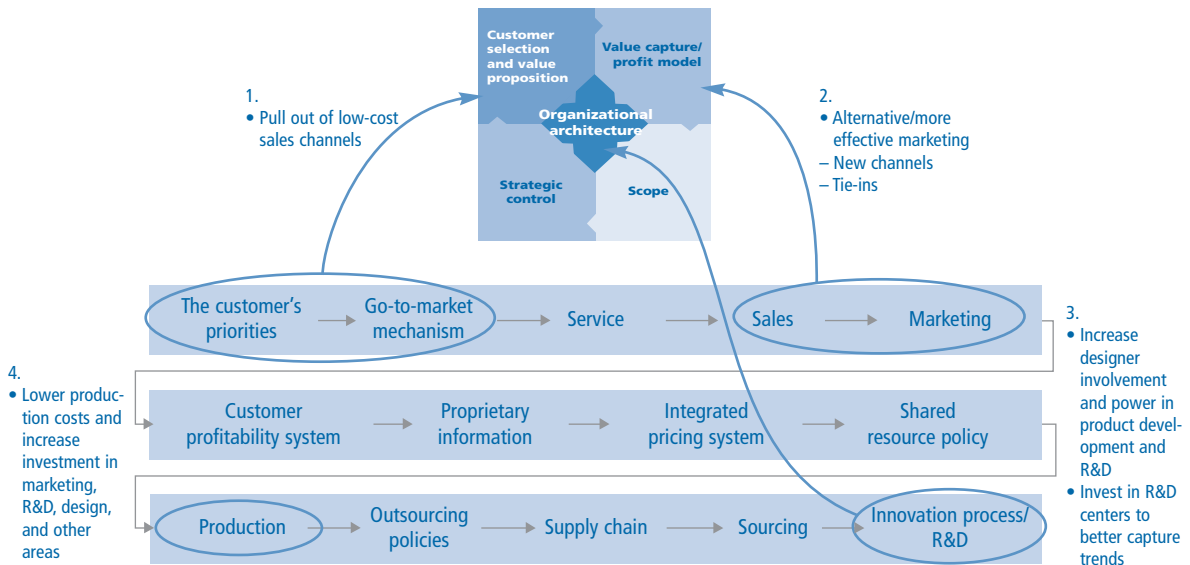
For many companies, the most effective first move is to focus on improving operations and head north. A business design where the components are a bit out of sync but are well-executed can be more valuable than an adventurous business design poorly executed. Keeping promises you have already made to investors and customers is usually an absolute imperative, so the decision to move north carries lower risk and is the most feasible option to generate value quickly. In every industry where we have worked, from pharmaceuticals to mining to paper to steel, achieving top-

If you try to fix the wrong problem, you will. Avoiding the usual misdiagnoses is half the battle.

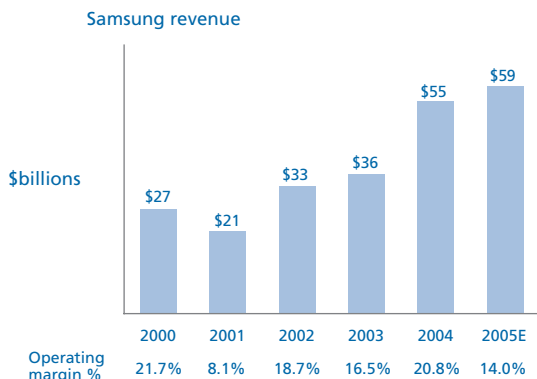
Exhibit 4 Samsung's business design reinvention starting in the late 1990s...



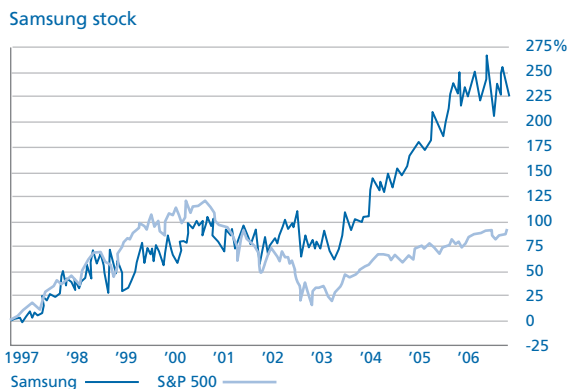
...Was supported by shifts in the operating system...



...Producing tremendous performance gains



Source: Samsung



Source: BigCharts.com

decile performance can be worth a two- to threefold improvement in profitability (Exhibit 5).

The case of Nissan is instructive here. In the late 1990s, Nissan suffered from lackluster financial results and weak processes in many areas. Labor productivity lagged competing automakers, Nissan models were tired and unappealing to consumers, and many operational decisions were out of alignment with the business design; to cite just one example, the entry-level Sentra compact model used the highest-grade steel.

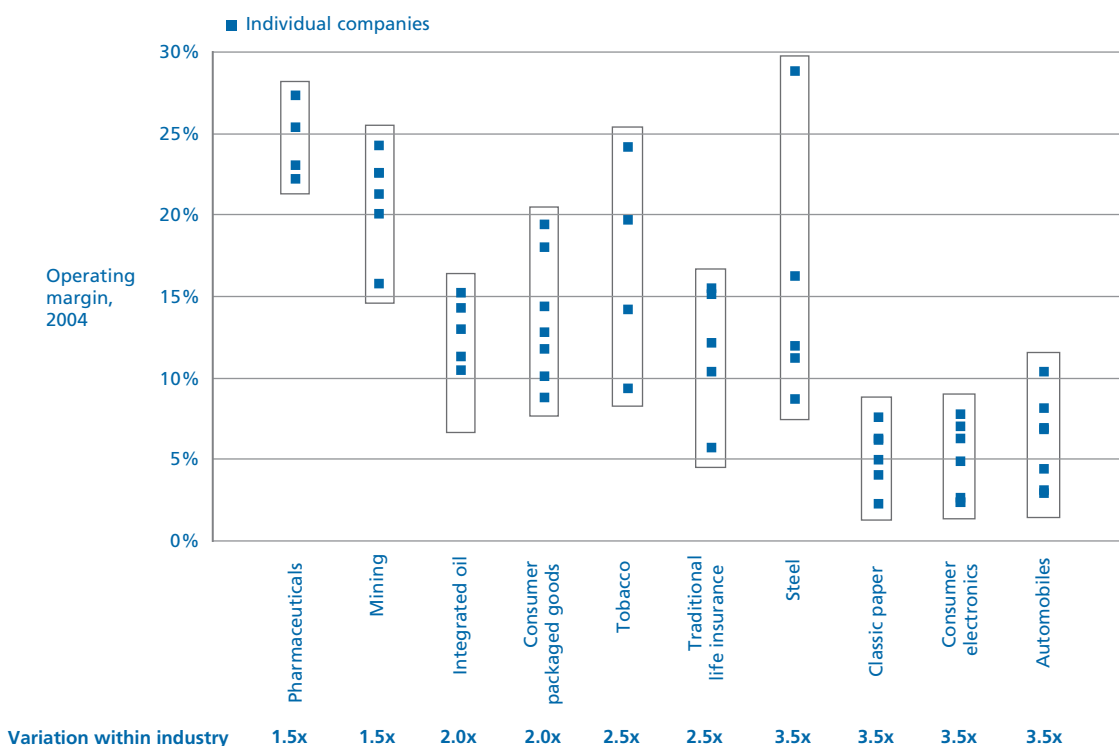
Within three years, Nissan had focused on a set of moves that improved performance across the board within the limitations of the traditional automotive OEM business design. To raise productivity, Nissan cut the number of vehicle platforms in half to 12, closed three plants, and reduced staff by 21,000 from a base of 148,000. To invigorate the launch process, Nissan moved aggressively to refresh its product line more frequently, with 30% of the product range replaced annually—twice

as often as the industry average. Senior management made sure that all levels of the organization had a better understanding of how profitability worked for individual products and businesses, and linked incentives more closely to profitability.

The result: operating profit margins rose from less than 2% to more than 10%. Investors viewed the company in a new light (Exhibit 6), and Nissan gained the flexibility and options to make further value-creating moves in the future.

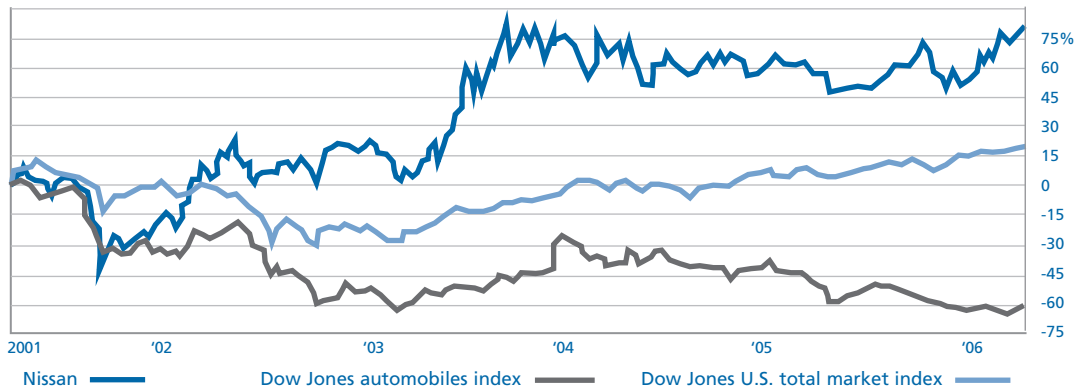
A move north can also set up a move east (just as a move east creates new opportunities to move north). We worked with a consumer product manufacturer whose strategic control was weakening because powerful distributors had consolidated and a focused competitor was taking market share. One option was to go downstream and get into distribution itself in order to regain control and visibility in the value chain. But that move carried a high risk of failure because of the firm's inadequate cost

Exhibit 5 The value of performance



Source: Mercer analysis

Exhibit 6 Nissan roars



Source: BigCharts.com

position and inexperience in distribution activities. The manufacturer chose to focus first on operational performance moves, which entailed redesigning its supply chain network, executing several major manufacturing productivity initiatives, and reducing its overhead to gain the financial strength needed for a business design reinvention within 18 months.

Becoming Unique

A smart, honest, and thorough business design audit can help drive truly breakthrough performance that goes well beyond catching up with competitors. Ultimately, the goal is to build a unique system that is very difficult for competitors to imitate—to protect your position in the northeast quadrant. The Spanish clothing retailer Zara, by sharply reducing the cycle time of its manufacturing, improved operational performance through reduced capital, warehouse, and inventory costs. As importantly, it created a unique value proposition (fast new fashion), a new profit model (sell more clothes at a higher price), and stronger strategic control (because it takes years for competitors to copy).

At IKEA, Anders Dahlvig, group president, notes that while many competitors could copy one or two elements of the retailer's operating

system and business design, "The difficulty is when you try to create the totality of what we have. You might be able to copy our low prices, but you need our volumes and global sourcing presence. You have to be able to copy our Scandinavian design, which is not easy without a Scandinavian heritage. You have to be able to copy our distribution concept with the flat-pack. And you have to be able to copy our interior competence—the way we set out our stores and catalogues."

As with any successful value creation effort, keeping the process evergreen, with regular monitoring, ensures that you can anticipate shifts in the external environment and respond early. Apply at least the same level of rigor to crafting your business design audit as you do to your process improvement programs or your annual financial audits (which, for clear reasons, are always done by external parties), and the payoffs will follow.

It's daunting to build and run a complex enterprise with many businesses, geographies, and sources of value. But there is little real choice, since that is how competition is evolving. A business design audit can help cut through that complexity, improve operations in the near term, and bolster your arsenal for leading the next stage of value growth. ❖