Wilson Perumal & Company's

Vantage Point

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The Operating Model Imperative for Operational Excellence

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There are countless ways companies define and seek operational excellence, but regardless of the approach or path taken, it cannot be achieved without having the right operating model in place. An operating model is the foundation for both a company's business strategy and its execution—it addresses the questions of who does what, where it is done, how best to deploy assets, and how to make decisions.

Just as companies cannot overcome poor execution with a well-designed structure, they also cannot overcome poor structures with great execution. No matter how well processes may be designed, executed, and managed, if they are being performed by the wrong people, in the wrong location, or not leveraging the right technology, partners, or assets, they will not be able to achieve operational exellence.

Companies define operational excellence in many ways, but we view it as the consistent and reliable execution of business strategy to achieve industry-leading performance. When organizations move forward trying to achieve operational excellence, they may do so in a number of ways. Some start center-led business excellence programs that leverage Six Sigma and Lean. Some strive for functionally-focused efforts trying to adapt leading practices and realize best-in-class benchmarks. Some focus on technology as a forcing mechanism for integration, standardization, and then automation. What all too many miss or ignore during these efforts though is the underlying complexity in the business and its operating model. By not addressing this complexity, such efforts will fall short.

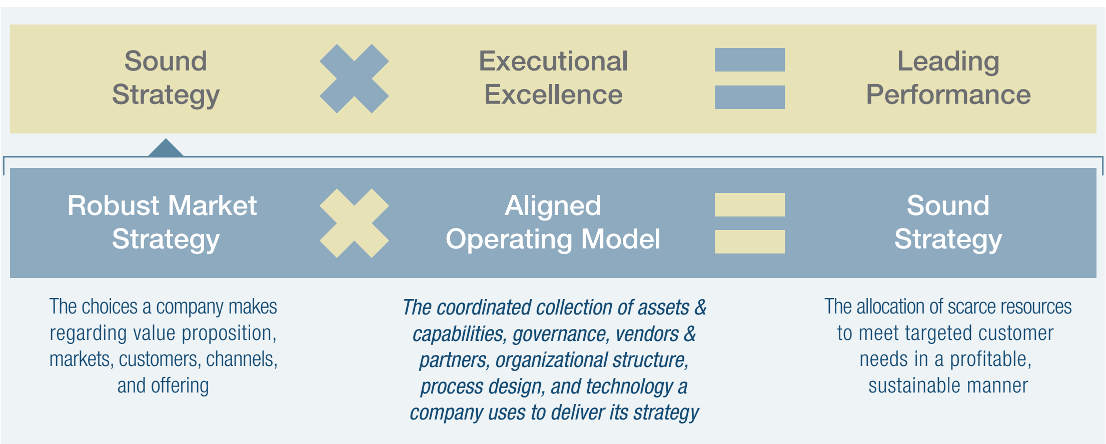
> "We languished for quite some time because we weren't structured in a way that allowed for us to implement a new strategy, have the right organization in place, and achieve the goals based upon the market opportunity that we have given on our assets."
>
> – SVP Software Company

The Link Between Operating Model and Operational Excellence

As organizations pursue leading performance, they often need to look beyond traditional approaches as achieving this goal requires two conditions: a sound strategy, the decisions about how to allocate scarce resources, and the ability to execute more consistently and reliably than the competition. With both these in place, organizations will be able to achieve their strategic objectives while also delivering and sustaining safety, quality, cost, environmental, productivity, and compliance performance.

The front office that was successful going to market with two product lines and a single value proposition no longer makes sense now that we have over 20 lines and essentially three different sets of customer — CEO Construction Materials

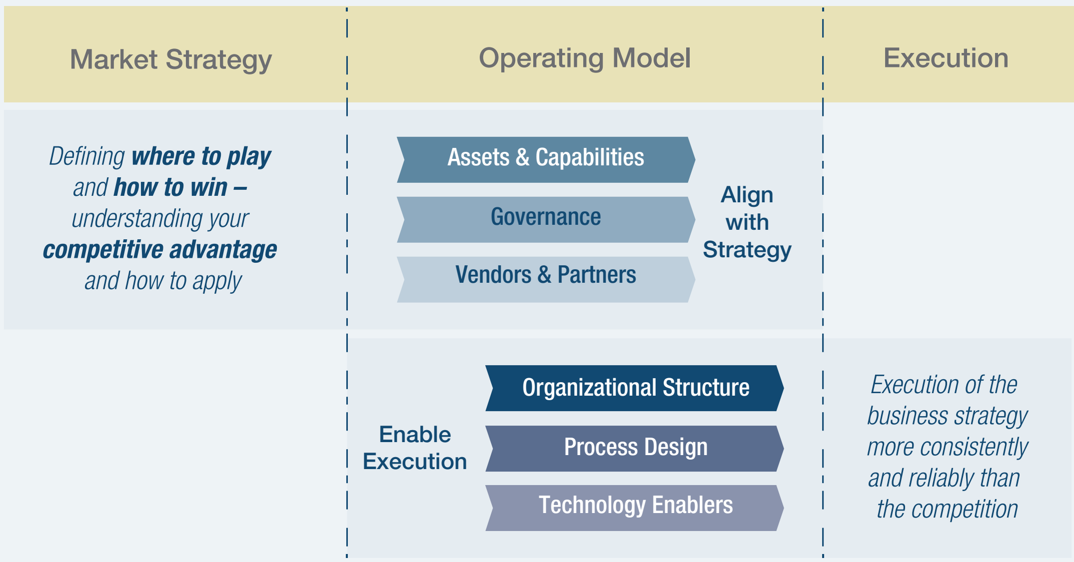
Consistent and reliable execution over time, or Executional Excellence, relies on a strong system of controls (typically in the form of a Management System) and a culture of Operational Discipline to ensure all employees do the right thing, the right way, every time whether or not such definition of "right" is written down. Execution alone is not sufficient to deliver leading performance. A sound strategy accompanied by a fit-for-purpose operating model that explicitly defines how that strategy will be executed is also needed.



Six Operating Model Design Elements

When correctly designed and implemented, operating models support efficient and effective attainment of long-term strategic goals and shorter-term operational and financial goals. Effective design starts by considering your company's market strategy, the business environment in which you operate, your current capabilities, and your performance objectives.

With this understanding, an aligned operating model can be developed to define how your company will deploy its assets, govern itself, engage with external partners, organize its people, design its processes, and deploy technology. Misalignment or ignorance of these design criteria will have significant negative downstream impact.



Six Operating Model Design Elements

Defining operating models as the coordinated collection of assets & capabilities, governance, vendors & partners, organizational structure, process design, and technology a company uses to deliver its strategy serves two purposes. First, it establishes the operating model as the foundation for both strategy and execution and second, it defines the operating model in recognizable, actionable ways, or elements. And while each of these elements addresses specific aspects of a company's structure, their interactions are critical and thus must be considered together for overall effectiveness.

Designing and locating an organization without considering how and where assets are best deployed or partners are best utilized will lead to bloat. We recently worked with a banking client that created a new organization in London while all of its assets (including data and analytical competency in addition to financial assets) were located in Asia. The result was a large, centralized organization unable to accomplish its goal.

Defining processes without consideration for how technology will be deployed or how those processes will be governed will lead to inefficiency and ineffectiveness. Another recent client had dispersed resource planning that led to lack of coordination and duplication of efforts. In this case, we helped implement a new, centralized resource management process to centralize governance, accountability, and assets (in this case, resource planning competency). For this organization versus the prior, consolidation and centralization of capabilities was the right answer.

Assets

Company facilities, including offices, factories/plants, warehouses, and research labs, that are owned/leased; patents and intellectual property used to generate revenue or manage operations; and data and competencies

Governance

Where and how operating decisions are made and who has the authority to make them; central v. local ownership; corporate policies establishing expectations for conduct and behaviors; audit & assessment functions ensuring compliance; performance reporting

Partners

Skills, abilities and capabilities the company relies on those outside the organization to provide; insourcing v. outsourcing; make v. buy; partners used to provide raw materials, distribute finished goods, or service the market

Organization structure

Operating & reporting structures needed to deliver the strategy; central v. regional v. local; assignments of roles, responsibilities, and expectations to each employee; skills & abilities for employees required for each role; relationships between departments, functions, and subsidiaries

Process design

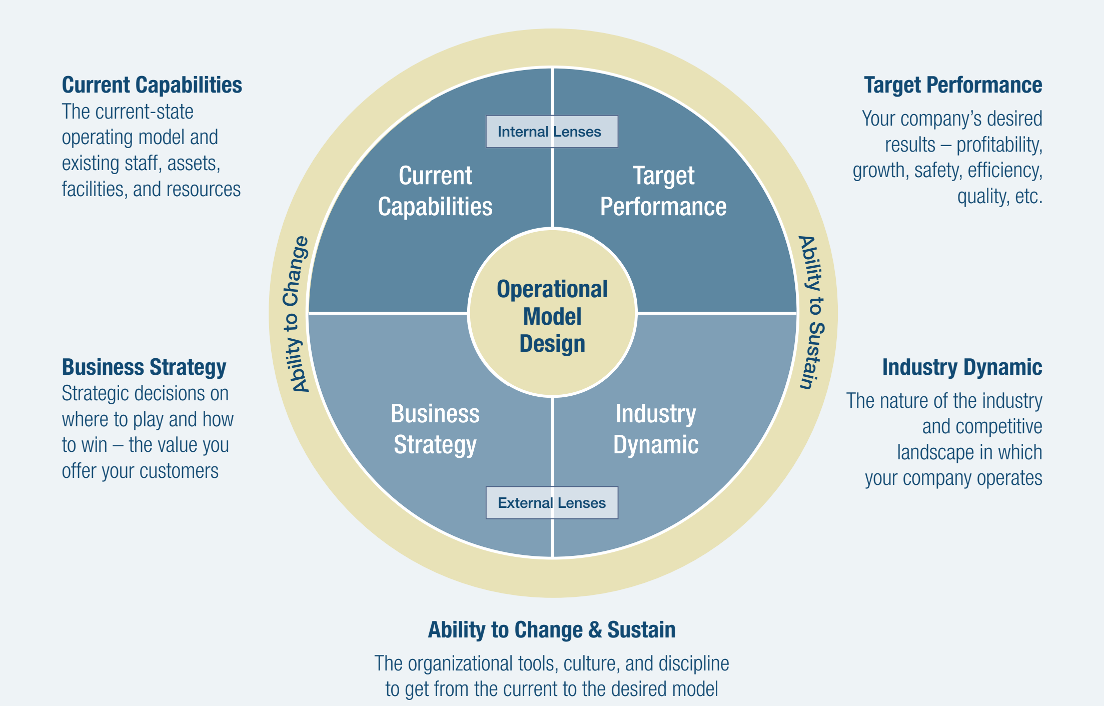
The best way of designing and sequencing activities to achieve business outcomes; where and how they are best performed, managed, and monitored to ensure control & performance

Technology

Infrastructure, application, and data architectures employed to help sustain the business as well as deliver value to the customer

No One-size-fits-all

Every company is different— industry, strategy, competition, capabilities, people, culture, and aspirations make each company unique. Therefore, there is no one-size-fits-all operating model that suits every company. There may be common starting points to consider within an industry or sector, but because all organizations have differences, however subtle, their operating models in turn will be, and should be, different. Understanding the context in which an operating model is being designed, both internally and externally, ensures an aligned and sustainable design that will enable operational excellence and continued success.



Operating Model Design Context

Internal Lenses

A company's current operating model along with its desired future performance help establish the foundation from which a redesigned operating model can be built. Knowing where you currently are and where you want to be provides the internal context for an operating model redesign.

› **Current Capabilities** the company's current operating model; existing assets, capabilities, resources and people; current performance levels across key value drivers

› **Target Performance** the desired level of future performance across key metrics & value drivers, e.g., growth, profitability, efficiency, safety, quality, etc.

External Lenses

No company operates in a vacuum. Therefore, the state of the competitive and regulatory landscape along with the way a company competes for customers must be taken in consideration when designing an operating model.

› **Business Strategy** what products are produced, where are they sold, to whom are they sold, at what prices are they sold, what channels are utilized; how the company creates value for its customers

› **Industry Dynamic** the industry the company operates in; the competitors and their strategies; external influences such government regulations, changing demographics, and shifting customer product/buying preferences

Ability to Change & Sustain

The ability and desire to change cannot be overlooked in developing or refining an organization's operating model. If the redesigned operating model is outside an organization's capacity to change, it doesn't matter how good the design is, it will never be successful. Not every organization has the leadership, culture, and time needed to make such change. An attainable level of change must be determined and considered when redesigning an operating model. The bigger the change, the more time, energy, and dedication required to pull it off. That dedication to change and willingness to follow through also speaks to sustainment over time. If the organization does not understand why the new operating model is necessary and does not see how it will carry them to a successful future, it is likely the change will not stick.

Revisiting the tie to Operational Excellence

When pursuing operational excellence, many companies limit their focus to waste elimination (or lean) in business processes. In many cases, however, real impact can only be realized with changes to roles and responsibilities, relocation of assets or how they are employed, how business partners are better utilized, and so on. Ignoring or leaving out these other operating model elements reduces effectiveness and leaves money on the table.

Given the interrelation of these six operating model elements, in most cases, organizations need to start their operational excellence

The **strategic capabilities** necessary to deliver an organization's strategy and compete is one lens for making operating model decisions. For example, being able to produce a product at the lowest possible cost is a requirement for a company going to market on price. Thus, they likely need to have excellent material sourcing capabilities along with efficient manufacturing and sales capabilities. In this case, there may be a scenario in which commodity management and procurement functions are consolidated and have good accessibility in low cost countries and a mandate to dictate policy on supplier spend. Given such authority and criticality, the company may assign a Chief Procurement Officer with a seat and equal vote at the corporate decision-making table along with other C-level executives. This company will answer the questions about who does what work and where it will be done will be answered differently that its competitor going to market on service.

journeys with a review of their current operating models, gauging whether or not they are still aligned with their strategy and they still make sense in the context of their current operating environments. Trying to improve execution when the right work is not being done by the right organization and/or in the right location will not only limit potential benefit, but may eliminate it altogether.

Considering the Operating Model ahead of Operational Excellence

There are several indicators that business performance issues are more tied to operating model design than pure process or execution issues. When one or more such indicators are present, organizations should consider revisiting the operating model ahead of, or in conjunction with, their operational excellence pursuits.

Large *differences in key financial ratios or performance metrics* when compared to others in the industry may be an indication of operating model misalignment. When SG&A or revenue per employee is out of line with several competitors, is it by design and yielding a clear benefit in share or margin? And if it is not, is it a process performance issue or is it a structural issue? If asset utilization is low, it can not only be a sign of poor planning processes and execution, but also of having the wrong assets in the wrong place.

Waning customer or market performance with a strong product or service offering may be another indicator of operating model misalignment. Best-fit operating models are typically aligned to markets and customers. As value propositions can differ significantly from one market or customer set to another, they need to be considered in how the organization is structured and where assets are deployed. Consolidation, centralization, and standardization of organizations, processes, and technology in a market or for a set of customers that demand quick response and high-touch may not make sense and could create significant process complexity. In contrast, having a highly dispersed, field-based organization in a market that is more focused on cost creates a structural hurdle that is hard to overcome even with the best processes and technology.

Cross-functional process performance is inconsistent in areas such as order-to-cash, time-to-market, or even issue-to-resolution. To get these critical processes right means the effective coordination of half dozen or more organizations (internal and external) that may be located around the globe. Revisiting structure in the context of such cross-functional value delivery is necessary ahead of process improvement.

> "It seems apparent we have too many people, yet we still aren't getting enough products to market, fast enough."
>
> – SVP Communication Services

Like a product portfolio, *organizations can proliferate over time.* This may happen because customer, market, and/or geographical expansion and will result in new requirements to serve. It may also happen because of a need to simply process more volume due to growth. Another way new organizations come about is the need to address change. Whether because of regulation, strategic initiative, or a desired emphasis, many companies define and stand-up new organizations to meet new or temporal requirements and then fail to transition those tasks to mainline organizations.

Larger-scale change is extremely difficult. Even with a clear understanding of who does and is responsible for what, the larger the number of organizations and more dispersed the decision-makers in the enterprise, typically, the longer the decision-making cycle becomes. And with this complexity, the harder the ongoing coordination effort. The ability to sense and respond effectively and efficiently to change is a sign of appropriate organization and governance structures.

Conclusion

Underpinning your strategy and your execution is your operating model, which supports your ability to meet your goals – whether they be shorter term operational targets or longer term market share or earnings objectives. While many companies undertake efforts to become operationally excellent to meet these goals, they often run into structural barriers that limit their effectiveness. These barriers result from the costs and capabilities that are locked in during the design or evolution of operating model elements such as organization and technology structure, process architecture, outsourcing or off-shoring approaches, and enterprise governance. By recognizing how these elements contribute to performance and making needed adjustments routinely through the years, companies improve the ability to become operationally excellent and realize leading performance.

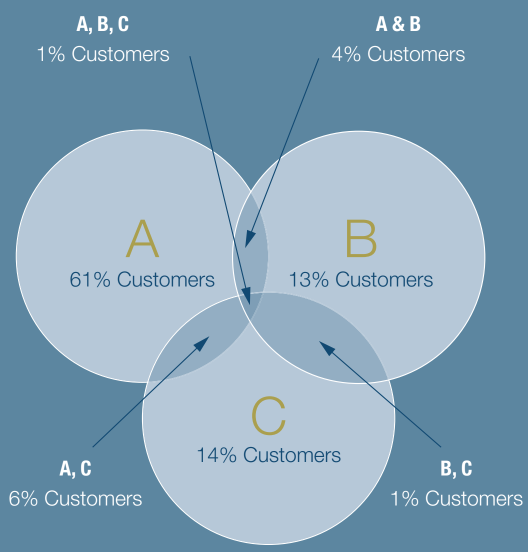
CASE STUDY

An engineering firm chose a new operating model over continous improvement to maintain growth

A successful engineered-product company with three product divisions was seeking to invest in a new phase of growth. Understanding where and how best to do so required a full understanding of true profitability; a challenging question, given significant shared sales, various 'service & support' organizations, national coverage, and products ranging from commodity construction materials to more complex engineered solutions. After an in-depth analysis of its front office, overhead, and channel performance, the company determined that, despite significant success over the last five years, the way it was organized to 'go-to-market' would not let it maintain growth and earnings in the longer term.

The current, single sales force was no longer an efficient solution

The company had shifted to a generalist sales force to slash costs during an economic downturn. However, it had since acquired a number of new companies and product lines, expanding its offering and market reach. Going from two to twenty product lines in six years dramatically increased the required breadth of knowledge and competency in Sales and Service. While the overall business had performed well, the performance and profit contribution of each segment, product line, and sales person was much less clear. After studying the historical sales transactions, it was determined that only 1% of its customers actually purchased from all three of the company's segments (see below). This was contrary to what the company had believed, and the key driver for why they be determnind change was necessary.



Customer sales across Segments A, B, C

A New Front Office

1. Move from a functional-based to a product-based alignment for the front office
    - The customer value proposition and buying processes were found to be different across product segments
    - While there was some cross-selling, the vast majority of customers bought products from a single product division
2. Split the back-office support to increase focus and remove complexity
    - Split Service in two with one group supporting two (of three) Sales divisions given their highly complementary processes and required competencies
    - Decouple certain order management and customer service activities to better align and organize skill sets while symplifying processes
3. Create a new Inside Sales group
    - Many customers did not need, nor did they prefer, a high-touch sales force
    - Given a significant amount of small quotes provided, many opportunities never were followed up with calls
4. Refine and improve use of distribution channel
    - A next tranche of customers either were small, buying single unit quantities, or substituting with other brands found more conveniently at distributors

Results

By reorganizing the front office sales and support organizations, the company was able to reduce process complexity as well as maximize focus and accountability. Further, it was able to reduce its cost-to-serve while expanding capabilities and reach. Not only will costs to sell be reduced, but more aggressive revenue plans have been targeted. The expected three year benefit for the company is in the tens of millions of dollars.

This article was authored by:

David Toth, Partner
dtoth@wilsonperumal.com

Scott Stallbaum, Case Team Leader
sstallbaum@wilsonperumal.com

About Wilson Perumal & Company:

Wilson Perumal & Company is a premier management consulting firm and the leading advisor on how to manage and capitalize upon the complexity of today's world. To learn more, visit www.wilsonperumal.com.

Wilson Perumal & Company, Inc.

One Galleria Tower
13355 Noel Road, Suite 1100
Dallas, TX 75240

contact@WilsonPerumal.com

www.wilsonperumal.com

Wilson Perumal & Company, Ltd.

Longcroft House Business Centre
2/8 Victoria Avenue
London, EC2M 4NS
United Kingdom