

High-Performance Business



A person wearing a white lab coat is shown from the side, with their right arm extended forward. The background is solid black, creating a high-contrast image. The lab coat is clean and professional, suggesting a medical or scientific setting.

Marks of distinction

By Tim Breene, Narendra P. Mulani and Paul F. Nunes

For more than a decade, companies have been told to compete on capabilities. But this advice can take companies only so far. For capabilities to make a difference in business performance, ultimately they must be distinctive—combined selectively to create an unassailable formula for satisfying customers.

For years, top executives have been advised to compete on capabilities. More specifically, they have been given two options. Option one: view capabilities as the bases of core competencies, areas of specialized expertise that companies create through organizational focus over time. Option two: view business capabilities as the processes that are central to the execution of the company's strategy.

But while the arguments used to support these two approaches to capability development are compelling, they tend to break down in practice. Management discussions centered on capabilities as the embodiment of strategy in action, for example, can often be reduced to the observation that what is needed is "a good strategy well executed"—which won't come as news to most executives. And core competence arguments begin to crumble when a fixation on capabilities excellence causes a company to lose sight of the broader market, leaving it to become the best buggy-whip maker in an increasingly automotive world.

The danger at the heart of both these admonitions is that the unwary company could mistakenly assume that
lasting business success
comes from

achieving world-class excellence in one or more processes. In fact, observation has shown us that in practice, conventional process excellence often fails companies as a means to achieve high performance. One need only look at the airline and wireless communications industries, where although there are more than a few companies with exceptional process capability—nearly flawless flight operations, for example, or superior wireless network management—profitable enterprises are hard to find.

By studying high-performance businesses within their competitor sets and across industries, Accenture has gained insights into what makes capabilities truly distinctive, and why distinctive capabilities are critical to lasting competitive advantage. We are also starting to see how high performers successfully create and manage the unique sets of business processes and resources that underpin their distinctive capabilities. Five key attributes make the difference.

No one attribute can give a company a distinctive capability. Together, however, these five consistently make the difference between business practices that are good but unexceptional, and those that make a real and lasting difference in company performance. An examination of each of the five elements of a distinctive capability reveals how companies actually build them, and what



other companies must do to find their own path to achieving them.

Companies with distinctive capabilities . . .

1. . . . define customer-centric algorithms for value creation.

All companies recognize the need to serve customers well. But how can a company achieve that essential goal in a way that gives it a sustainable competitive advantage? A high performer relies on an algorithm that charts the path from process to profit.

A business algorithm is a formula for doing business, either at the enterprise or business unit level, that translates a big idea regarding customer needs into a specific set of connected business processes and resources that cost-effectively satisfy those needs. The result is significant value for customers and shareholders.

There are two crucial elements to creating a successful algorithm. The first is deep insight into what consumers truly value (or will value) in an offering category, and an understanding of the marketing capabilities—for example, building the branded experience—necessary to create and sustain demand.¹ The second is originality in identifying the most profitable configuration of resources to deliver the promised value. Such originality can come only from deep knowledge and mastery of a range of capabilities, from finance to supply chain to human performance.²

Consider Dell, which went beyond a simple telephone model, and later

an Internet model, of selling personal computers and electronics. The company recognized that in addition to the cost savings it captured by not having its own retail stores and not selling through traditional retail channels, it could use the time the customer was willing to wait for home delivery to postpone actually assembling the PC until after it was ordered. This enabled Dell to reduce costs and prices even more. The combination of these two distinct processes gave Dell a business algorithm that has made it the No. 1 seller of PCs today.

One leading auto insurer formulated its algorithm after recognizing that what many customers value in auto insurance—and the main factor in customer retention—is fast claims payment. The company leveraged new technologies to link a number of processes so that most customers receive the settlement check on the spot, immediately after the claims adjuster has inspected the damage, and not weeks later. Result: dramatic business growth and an actual reduction in the ratio of costs to claims.

Creating a successful algorithm is never easy. It requires deep insight into customers' current and future needs, and it demands

¹ For more on marketing mastery, see "The best and the rest," *Outlook*, October 2004.

² For more on achieving mastery in these capabilities, see "State of the art," "A seat at the table" and "Disturbing the system," *Outlook*, June 2004, as well as "Supply chain and the bottom line," *Outlook*, February 2004.

the creative use of resources to manage the costs of delivering exceptional value. Yet the high performers we've observed all understand, across a wide range

of employee levels, the unique value-creation process that enables them to make money—and that is, in essence, the formula for their success.

2. . . . align their capital deployment with these algorithms.

The key to making a distinctive capability work is ensuring that capital deployment is disproportionately targeted to the underlying business algorithm. At a minimum, this means each component process has the financial backing it needs to be successful.

This kind of commitment can be substantial. One retailer, for example, is estimated to have spent \$500 million in the early 1990s to create the infrastructure needed for its algorithm's linchpin supply chain capability, a critical process in its business algorithm. A major implication of this insight into how high performers fund processes is that annual budgeting versus zero-based budgeting can lead to the misappropriation of funds to areas that, as the core processes in the algorithm change over time, no longer create substantial value.

Core processes in high performers not only get adequate financial support. They also tend to receive the greatest focus on human capital, from management on down to line employees. "Hero" functions—the ones whose people always seem to get the most credit for a business' success—are therefore often

the same as the core processes of the algorithm.

A CEO's provenance is often a strong sign of where a company's key algorithm processes are located. Another is the differentiated way a company treats the employees within key processes. Accenture research shows that high performers often devote special resources, including performance improvement efforts, to such employees.³

Their generous funding of key processes does not mean that high performers ignore cost management. Indeed, the high performers we've observed are fanatical about asset efficiency, and they use asset innovation as a key component in their algorithms. The companies seek advantage not just from high margins but, wherever possible, from a high return on net assets, creating a low-cost structure that can sustain a first mover in the face of copycat competitors.

Today's low-cost carriers in the airline industry, for example, have innovated to create greater returns from both their fixed assets and their workforces—a powerful one-two punch of capabilities. First, these companies invested in a uni-

³ "The Mysterious Art and Science of Knowledge-Worker Performance," by Thomas H. Davenport, Robert J. Thomas and Susan Cantrell, *Sloan Management Review*, Vol. 44, No. 1, Fall 2002.

form fleet of aircraft, usually Boeing 737s, eliminating the increased maintenance and operating costs associated with a mixed fleet. Next, they make the most of their human capital by having employees work in multiple roles: They not only assist passengers in-flight but also clean the cabin and, upon landing, frequently serve as additional gate agents. Together, these reduced asset costs help these carriers maintain their powerful low-cost, high-customer-value position against the major carriers.

It is important to note that while high performers seek a substantial return on assets, they are extremely careful not to go too far and embrace capital deployment models that are highly productive in theory but that cannot or do not support a successful algorithm. UK-based retail hypermarket Tesco, for example, maintained its Internet home

shopping and delivery service with a model of picking and packing groceries inside its stores; its competitors built ostensibly more asset-efficient warehouse operations to support their models. Result: Tesco has managed a very successful online grocery business while some other online grocery operators have struggled to succeed.

Tesco management also recognized that if store employees were to select the groceries for delivery, the selection process had to be very efficient. This prompted the company to design a system in which employees use computer-assisted carts that determine the most efficient path to walk within each store and that allow up to six orders to be filled simultaneously. (For more on high performance in the retail hypermarket industry, see “Consuming passions,” page 14.)

3. . . . concentrate their operational integration efforts on the core processes of these algorithms.

Operational integration has been both an operations nirvana and a business buzzword for some time, but it is also an important part of what makes the capabilities of a high performer distinctive. While many companies struggle to integrate all of their processes, building ever larger interconnected webs of information sharing (usually with mixed results), high performers focus their integration efforts. They make a substantial investment in integrating only what truly matters to their business algorithm—they don’t try to connect everything to everything else.



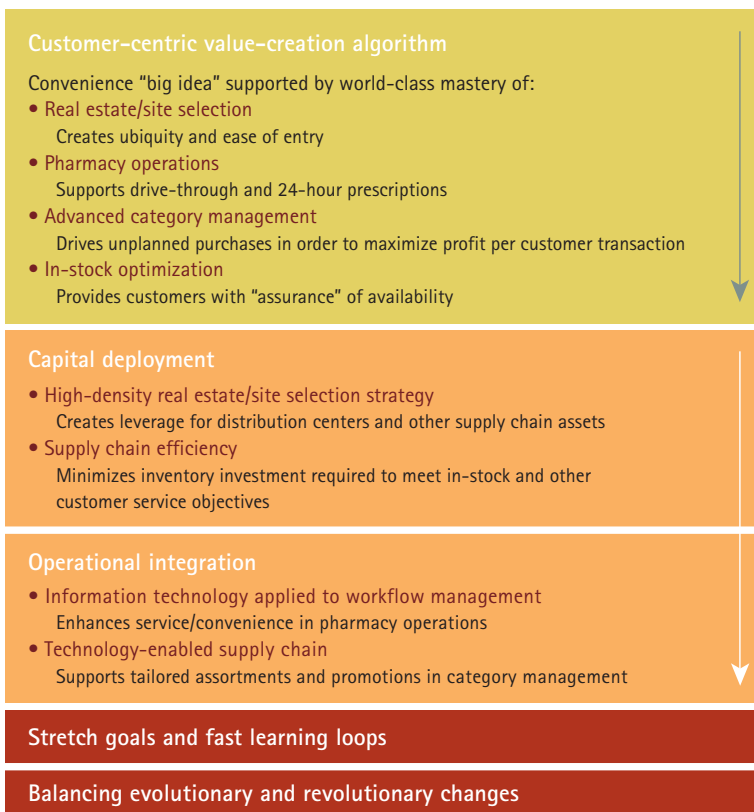
Creating the right integration in the snack food business is a good example. One company's value algorithm is focused on freshness, so speed from its kitchens to store shelves is critical. The company achieves this goal through a direct store delivery model that tightly couples production with delivery systems; it also uses delivery employees as sales personnel.

The system makes the consumer happy by putting fresh products on the shelves and by limiting out-of-stocks, while also making the company's profit equation work better. By increasing the speed to the shelf, the company dramatically improves the return on its production and delivery assets, and nearly eliminates

"Convenience" driven value-creation algorithm in retail pharmacy

In the retail drug industry, one high performer has built its business algorithm around the insight that customers most value convenience. Commitment to this insight has driven the company's choice of key component processes, which make up its distinctive capability model, as well as the concentration of capital deployment and operational integration on these capabilities.

Value-creation algorithm



Distinctive capability model

Customer-facing	Back-office
Pharmacy operations	Supply chain
Category management	Information technology
In-stock optimization	Leadership development
Real estate/site selection	

warehousing costs. Even better, its model is one competitors have found hard to duplicate.

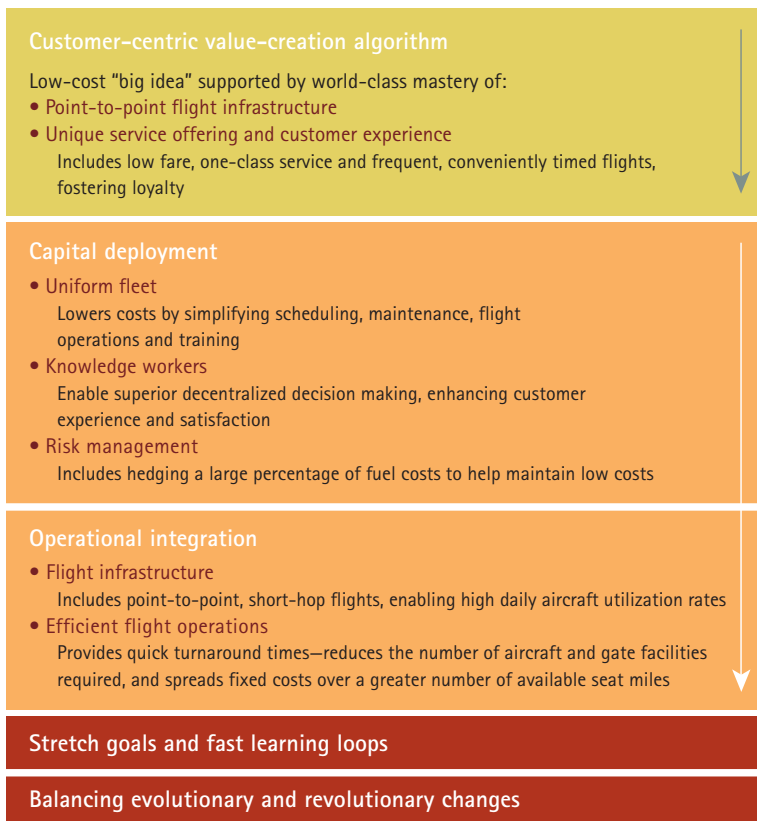
Though it is counterintuitive, to make an algorithm work, some of the individual parts must deliberately not be optimized. For example, Spanish clothing retailer Zara creates spare capacity in its

production and distribution systems to meet “velocity goals,” which benchmark the speed at which new items are delivered to stores. One way it does this is by producing and shipping goods in small batches, a seemingly inefficient way of operating. However, the company knows that maintaining velocity is

“Low-cost” driven value-creation algorithm in air travel

In the airline industry, low-cost carriers have achieved great success with a value algorithm that combines cost savings in customer-facing processes with high asset utilization in operations. These carriers' processes, which make up their distinctive capability model, include approaches such as providing only a single class of service, using a uniform fleet of aircraft and having employees serve in multiple roles.

Value-creation algorithm



Distinctive capability model

Customer-facing	Back-office
Service offering	Uniform fleet
Customer experience	Knowledge worker enablement
Flight operations	Risk management
Flight infrastructure	

more important to its overall business success than achieving incremental cost reductions in certain operating assets.

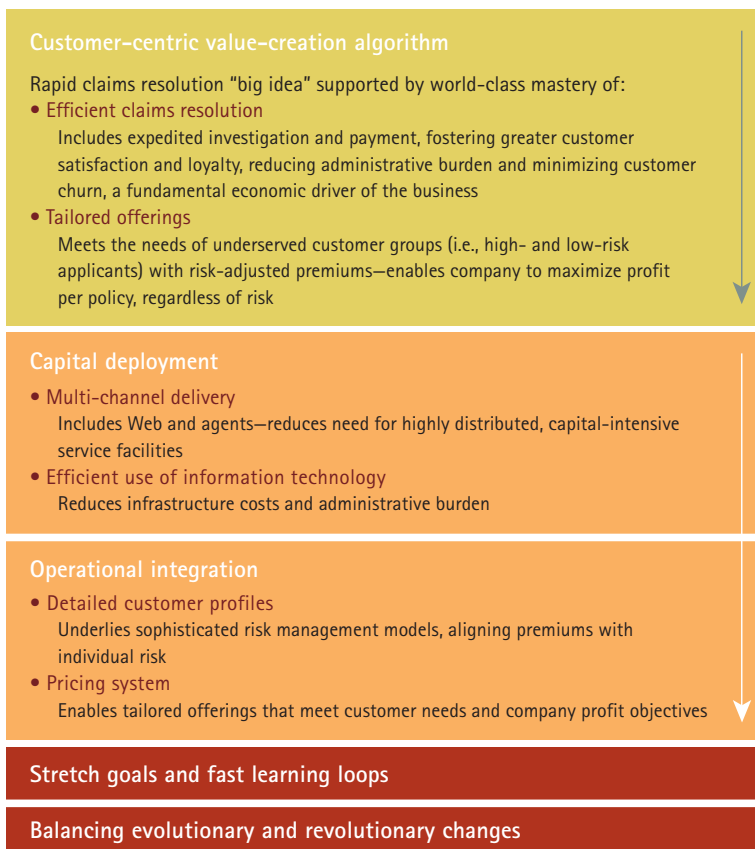
One global manufacturer of consumer goods sacrificed optimal product innovation to stay true to its business algorithm. For

example, to avoid disrupting its continuous flow production model, the company modified one new item to make it less complicated to manufacture—despite the fact that testing revealed this would make customers like the product less. The company recognized its success does not depend on

“Rapid claims resolution” driven value-creation algorithm in insurance industry

In the insurance industry, one high performer has built a customer-centric value algorithm around the insight that customers value immediate claims resolution and that all customers can be profitably served regardless of risk. To provide such highly efficient services to customers, the company uses integrated processes, which make up its distinctive capability model, enabled by the strategic use of technology.

Value-creation algorithm



Distinctive capability model

Customer-facing	Back-office
Claims resolution	Risk management models
Pricing system	Information technology
Tailored offerings	Customer profiles
Multi-channel delivery	

product innovation; instead, its business algorithm is based on delivering high volumes at

the low prices such volume enables, which, in turn, keeps demand high.

4. . . . continuously improve the algorithm's performance through stretch goals and fast learning loops.

If a company is to succeed in today's highly competitive marketplace, its business algorithms require continuous improvement. The company must quickly move along the learning curve, increasing barriers to competition, improving cost structures, and enhancing the fit of its offerings to customer needs by effectively capturing and acting on customer insights.

High performers achieve this first by continually setting stretch goals for their organizations, especially for the core processes of their value algorithm, and then by employing fast learning loops—auxiliary processes that quickly transform insights about how to improve into actions that result in improvement. This enables them to achieve what we call “stretch learning”—the ability to gain the knowledge necessary to improve not just incrementally but dramatically.

High performers understand that management cannot dictate the solutions that allow them to achieve true stretch goals. To encourage stretch learning, goals must appear unattainable. Meeting those “impossible” goals can then occur through rapid and creative collaboration involving employees of all levels, outside experts and business partners. Because reaching stretch goals is about more than simply increasing labor, the goals are

sufficiently aggressive only when they force employees to work smarter, not harder.

An important lesson about stretch goals comes from carmaker Toyota Motor Corporation, long famous for its continuous improvement activities. Three years ago, its North American parts operation launched a key change initiative, named Stretch Goals, through which it sought to save \$100 million in distribution costs, to remove \$100 million of inventory costs and to improve customer satisfaction by 50 percent—all at the same time. Management realized that each individual stretch goal could be easily met if other parts of the operation were allowed to suffer—for example, inventory could be reduced if backorders were allowed to rise, at the cost of customer satisfaction. To avoid the pointless frustration of simply squeezing one end of a balloon, Toyota successfully paired its stretch goals—for example, reducing packaging costs and damage—to make real progress. Recently, the company celebrated having only narrowly missed making all three goals.

High performers base their fast learning loops on better measurement processes. UnitedHealth Group, for example, recently created a database that collects information about hospital and physician activities and

then links it to evidence-based performance standards. The company uses this database, the largest of its kind in the healthcare industry, to evaluate all the components of patient care teams over time and to rapidly adjust their behavior to improve care. (For more on the value-creating use of data, see “From data to decision,” page 72.)

Another reason high performers are able to achieve stretch learning is that

they better understand their progress along individual learning curves; just as important, they are better able to move on to new learning curves as the current one flattens—but before it bottoms out completely. One soft drink manufacturer achieves this by effectively designing new performance improvement programs each time it notices that its measured productivity improvement is slowing, effectively creating a continuous series of step-change improvements in productivity.

5. . . . maintain a balance between evolutionary and revolutionary change as capabilities and algorithms are inevitably adapted.

Distinctive capabilities must be dynamic, because at their heart they rely on customer insight, which requires them to be responsive to ever-changing customer needs. Beyond that they must also respond to the demands of environmental change and technology disruption.

High performers are particularly good at both adjusting their algorithm and redefining it when circumstances require them to. The secret for high performers appears to be in achieving the right balance—knowing when an algorithm must evolve and when change must be more revolutionary. We have seen many companies fail because they gave up on an algorithm too soon; we have seen just as many fail because they held onto an algorithm too long.

One thing high performers do to maintain this right balance is to move quickly and continuously to acquire the new capabilities needed

to adapt their algorithm to changing market conditions. One company that has done this successfully is packaged goods manufacturer Kellogg Company. The company recognized that more and more, today’s consumers are buying food at convenience stores, fast-food outlets, club stores and other locations beyond supermarkets and grocery stores. It also recognized the need to ensure that sales were not exposed by having only a small number of key retail buyers. To increase the variety of its sales outlets, the company purchased Keebler, whose products are widely available in vending machines. Now Kellogg’s Nutri-Grain bars, Pop-Tarts and even single-serving cereal bowls are available at many more places, increasing the consumer reach and market share of these products, while simultaneously avoiding relying too much on key retailers.

Another way high performers successfully preserve their algorithm

is by refreshing its component capabilities when the algorithm is faltering but not yet failing. Consider Domino's Pizza. Rapidly growing labor costs due to high attrition have increasingly challenged the staffing component of its successful algorithm of fast, affordable delivered pizza.

Knowing that its emphasis on selling low-priced pizza precludes increasing wages across the board for its more than 135,000 hourly employees, the company set out to reduce attrition—at the time running at 158 percent per year—and to recoup the damaging associated costs, estimated at \$2,500 per lost employee. By investing in more selective hiring, better training and greater incentive-based compensation for its managers, the company has been able to reduce its attrition to 107 percent per year, bringing its cost structure back in line and preserving the viability of its successful algorithm.

These are just a few of the many considerations managers have in creating and sustaining distinctive capabilities, and this is but an early and brief synopsis of what we are learning. But those companies that can begin to incorporate, or improve, these elements in their current business activities are well on their way to creating a high-performance business and earning their own marks of distinction.

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