CHAPTER 1

What it Takes to be a High-Performance Business

PURSUING EVER-HIGHER LEVELS OF PERFORMANCE

Today’s global business environment is marked by unprecedented complexity, uncertainty, and competition. Why are some companies able to increase shareholder value despite these challenges? How do they continue to thrive and innovate, year after year, regardless of disruptive industry shifts and unpredictable circumstances? What sets these companies apart?

By definition, few companies are able to consistently outperform their peers over multiple economic cycles. In an extensive research project, Accenture analyzed the high performers to determine what set them apart from the rest. Among many variables, we examined whether the ability to both generate and sustain high performance was linked to an organization’s capabilities in finance and performance management. Not surprisingly, we found a strong correlation between those companies that were masters of finance and those that were high performers in their industries.

We also discovered that chief financial officers (CFOs) in these high-performance businesses are operating outside of their traditional roles. Instead of managing routine finance operations, they are much more engaged with their senior executive teams in helping to identify value-creating opportunities and in supporting the business in leveraging those
opportunities. Such changes are exemplified in the leadership of Dave Burritt, Caterpillar’s CFO, as the story of his effort and success demonstrates.

THE LINK BETWEEN FINANCE MASTERY AND HIGH PERFORMANCE AT CATERPILLAR

Dave Burritt, CFO
Caterpillar Inc.

Dave Burritt is a keen advocate of high-performance finance. His $30+ billion company is one of 600 enterprises worldwide in the intensely competitive industrial equipment industry. Buoyed by strong global demand for its products and services, Caterpillar is successfully contending with major challenges: rapidly accelerating commodity prices (steel prices have increased from $387/ton to $877/ton since 2002 and crude oil is now trading close to record price levels), hypergrowth in China and across Asia, and tightening regulatory standards for hydrocarbon emissions.

Along with Caterpillar, a small group of companies in the industrial equipment sector excel in managing change and creating value. Among these top performers are Kone, ITT, Cooper Industries, Sandvik, and Danaher. Collectively, they stand out from the crowd in the total returns they have delivered to shareholders.

Among these companies, we have chosen to focus on Caterpillar for three reasons. First, its distinctive franchised selling model, supported by its CFO’s commitment to innovative finance strategies. Second, its consistently superior profitability, as measured by a 50%+ growth in revenues since 2002. And last, because Caterpillar continues to reinforce and extend its outstanding leadership position as the world’s largest engine manufacturer and one of the most strategically astute players in its industry.

We asked Dave Burritt to describe Caterpillar’s current outlook and where he sees the company heading over the next couple of years. “Right now,” he noted, “we are in the sweet spot of the economic cycle and our business model. Our numbers have just skyrocketed. While past performance is no guarantee of future success, last year was remarkable: we delivered an 85% increase in profits and a 33% increase in sales. Historically, we have to go back to 1947 to find percentage increases in sales and
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revenue like these. While winning market share in an upturn, we've also responded exceptionally well to some serious industry issues.

“Who knows how long the current market will last? Whatever happens, we are going to be prepared for the future. We’re spending a lot of time on increasing our flexibility, on scenario planning if you will, so that we can take advantage of the continuing upturn while also modeling possible responses if things shift and turn against us. We’re raising the bar, looking at our metrics and repositioning the business. We are setting lower breakeven targets across the company and measuring them at the individual business-unit level.

We reach $30 billion in sales and revenue two years early, but haven’t hit our return-on-sales metric. We’ll have a lot of work to do in the short term. Over the long term, we plan to reframe our metrics. They need to be more asset-based and more value-based – and to reflect a stronger emphasis on cash. Eventually, we want a totally value-based management environment.”

Figure 1.1 Caterpillar’s performance relative to its peers
Source: Accenture analysis
Dave went on to explain his leadership posture and how he and his senior finance team are supporting Caterpillar’s drive to push its performance to the next level. “We’re working this issue very hard,” Dave commented. “We have restructured our entire finance organization. Until recently, it consisted of traditional accounting, treasury, tax, and investor relations departments. But today, we’ve added new functionality, such as our Strategic Consulting Organization, which works closely with our company’s Executive Office and Strategic Planning Committee. Our finance resources now include Product Source Planning, a group that focuses on our vision for the future and our global footprint by identifying the investments we should be making around the world. Then we have our M & A team, which is charged with searching out opportunities in adjacent space.

“Finally, we have very rich and deep thought leadership in our organization. Our Business Strategic Support Group has a very strong knowledge of economics, but it also leads our initiatives in competitive intelligence, market research, and product and technology innovation. This group helps us monitor our competitors’ global footprints so that we know what actions they’re taking and how to respond. The goal is to be able to drill down into our competitors’ statements as well as our own. This gives us greater granularity and connectivity. We have all the pieces in place to enable our company to become a ‘master of the business.’ As we strengthen our ability to team across the organization, we see a marvelous opportunity to point Caterpillar’s leadership towards new pools of value – areas where we can leverage our strategic assets to out-compete our industry peers.”

Caterpillar has been improving performance year after year. We asked Dave to identify the factors that have propelled his company to ever-higher levels of achievement. “If we go back to the 1990s,” he explained, “the most significant event for us was our decision to restructure the company into individual business units. At the time, we had reached about $10 billion to $11 billion in sales and our business units were, in effect, operating as cost centers. We decided to push authority and full P&L accountability down to the business-unit level. This really made a huge difference.

“I believe that the other significant factor is the mindset that we have now as a Six Sigma company. This has given us discipline, structure, and a common language to achieve shared goals on big projects. It is helping us with our quality and growth, helping us control costs, and helping us with innovation. Currently, we have over 500 breakthrough projects in development. Our mission is to attain world-class status.”
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We measure our progress with a lot of rigor. Every month we reconcile ongoing results with our bottom line. For us, the brand of Six Sigma is rugged, tough, reliable, durable, enduring, disciplined. It’s a great cultural fit with our business.”

In the late 1990s, Caterpillar introduced value-based management into its European finance operations. Dave led that initiative, so we asked him to explain the rationale behind it. “We saw an opportunity to improve people’s understanding of the business and help them focus on what drives value for Caterpillar. I think we were successful in educating people and in putting in place a framework. I believe that the strong value-creating metrics within our Six Sigma model have become the enduring legacy of that project. We folded what we learned from our value-based management initiative into the rollout of Six Sigma, so that the numbers generated from Six Sigma projects capture true performance. Our strategic selection filters use a value-based approach, so that new projects are screened to ensure that they’ll deliver the greatest value for Caterpillar. Some units are better at this than others, but today, everyone takes potential projects and drops them into this filter. So I would say that the value-based management work that we did in Europe became a good foundation for our deployment of Six Sigma metrics that are very robust.

“Some of the things we talk about at Caterpillar are meaning, action, structure, and truth (MAST). Meaning is the burning platform for us. We are good at painting a picture of why something’s important and getting people all fired up about it. We take action. We’re a results-oriented organization. We know how to move forward and make things happen. Structure involves process, people, and resources. When we trip and fall, it’s usually because we didn’t do a good job of putting the right structure in place. Finally, there’s the truth. For us, this is about capturing value in a quantifiable way that reconciles with SEC published reporting. When people see the numbers coming out of any project or initiative, we want them to know that those numbers are accurate, reconciled, auditable, and enduring. If you don’t have truth in your numbers, your structure will fall apart. If you don’t have a strong structure – the resources and the people to get something done – you won’t take any action. The result? You won’t be able to achieve the meaning or the burning platform that you aspire to.”

CFOs today are confronted with competing priorities. On the one hand, finance activity has never been more intensely focused on conventional technical accounting issues, basic financial management, and corporate governance. On the other
hand, even as demands for core finance capabilities are escalating, CFOs are being asked to operate far beyond traditional boundaries and become directly involved in leadership, strategy, and execution. We asked Dave to comment on balancing these divergent finance agendas. “The majority of my time is focused on the question, ‘What does value look like from a stockholder’s perspective?’ – and on helping to create and execute strategies to keep us on an upward performance curve. We are increasing our transparency to support these efforts.

“For example, we’ve completely revamped our reporting. We’ve moved all supplemental information to our Web site, tabulated our published information to enhance readability, and added bucket or waterfall charts to capture our corporate outlook. We’ve also added a Q&A document to help people understand our business better and to reinforce our key messages, headlines, and proof points. When the investment community sees into our business with more depth, it understands the issues that we need to fix as well as the things that we’re really good at. Instead of just giving numbers, this new reporting approach reflects all the dimensions that we see. It also provides targets for us to aspire to.

“I also work with our economists on competitive intelligence and with our Strategic Planning Committee. However, the lion’s share of my time is spent on people issues – helping my direct reports better integrate their functions with one another. A good bit of time is devoted to succession planning: who we need to develop and who we need to move around the world. Overall, I’d say that my time revolves around managing the critical success factors for my organization – and making sure we have the right people in the right place at the right time.

“We are refocusing our finance organization on this notion of ‘being world class or finding somebody else to do it for you.’ We are creating greater alignment with both short-term results and the drivers of sustainable long-term value creation for our entire company. We want everyone focused on stockholder value, improved cash flow, and greater profitability. We also want to make sure that we’re offering the great leadership training provided by Six Sigma.”

Dave Burritt’s experience at Caterpillar clearly demonstrates how and why finance has come to play a pivotal role in driving corporate performance. Dave’s dynamic approach also illustrates the many ways in which forward-thinking chief financial officers are reshaping their finance
organizations to meet rapidly evolving global challenges. As his comments suggest, Dave and his finance team are involved in every aspect of Caterpillar’s operational, strategic, and value-driving agendas. His views confirm our findings on the rapid convergence of strategy with economics and finance.

In addition to this strategic thrust, however, CFOs face continuing pressure to handle the basic blocking and tackling of accounting and finance. Many fully expect their workloads to grow over the next several years. In particular, emerging regulatory and statutory reporting requirements created by the Sarbanes-Oxley Act (SOX) and the recently introduced International Financial Reporting Standards have dramatically increased complexity. The CFOs we interviewed also face tough capital allocation decisions. They must address rising costs for financial transaction processing, controls, and reporting – the first such increase in 13 years – while trying to invest in developing new capabilities that really drive their businesses forward.

We are witnessing a fundamental overhaul of the finance function and its footprint across the enterprise. The way that CFOs and finance leadership teams engage with alliance partners and the ‘ecosystem’ of company networks so vital to many industries is changing dramatically. As more and more companies collaborate more closely to deliver new products and services around the world, performance management has become more about managing an extended network of companies than simply managing vertically integrated enterprises. This presents significant challenges to the legacy finance operating model.

CFOs face major challenges in helping their organizations achieve high performance. They will be better prepared if they have a full understanding of what the task entails. In the remainder of this chapter, we explain the metrics that define a high-performance business, why scale alone is not the answer, and the three building blocks of high performance.

IDENTIFYING AND EVALUATING HIGH-PERFORMANCE BUSINESSES

The Accenture Institute for High Performance Business has analyzed the performance of hundreds of leading organizations worldwide across multiple industry sectors. One of the key objectives of our research is to help companies understand and methodically emulate these model enterprises – that is, to learn from and apply their successful approaches. From the outset, it has been our view that the drivers of high performance are identifiable and measurable – and that they can propel a company
CFO Insights: Delivering High Performance

High-performance businesses outpace their peers in total returns to shareholders, revenue growth, and spread performance (ROIC minus WACC) over three-year, five-year, seven-year, and fifteen-year time frames. They are rewarded with superior valuation multiples compared with their lower performing peers, and expectations about their future success are higher. They benefit from the perception, both internal and external, that they will continue to achieve stronger relative performance going forward, regardless of the trends and demands affecting their competitors and industries. Figure 1.2 identifies the industries that we have researched and analyzed.

Is industry a factor in high performance?
It is hard to overstate the importance of industry as a determinant of high performance. In fact, according to our findings, the dynamics of certain industries encourage the creation of long-term shareholder value. We are not referring here to the obvious benefits that a company derives from being part of a rapidly expanding industry sector – especially in a fast-growing geography such as China (see Chapter 15, High-Performance Finance in China). The influence that industry exerts is both more complex and elusive. To assess accurately true high performance, we modified our basic methodology to account for industry-specific factors.
In the global pharmaceutical industry, for example, stock price is based heavily on implied future value (that is, growth and profitability expectations) from drug R&D pipelines. As a result, we found it necessary to analyze projected value components of total return to shareholders to determine high-performance business attributes. In the utilities sector, where nimble adaptation to regulatory shifts is an attribute of high performance (see Constellation Energy, Chapter 7, *Capital Stewardship*), a ‘market environment scorecard’ was used to factor in the value of strategic positioning, adaptation to regulatory demands, and financial flexibility. In the industrial equipment sector, a very capital-intensive industry with a long business cycle, a 10-year total return performance screen was included along with standard 3-year, 5-year and 7-year reviews to establish relevancy.

There are also industries that have staked their perceived value on global scale and the successful amalgamation of different business models. A case in point is financial services, where universal providers now strive to offer bundled insurance, investment banking, asset management, and brokerage services to both institutional and retail customers (see Swiss Re in Chapter 4, *Value-Centered Culture*). From a capital markets perspective, companies in these industries define value creation at the corporate level, regardless of the particular mix of operational business models.

Certain industries have undergone radical structural change during the past decade, making the application of high-performance business criteria from even five years ago irrelevant. In these dynamic industries, we assessed high performance not only by applying peer benchmarking standards, but also by conducting longitudinal analyses of shifting industry conditions. In the United States (US) healthcare provider sector, for example, we evaluated companies over a 13-year period spanning three industry inflection points (see UnitedHealth Group in Chapter 2, *High-Performance Leadership*). Our research into this sector revealed that from 1990 to 2003, the fundamental drivers of high performance changed three times, from tightly managed care in the 1990–1995 period to product flexibility and open-plan models in the 1995–2000 period to administrative cost management in the 2000–2003 period.

Is scale an advantage in achieving high performance?

Does size matter? This is a question constantly posed by CFOs in a range of industries. Nitin Nohria, the Richard P. Chapman Professor of Business...
Administration at the Harvard Business School – and co-author of the breakthrough business book, *What Really Works* – conducted a major study in which the impact of size on performance was explored. During the study, Professor Nohria and his colleagues analyzed more than 200 well-established management models employed over a 10-year period by 160 companies to identify successful management practices. Their conclusion: being big is no guarantee that a company will deliver superior business results over time. Despite this reality, the study found that many companies assumed that success depended on size – on their being the biggest player in their industry sector.

Professor Nohria also dismantled another myth concerning low cost. “You do have to pay attention to cost,” he stressed, “but you don’t have to be the lowest-cost player. Everyone doesn’t have to be Wal-Mart and there are high-end retailers that are very successful in their space.” He added, “You also don’t have to delight the customer. You simply have to consistently deliver what you promise.” In his view, the silver-bullet cures prescribed by most management thinkers over the past decade – such as downsizing, rightsizing, and total quality management – can’t deliver positive results in every company because every company is different. “The ideas may be brilliant, but they aren’t universal,” Professor Nohria cautions: “Jack Welch’s work to reinvent General Electric (GE) makes a great success story, but it’s not a blueprint to follow if your company doesn’t resemble GE.”

For decades, scale-driven strategies and a preoccupation with market position have led companies to presume that size, by itself, delivers superior performance and sustained success. In the right context, scale does confer advantages, including increased production efficiencies, amplified purchasing power, and greater brand prominence. However, Professor Nohria’s research underscores a sobering, but revealing, fact: scale alone does not assure a company’s long-term competitiveness.

The Corporate Strategy Board study, “Stall Points”, states that of the 172 companies that spent time on *Fortune*’s list of the 50 largest companies between 1955 and 1995, only 5% were able to sustain a real, inflation-adjusted annual growth rate of more than 6% throughout their reign on *Fortune*’s list. In addition, fewer than 5% of all publicly traded companies maintained total returns to shareholders that were higher than their industry peers during the 10-year period analyzed. From automakers to personal computer manufacturers, the list of companies that dominated their industries for a time – only to fade away as shifts in demand, technology or business models eroded their base – is a long one. As indicated
in Figure 1.3, our research demonstrates that scale as an endgame strategy is, at best, unreliable in delivering high performance.

While size is important, our research confirms that it is not a prerequisite for high performance. Across industries, the basis of competition is rapidly shifting from battles between companies to battles between networks of companies. This shift is far-reaching in its impact, according to Marco Iansiti, the David Sarnoff Professor of Business Administration at Harvard Business School. As Professor Iansiti notes, competing successfully involves “exerting influence over vast networks of companies and managing assets you don’t own.” 4

In today’s global marketplace, size is being radically redefined. It is no longer simply an issue of scale; it’s about strategic reach and alliance building. This is where the skills of the CFO come into play in understanding where and why alliances, joint ventures, and cooperative agreements
make more sense than the alternative and then in setting up the manage-
ment processes and systems to support effective control and leadership. 
Caterpillar, for example, has entered the Chinese market via the joint 
venture route. Steve Guse, Caterpillar’s Asia Pacific CFO, has been very 
involved in helping to establish operational management disciplines, 
financial management systems compliant with US Generally Accepted 
Accounting Principles (GAAP), and disciplined governance procedures. 
According to Steve, these control mechanisms are critical success factors 
that a company must get right from day one.

While vertically integrated scale is receding in value, network scale 
is steadily growing in importance. The combination of readily available 
technology and capital has pushed many industries in the direction of a 
fully networked structure in which even the simplest product or service 
is the result of collaboration among many different organizations. These 
business “ecosystems”, based on interdependent relationships and net-
worked capabilities, can confer powerful competitive advantage.

Companies such as Wal-Mart and Microsoft have realized this, and 
pursued strategies that not only aggressively further their own interests, 
but also promote their ecosystems’ overall health. To this end, Microsoft 
and Wal-Mart – along with many other leading players, including Ameri-
can Express, eBay, Linux, and Nokia – have created platforms in the form 
of services, tools, or technologies, and allowed members of their business 
ecosystems to enhance their performance via access to these resources.

This is precisely the approach taken by London-based Symbian Ltd, 
a keystone company in the telecommunications industry. The company 
creates and licenses the Symbian OS platform, an operating system based 
on open standards for advanced mobile phones, also known as smart 
phones. Jointly owned by major telecom players, Symbian has grown by 
attracting new members to its flourishing business ecosystem. To date, it 
works with more than 250 partner technology companies and hundreds 
of application developers responsible for more than 4136 commercially 
available Symbian OS applications. Moreover, its platform dominates 
the global market. According to Gartner Dataquest, shipments of smart 
phones running Symbian accounted for more than 80% of all advanced 
mobile phones shipped in the third quarter of last year.

The result of cooperative strategies like Symbian’s are complex, extended 
performance management systems that reach far beyond the internal 
boundaries of the traditional vertically integrated organization. The 
implications of operating in an interdependent business ecosystem, where 
size is not an endgame strategy, ripple throughout an entire organization and
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affect it at every level, from the CFO suite to functional teams engaged in R&D and product design. As Harvard's Professor Iansiti observes, “The minute you put technology in a product and begin to connect that [technology] to other products in a network, you create the linkages that have huge strategic importance.” He goes on to add, “We have information technology everywhere: in phones, in cars, in appliances, in security management, and in our bodies. All this is becoming connected – and so are the companies that developed and produced the products in the first place.”

HIGH PERFORMANCE AND ENTERPRISE VALUE CREATION

High-performance businesses effectively balance today and tomorrow, consistently delivering superior results and outperforming their peers over time – across business cycles, industry disruptions, and leadership changes. Through our research, we have determined that at the core of every company’s ability to achieve high performance is what we call ‘competitive essence’ – the unique combination of business assets that shapes a company’s ability to innovate, build competitive advantage over its rivals, succeed in today’s markets, and position itself to capture new markets. What distinguishes high-performance businesses from their competitors is the way they develop and sustain competitive essence.

After analyzing the performance of hundreds of leading companies, we have identified three building blocks of high performance:

1 *Market focus and position*: the basis for exploiting growth opportunities and structural economic advantage through unique insights into current and future value.

2 *Mastery of distinctive capabilities*: the ability to create and exploit a set of hard-to-replicate capabilities that maximize differentiation and create value.

3 *High-performance anatomy*: the combination of factors that underpin distinctive capabilities and drive the ability to out-execute competitors.

High-performance businesses continually balance, realign, and renew these three building blocks to preserve and strengthen their competitive essence through a careful combination of insight and action. Figure 1.4
CFO Insights: Delivering High Performance

Understanding the Building Blocks of Success

1. Market Focus and Position. High-performance businesses seek unique insights into drivers of current and future value, anticipate changes and translate rapidly into differentiated operating models and business architectures.

Moreover, high-performance businesses focus continuously on business model and service innovation, making markets rather than just riding them.

2. Mastery of Distinctive Capabilities. In addition to concentrating on market position and scale, top performers also focus on mastering distinctive capabilities relevant to their target customers.

Accenture research has thus far identified five areas of functional mastery: information technology; human and organizational performance; marketing and customer management; finance and performance management; and supply chain management.

3. High-Performance Anatomy. If distinctive capabilities can be thought of in terms of functional mastery, performance anatomy is about the organizational characteristics that underpin these capabilities. High-performance businesses unleash the organization’s energies and core competencies; accelerate insight into action to out-execute competition; and manage the balance between today and tomorrow.

Performance anatomy is not just a fancy term for culture. It is determined by the mindset top management brings to such diverse areas as strategy, planning and financial control, leadership and people development, performance management and use of information technology.

Figure 1.4  The building blocks of high performance

describes the three building blocks and their components, which are explored in greater detail in the next section.

Market focus and position

The first building block of high performance reflects a company’s capacity for maximizing growth opportunities and structural economic advantages. High performers understand the dynamics of their industries better than their competitors and successfully manage the creation of value through appropriate strategies. Every company has some level of appreciation for the intrinsic value of good strategy. What sets high performers apart is what they see as the best means for creating value and how they perceive the role of strategy in generating it.

In many professions, such as medicine and the law, determining the right course of action is frequently a matter of determining the right answer to myriad smaller questions. In business, good decision making about market focus and position is likewise made up of good component decisions. Our ongoing research into high-performance business reveals that market focus and position are optimized when companies concen-
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trate first on getting the right answers in three critical areas of strategic decision making.

1 How to manage for today and tomorrow
For high performers, good choices are rooted not only in their present capabilities but also in those they can readily develop. Because of the risks of scaling through acquisition, high performers know they must maintain a constant emphasis on organic growth, at every level of scale and industry maturity. Maintaining organic growth over time, however, is not easy. Deciding to broaden a company’s scope into new businesses, or to increase its reach into related markets or new geographies, must be based on intelligent assessments of numerous factors.

Yet in high performers we see a characteristic wisdom to filter their opportunities – before making a decision – constantly and carefully through two important screens: the limits of their capabilities, and a perspective of multiple horizons of strategy. We have observed these organizations to be what we might call “realistic dreamers.” They push themselves to the limits of their capabilities, but not beyond.

Every organization has a frontier of “doability” in its strategy and visioning, and high performers have an intuitive sense of where that frontier lies. For example, Toyota Motor Corporation, once known mostly for its compact sedans, successfully extended its frontier and now enjoys great success with its Lexus luxury brand. Another example is Microsoft Corporation, which has been among the most adept at taking visionary strategic positions that are also, upon inspection, highly actionable because they leverage real existing capabilities.

Take Microsoft’s Xbox. Moving into the gaming arena was a daring move when the company introduced its game console in 2001, a year after Sony’s PlayStation 2 hit the market. But Microsoft believed it had the marketing and distribution strengths as well as the brand awareness to enable it to win in this market. Though the Xbox still has only a fraction of PlayStation 2’s installed base, it did manage to outsell PlayStation 2 for the first time during the last quarter of 2004, signaling that Microsoft did not overshoot its capabilities in this space.

The ability to make the right decisions in this dimension is also based on a company’s skill at managing, often simultaneously, across near-, medium-, and long-term time horizons. High performers make decisions that actively implement an overall strategy across multiple time horizons, even when those decisions require enormous additional investments that threaten to cannibalize their existing businesses. The secret
in high performers is funding new businesses from the profits of cash cows when they are richest, not waiting until such funds have dried up. Microsoft, for example, has been effectively managing multiple horizons by using the cash flow from its core operating systems business to build a leadership position in desktop applications, and has done so with offerings like Office and Internet Explorer, as well as in related ventures like Xbox, MSN and server applications.

2. **How to best parent operated businesses**
High performers choose highly distinctive value-added activities for their corporate cores, and then build or acquire a set of businesses uniquely able to benefit from the core and the other business units. Procter & Gamble, for example, shares leadership capabilities, a strong brand, marketing expertise, a shared distribution network and deep skills in new product development throughout the company, to the benefit of all units. 3M has a distinctive capability in research and development that it spreads across its business units.

Parenting in high-performance businesses is not a “bare minimum” or perfunctory approach only about supervision or shared services. These companies’ executives are active leaders and drivers of change. Unlike average companies, high performers derive significant real competitive advantages from their corporate centers, and do so by design. Yet they also recognize that the role of the corporate center is not fixed but must evolve over time. Jack Welch may have become justifiably famous for his management of GE, but the real badge of accomplishment came from the fact that he actually tended the company through a number of distinct eras of management, successfully achieving different corporate agendas in each era. And Welch’s last directive to successor Jeffrey Immelt is alleged to have been, “Blow it up!” – the same advice he had received from his predecessor 20 years earlier.

High performers also know that what their businesses need from a parent changes with the maturity of the business and its industry lifecycle, the changing structure and nature of the portfolio, external events and disruptive technologies. Because of constant changes in competitive circumstances, the acid test of parenting for high performers is not whether the core is adding value but whether it is still adding more value than an alternative parent company could.

3. **How to compete through organization design**
The best companies develop unique designs and leadership structures
that reinforce their chosen sources of competitive advantage, rather than follow a formulaic design process from a textbook. High performers know their strength lies not in the labels on the organization chart but in the unique ways their organizations are able to execute that design. High performers do not create differences just for difference’s sake, however.

One particular way these companies differentiate their organization design is by creating what business school professors Lynda Gratton and Sumantra Ghoshal have called “signature processes.” Unlike best-practice processes, signature processes create distinctive advantage because they have grown as the company has grown, and are intimately connected to the passions of the executive team. Nokia provides an example of how a company can dominate its market through a signature organization design. Because Nokia’s heritage is as a software technology company, the doctrines of standardization and reusability are deeply ingrained in its culture. Development is faster, and costs are lower, when software development occurs “modularly.”

That modular philosophy eventually found its way into Nokia’s organization structure; in the company architecture, business units and functions are comprised of modular teams of people with common competencies and skills. In the end, however, the real advantage of Nokia’s approach, as high performers know, is the capacity for change – the increased organizational flexibility and agility such an approach allows.

**Mastery of distinctive capabilities**

The second building block of high performance involves creating and exploiting a unique set of capabilities. Whether in sports, the fine arts or business, mastery of a core skill, talent or competence is essential to achieving high performance. One needs to look no further than the Olympic Games to confirm this. Competence is a given – it is required to simply compete – but it is never enough to win the gold medal. Discipline, fierce commitment, and the determination to deliver their personal best are what distinguish Olympic champions from the rest of the field. In the business world, it is much the same. Competence is necessary, but not sufficient. Companies must have a command of business basics, such as technical accounting, business controls, and risk management. Here again, however, only the mastery and extension of distinctive capabilities provide sustainable competitive advantage.

Caterpillar offers a striking example of how core strengths can be tied to a differentiated customer experience to create a suite of distinctive capabilities. Its exclusive global dealer network constitutes a significant
extension of the Caterpillar organization and brand, employing more than 100,000 people worldwide. The dealer franchise is not only the primary sales channel for the company, it also ensures that Caterpillar’s customers experience consistently high standards in after-sales service and support at just about every location imaginable on the planet. It is this kind of asset utilization advantage, tied to the customer experience, that creates distinctive capabilities. It also results in a combination of well-deployed resources that competitors find very hard to beat.

For capabilities to produce superior business performance, they must not only be distinctive, they must be aligned and, in many cases, fully integrated. Companies must cultivate and combine their strengths in ways that create a defensible, hard-to-replicate formula for business success. By studying high-performance businesses, we have gained insight into what makes their capabilities truly distinctive and why developing them is critical to achieving sustainable superior performance. Five key attributes make the difference.

1 Customer centricity

A high performer defines what we call “a customer-centric algorithm for value creation.” This is essentially a formula for doing business that translates into a big idea regarding customer needs – and the processes and resources necessary to satisfy those needs cost-effectively. Creating this blueprint for success requires a company to have deep customer relationships and insight. It also demands that it be creative in its use of resources to manage the costs of delivering exceptional value to both customers and shareholders.

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 processes, as reflected in their distinctive capabilities, include approaches such as providing a single class of service, using a uniform fleet of aircraft, and having employees serve multiple roles. The CFOs in most low-cost airlines understand the leadership role they need to play and know specifically where to focus their business-support resources. As a result, most have adopted an outsourced shared service model for passenger revenue accounting. This enables them to pool transaction processing operations using an industry service utility called Navitaire. Figure 1.5 illustrates the operating model used by low-cost airlines.
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Value-creation algorithm

Customer-centric value-creation algorithm
Low-cost “big idea” supported by world-class mastery of:
- Point-to-point flight infrastructure
- Unique service offering and customer experience
  Includes low fare, one-class service and frequent, conveniently timed flights, fostering loyalty

Capital deployment
- Uniform fleet
  Lowers costs by simplifying scheduling, maintenance, flight operations and training
- Knowledge workers
  Enable superior decentralized decision making, enhancing customer experience and satisfaction
- Risk management
  Includes hedging a large percentage of fuel costs to help maintain low costs

Operational integration
- Flight infrastructure
  Includes point-to-point, short-hop flights, enabling high daily aircraft utilization rates
- Efficient flight operations
  Provides quick turnaround times - reduces the number of aircraft and gate facilities required, and spreads fixed costs over a greater number of available seat miles

Stretch goals and fast learning loops
Balancing evolutionary and revolutionary changes

Distinctive capability model

Customer-facing
- Service offering
- Customer experience
- Flight operations

Back-office
- Uniform fleet
- Knowledge worker enablement
- Risk management
- Flight infrastructure

Figure 1.5  The operating model of low-cost airlines
2 Asset efficiency
High performers are often fanatical about asset efficiency. At the same time, they know instinctively when and where investments will sustain a first-mover advantage in the face of copycat competitors. This commitment is critical. The US retail giant Wal-Mart, for example, is estimated to have invested more than $500 million in the early 1990s to create the infrastructure for its cross-docking system. This has proven to be money well spent since the investment has enabled Wal-Mart to deliver continued high performance. Capabilities around capital stewardship, which we explore in Chapter 7, are a strong focus for high performers. Such stewardship reaches beyond simple asset accounting and investment planning.

3 Selectively integrated core processes
High performers focus their operational integration efforts. They concentrate on connecting the core processes that support their formula for value creation. While many companies struggle to make all their processes connect, high performers try to integrate only those that truly matter to their business.

Though it may appear counterintuitive, high performers deliberately choose not to optimize selective parts of their businesses. They can make these tough choices because they have a clear understanding of their algorithm and a deep knowledge of what adds value. UnitedHealth Group, for example, has chosen not to deploy shared services for transaction processing because it has determined that “transaction processing” is not critical to competitive success in its industry sector.

Companies that don’t understand their algorithms try to optimize everything, and fail to recognize the trade-offs in performance that must inevitably be made. Ultimately, they wind up abandoning their performance improvement strategy altogether because they try to optimize all the parts of the business as opposed to only those that really deliver high performance.

In contrast, Zara is a prime example of a company that understands and exploits the three building blocks of high performance. A leading clothing manufacturer and retailer headquartered in Arteixo, Spain, Zara bases its high performance on the mastery of supply-chain management. As a result, it has built supply chain logistics into its business strategy and has devoted significant attention to designing an integrated operating model around this core competence. This focus allows Zara to
consistently set industry standards for time to market, order fulfillment, and customer satisfaction.

4 Stretch goals
High performers continuously improve their algorithms through stretch goals – objectives set just beyond a company’s reach, so that it must strive to attain them. After a company has defined its formula for success, allocated the resources to build it, and launched it operationally, it must commit to the process of continuous improvement. The idea is to improve not incrementally but dramatically, by continually setting stretch goals that push performance to new levels. High performers achieve this by employing fast-learning loops – processes that quickly transform insights on how to improve their algorithm into actions that result in precisely those improvements.

Stretch goals yield the best results when they force employees to work smarter, not harder. Japan’s Toyota Motor Corporation offers an important lesson on stretch goals. Long famous for its continuous improvement programs, Toyota recently launched a formal “stretch goals” initiative in its North American Parts Operations, the parts and accessories distribution arm of Toyota Motor Sales, USA Inc. Three goals were set: saving $100 million in distribution costs, cutting inventory costs by $100 million, and improving customer satisfaction by 50% – all at the same time.

Steven J. Spear, an assistant professor at Harvard Business School’s Technology and Operations Management Unit, has studied Toyota for nearly a decade. His work focuses on “decoding Toyota’s DNA” and on identifying the underlying principles that account for its consistent ability to outperform competitors. “Toyota hasn’t figured out a silver-bullet solution. But it has figured out what to do to get much better much faster and across a broader range of processes and functions than anybody else in the industry,” Professor Spear observes. “Moreover, it achieves competitive advantage through operations on the basis of its ability to learn more quickly and more consistently than competitors.”

If BMW is the ultimate driving machine, as its advertising message asserts, then Toyota is the ultimate learning machine, contends Professor Spear. “It’s Toyota’s insatiable appetite for learning that allows it to achieve much higher levels of performance across quality, efficiency, productivity, flexibility and lead time.” More important, Toyota management involves employees at all levels in its quest for perfection. What’s more, it supports employees by supplying them with key data to help measure – and improve – their performance.
“By establishing stretch goals at every cut and slice of the organization, you have employees coming to work thinking how they can subtract two or three seconds from the assembly process,” Professor Spear explains. He should know. As part of a Toyota team, he spent six months visiting many of the company’s plants around the world. At first, he was amazed by the number of supervisors, managers, and team leaders involved in the company’s continuous improvement process. He soon realized that what first appeared to be a bloated organization is really one that “fosters, facilitates and nurtures the constant drive to do better. These are the people who get employees to think about the two-to-three seconds they need to shave off production time. And once the employees get it down to 51 seconds, these are the same people who ask the question: ‘If we got it to 51 seconds, then why can’t we get it down to 47?’” Professor Spear adds.

To demonstrate its commitment to doing whatever it takes, Toyota recently announced Global Vision 2010, a long-range program to reinvent itself. In launching the program, Toyota stated: “We realized we needed to develop a greater sense of urgency in our business. Success is good,” it added, “but without urgency, serious weaknesses set in, customer focus declines, creative ideas dry up and before you know it you are in trouble.” To avoid this dangerous scenario, Toyota keeps a keen eye on the market – even in the best of times.

5 Dynamic algorithms
Toyota’s relentless drive for improvement keeps its algorithm alive and vibrant. The pace of change requires algorithms to be dynamic, which is why the fifth attribute that contributes to distinctive capability is often the hardest for companies to get right. This is because revitalizing the formula for success requires constant vigilance and keen marketplace awareness. High performers are particularly good at both adjusting this and dramatically redefining it as circumstances require. Moreover, they have the foresight to refresh component capabilities when the algorithm is faltering, but not yet failing.

In contrast, lower performers lack such foresight and flexibility. In many instances, they don’t succeed because they give up on the formula too soon or hold on to one for too long. These businesses tend to see potential problems everywhere, a costly mindset that drains time and resources – and, ultimately, marks them for failure. Intel’s legendary CEO Andy Grove identified this problem explicitly. In his book, *Only the Paranoid Survive: How to Exploit the Crisis Points that Challenge Every*
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Company, Grove described how high performers can immediately spot the difference between a real and a perceived threat to their business – and react appropriately.

High-performance anatomy
High-performance anatomy, the third building block of high performance, is perhaps the most elusive characteristic that great companies display. This attribute can best be described as the unique way in which a company translates insight into action. We believe that high-performance anatomy is what empowers companies to excel in their drive to out-execute their competition. Think of it as a predisposition to perform at the highest level. It is the tangible expression of the “vision and values” of an organization, especially those of its founders.

High-performance anatomy informs a company’s identity and infuses every aspect of its operations as they unfold across business cycles, industry disruptions, and changes in leadership. Distinct from culture and organization design, high-performance anatomy defines a company across five dimensions.

1 Action-oriented insight
High performers thrive on action-oriented insight, proactively creating and shaping markets based on the relentless pursuit of customer-valued innovation. In the process, they achieve a near-perfect balance between execution and market focus. High-performance businesses also have a sharp focus on intangible assets and often develop innovative models to manage and measure them. They are keenly aware that future performance is not always driven by, or dependent on, resources that appear on a conventional balance sheet. This mindset enables high performers to deliberately manage their agendas to ensure a balance between today and tomorrow. Thus they demonstrate mastery of the creative tension between organizational stability and the need to adapt to constant change.

High-performance businesses are not only focused on pleasing their customers and exceeding shareholder expectations, their disciplined ability to execute is also the envy of their competitors. High performers value and believe in rigorous execution – in the adherence to budgets and deadlines that foster mutual trust and reliability throughout the organization (See Figure 1.6).

2 Exceptional productivity
High-performance businesses achieve extraordinary levels of produc-
tivity through the way they train, lead, and engage employees. All the CFOs featured in this book expressed a passion for developing people and their capabilities. High performers prove more effective than their competitors at exploiting the collective intelligence and motivation of their workforces. How? According to our research, there is a strong correlation between financial performance and the priority that organizations place on human capital development. For example, leading companies are far more likely than others to regularly measure the link between investments in people and business results. Moreover, their chief executive officers (CEOs) take a much more visible and direct role in people-development initiatives. In this way, high performers create what we call a “talent multiplier”, which produces better results per dollar of investment in their workforces.
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In the companies where we observed this trait, the CEO and CFO frequently take a visible and direct role in people-development initiatives. The goal is to cultivate employees who operate well above their title or level, magnifying their impact and individual contribution to workforce return on investment (ROI). The result: highly motivated employees who take the initiative – a multiplier effect that serves as a hard-to-imitate competitive advantage.

Take the Delaware-based MBNA Corporation, which issues credit cards to more than 50 million customers and manages assets worth more than $100 billion. Since its founding, the company has targeted upscale customers as part of “affinity groups” like dentists or association members, and set out to provide them with a superior customer service experience. The company’s entire performance anatomy supports this mission and is reflected in every aspect of MBNA’s operating style.

The company’s talent multiplier can be seen in its careful recruiting of individuals who can be expected to excel in customer interactions. Recruiting is an intensive process that includes peer interviews to ensure fit. Behavior is reinforced by the company’s generous benefits, and evidenced in its selection by Fortune magazine for five years in a row as one of the best companies to work for. MBNA’s continuous renewal mindset is reflected in its requirement that all employees spend at least four hours per month “customer listening.” “Customer satisfaction” scores are posted daily; individual incentives are tied to customer satisfaction, keeping the focus on ongoing, value-creating change. Even employee pay stubs are inscribed with the words “Brought to you by the customer.”

To create this type of deep commitment, aligning an organization’s workforce with its strategic mission is essential. In our work with a wide range of companies, we have observed at least three successful approaches for accomplishing this. Some companies create alignment through the force of a strong and capable leader’s personality. Other high performers achieve it through longtime collaboration within a core leadership team, such as those at Nokia and Walgreen Co. Alignment can also be created by infusing an organization with a shared sense of purpose. This is conveyed not through abstract mission or vision statements, but through leaders training leaders, active stewardship at all management levels, and the requirement that all employees personify the company’s values in their daily work.

3 Information technology (IT) as a strategic asset
The third dimension of high-performance anatomy is the recognition
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of IT’s strategic value. High performers recognize IT as an enabler in generating innovation and new value creation. High performers regard information technology as a source of operational excellence and competitive advantage. They look beyond using IT as a tool for controlling costs, and view it as the means for capturing the business value of information. They are quick to adopt new technologies – and eliminate ones that don’t work.

They also encourage employees to use IT intensively and creatively. There’s not a big “rah-rah” celebration around the next technology initiative. And there’s no hype or fancy names. The view that IT is a strategic asset is embedded in the company. Everyone in the organization sees it as a way of doing business. In contrast, poor performers allow their IT investments to be driven by replacement cycles. As a result, the lion’s share of their IT investments is spent on running, fixing, and only incrementally improving existing systems, rather than on using them to deliver competitive advantage.

4 Meaningful performance metrics
Fourth, high performers manage a selective scorecard that is aimed at sustaining their competitive essence. This unique scorecard tracks critical tangibles, such as financial performance, but also emphasizes value-enhancing intangibles, such as employee motivation. High-performance businesses know specifically what drives their superior results and devise methods to measure what matters. Their performance metrics are broadly inclusive yet highly selective in their focus.

5 Effective change management
Fifth, high performers continually find ways to keep their organizations energized and employees on their toes. They do this by encouraging their employees to shoulder three simple but powerful responsibilities: doing their work well in order to accomplish key business objectives; improving the way their work is done by continuously striving to work smarter; and revolutionizing their work by seeking out the next wave of products and processes to boost performance. The CFOs interviewed for this book unanimously agreed that change is a constant that must be factored into any corporate agenda. Indeed, many of the CFOs we talked to said that change management was now a core competence of the finance professional.
CONTINUOUS IMPROVEMENT

High-performance businesses do not just expect success – they relentlessly pursue it through continuous improvement. They understand the dynamics of their industries better than their competitors and master their distinctive capabilities to achieve superior execution and results. In doing so, they successfully manage the creation of value. As we will see, the CFO plays a vital role in helping their companies develop the attributes that lead to high performance.

CFO INSIGHTS: LESSONS FROM THE MASTERS

There are three common building blocks to a high performance business, and the finance organization has a role to play in each of these.

- The first is market focus and position. Finance helps the company understand the economic fundamentals of its industry, how value is created – and how it is perceived by the rivals it competes with for investment capital. Finance uses insightful analytics to enable its enterprise to either defend or extend the market position it holds – and determine when to seize new opportunities in new markets.

- The second building block is the mastery of distinctive capabilities. Finance plays an active, front-line role in identifying and building these capabilities by participating in all major decision-making cycles. The CFO helps to determine which capabilities really make a competitive difference strategically. The finance team helps build these distinctive capabilities, whether they involve pricing effectiveness, a faster cash conversion cycle or more efficient use of capital.

- The third building block is what we call high-performance anatomy. From the CFO’s perspective, supporting this area requires a focus on the performance management system embedded within an organization. Finance executives have a major role to play in making sure that their entire organization understands how to deploy robust systems to monitor what’s
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Going on in the business and how to deliver timely, accurate information to decision makers. Finance must also have the discipline to enforce resource allocation decisions and performance management requirements across the business.

REFERENCES


