



Kaizen Solutions Inc.

Driving Performance from Strategy

Why Operational Effectiveness Alone is Not Enough

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Today, more than ever, the quest for productivity, quality, and speed has spawned a significant number of tools and techniques: Lean Manufacturing or Service; Business Process Improvement; Six Sigma; Total Quality Management, etc. Although the operational improvements resulting from these practices have often been dramatic and impressive, many companies remain frustrated by their inability to translate those gains into superior profitability. This white paper examines why this might be so.

In the last two or three decades, companies have been required to adapt to new marketplace realities. The global economy and the impact of the Internet have both combined to require a new set of rules, where companies must become flexible and fast enough to respond to new competitive and market changes. Due to the hypercompetitive nature of today's global economy, companies have been forced to outsource aggressively and seek greater efficiencies and speed in internal operations and processes in order to maintain a level playing field with rivals.

This new dynamic has conspired to place an undue emphasis on operational effectiveness and how things may be done more efficiently and effectively than competitors. However, the key notion of what should be done, which is properly the role of strategy to determine, has been forced into a subordinate position. This brings us to what the authors feel is the root cause of the problem: the failure to distinguish between operational effectiveness and strategy, and the complementary role of each for achieving superior performance.

Operational Effectiveness: Necessary but Not Sufficient

It is the authors' argument that operational effectiveness and strategy are both essential to superior organizational performance. However, while they are both necessary, neither alone is sufficient. Furthermore, they each work in very different ways.

A company can outperform its rivals only if it can establish a difference which it can preserve. This difference may manifest itself by an ability to deliver greater value to customers, or an ability to create comparable or similar value at a lower cost. A third option is for a company to do both. When differentiation is achieved, profitability follows: delivering greater value allows a company to charge higher unit prices, while greater efficiency results in lower costs.

Differences between companies in cost or price derive from the manifold activities which are required to create, produce, sell, and deliver their products and services. Cost is incurred by performing particular activities and a cost advantage can result when a company performs these activities more efficiently than competitors. Similarly, differentiation can arise from both the

choice of activities and how they are performed. It follows, then, that activities are the fundamental productive unit of an enterprise.

Operational effectiveness relates to how an organization chooses to perform its activities. By focusing on operational effectiveness, a company chooses to perform key activities better than competitors perform them. Implicit in the notion of operational effectiveness is the concept of efficiency, or doing more with less. However, operational effectiveness is not strictly limited to efficiency – it may also refer to how well a company utilizes its inputs by, for example, reducing supply chain defects, or by developing and bringing products to market faster.

In contrast, strategy refers to the means whereby a company creates for itself a unique and valuable position in the marketplace – a position which, by its very definition, requires a different set of activities. Strategic positioning means performing different activities than competitors, or performing similar activities in different, but not necessarily more efficient, ways. If operational effectiveness refers to how well things are done, strategy is the driver for what should be done in the first place.

This brings us to the key reason why operational effectiveness alone is not enough: by ignoring or subordinating strategy to determine what activities should be done, organizations run the risk of investing significant time, money and resources into improving operations and processes which are not necessarily the ones needed to create a differentiated competitive position in the marketplace.

It is instructive to look today at one of the leading toolsets for enabling operational effectiveness: Lean Manufacturing, which finds its roots in the best practices of the Toyota Production System. Toyota began pioneering “lean” concepts in the 1930’s and 40’s in response to market needs. At that time, Toyota could not pursue a mass production paradigm, since its domestic market required much smaller numbers, but a greater variety, of cars. Thus, the company had to adopt a strategy whereby it differentiated itself in the marketplace from mass producers and, as a consequence, had to support that differentiation through operational effectiveness. That operational effectiveness was, in turn, enabled by the tools and techniques of the Toyota Production System (TPS).

However, while the tools and techniques of the Toyota Production System have been widely understood and disseminated, the strategic foundation on which they were based has been largely ignored or downplayed. The net result is that many firms blindly try to apply these tools and techniques without first determining how they will differentiate themselves in the marketplace by performing different activities from rivals, or by performing similar activities in different ways.

This concept can be better understood through Michael Porter’s concept of the Productivity Frontier (see Figure 1 below). The Productivity Frontier constitutes the sum of all existing best practices known at any given time. It represents the maximum value that a company delivering a particular product or service can create at a given cost, using the best available technologies, skills, management techniques, and supply inputs. As a company improves its operational effectiveness, it moves towards the frontier. Doing so may require capital investment, new ways of executing work, or new ways of managing.

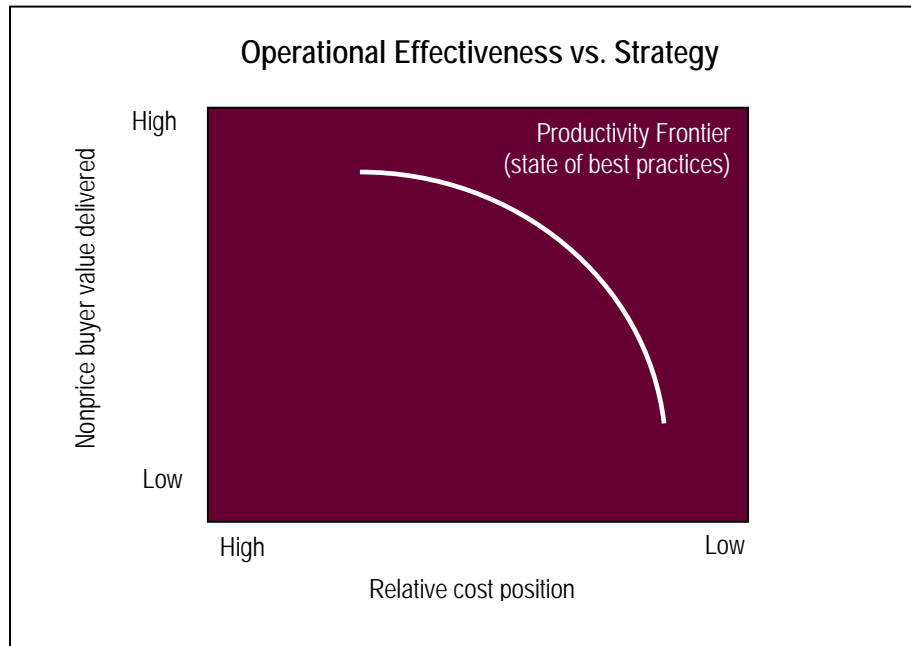


Figure 1: The Productivity Frontier

As new technologies and best practices are created and identified, the productivity frontier shifts outwards. Lean production, for example, has caused the frontier to shift outwards by allowing organizations to achieve significant improvements in productivity and asset utilization.

Companies move towards the productivity frontier by pursuing operational effectiveness – finding more efficient ways of performing the same activities as competitors. However, they are not necessarily finding different activities to perform, nor are they performing similar activities in different ways. Research shows that few companies have competed successfully on the basis of operational effectiveness over an extended period. This is because new best practices rapidly diffuse and disseminate among competitors, and any differentiation achieved through operational effectiveness is likely to be short lived. Even Toyota, the lean example par excellence, does not consider itself to be “lean” – they avoid using that word, largely because of the stasis it implies. Rather, Toyota refers to TPS as the Thinking Production System, implying that it is constantly evolving and changing, and therefore representing a moving target for competitors.

A second reason why operational effectiveness alone is not enough is the fact that the productivity frontier represents a convergence point for all companies pursuing it. The more companies pursue the same things, the more they look alike. As rivals imitate one another’s improvements in quality, speed, or supplier partnerships, operational effectiveness strategies converge and competition becomes a series of races down identical paths that no one can win. Lacking a strategic vision and context for change, competition based on operational effectiveness results in wars of attrition that can only be slowed or arrested by limiting competition.

Strategy Rests on Unique Activities

In contrast to operational effectiveness, competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value. The essence of strategy is in the activities – choosing to perform activities differently, or choosing different activities than rivals.

Before pursuing operational effectiveness, companies would be better advised to determine what strategic position they wish to assume in the marketplace. Strategic positions can be based on customers' needs, customers' accessibility, or the variety of a company's products or services. Variety-based positioning is based upon the choice of products or service varieties, rather than customer segments. Needs-based positioning is derived from serving most, or all, of the needs of a particular group of customers. Access-based positioning is that of segmenting customers who are accessible in different ways, including functions such as customer geography or scale.

Whatever the strategy adopted – variety, needs, access, or some combination of the three – positioning requires a tailored set of activities because it is always a function of differences on the supply side, that is, of differences in activities. The essence of strategic positioning is to choose activities that are different from those of rivals. If the same set of activities were best to produce all varieties, meet all needs, and access all customers, then operational effectiveness alone would determine the winners and losers. The fact that different activities are needed to achieve successful competitive positions should give all companies pause for thought to consider the prime role of strategy above that of operational effectiveness.

Reconnecting With Strategy

The initial success of a company is usually attributable to that company being able to establish a unique strategic position in the marketplace. However, as time progresses, even firms which once had very successful strategies find that their strategic position decays and deteriorates. Usually, this deterioration in strategic position is attributable to an accumulation of successive changes over time which serve to dilute the original strategy. Such decay is often not noticeable at any point in time, but eventually, over time, even very established companies find that they have compromised their way to homogeneity with their competitors.

Forces shaping such strategic decay include incremental additions of product varieties, incremental efforts to serve new customer groups, and copying competitors' activities. When strategic decay occurs, it is essentially because the firm has matched competitors' product offerings and practices, and is attempting to sell the same things to the same customer groups. As a result, uniqueness is lost and homogeneity with competitors achieved.

When such a phenomenon happens, a company must do what a new entrant would do: start its strategic positioning process all over. In effect, the company must reconnect with strategy. Within most well-established companies still lies a core of uniqueness. This core of uniqueness can be identified by asking questions such as the following:

1. Which of our product/service varieties are the most distinctive?

2. Which of our product/service varieties are the most profitable?
3. Which of our customers are the most satisfied?
4. Which customers, channels, or purchase transactions are the most profitable?
5. Which of the activities in the value chain are the most different and effective?

Addressing these questions allows an organization to peel away layers that may be obscuring the underlying uniqueness. As these layers are peeled away, the underlying strategic positioning can be revealed. For example, it could be that a small percentage of product varieties or customers may account for the majority of a company's sales and profits (the Pareto principle). The challenge, then, is to refocus on the unique core and realign the company's activities with it. Customers or product varieties which are only peripheral to sales and profitability can be pruned or allowed to fade away through attrition.

About the Authors

Stewart Anderson is president of Kaizen Solutions Inc. and is the leader for Kaizen's Operational Effectiveness practice. His expertise covers a range of areas, including process improvement, cost and inventory reduction, product development, productivity improvement, and supply chain management. He has advised companies in the manufacturing, service and contract manufacturing industries. Stewart is a certified trainer in Lean Manufacturing principles and techniques.

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