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An exclusive preview from Kaplan and Norton's new book, *The Execution Premium,* due out this spring.

Developing the Strategy: Vision, Value Gaps, and Analysis

By Robert S. Kaplan and David P. Norton, with Edward A. Barrows Jr.

During the past 30 years, much attention has been focused on how companies can formulate new strategies for sustainable advantage. In this first of two articles on strategy development, adapted from Kaplan and Norton's forthcoming book, *The Execution Premium,* the authors explore the key steps that establish a foundation for formulating strategy, from defining mission, vision, and values to strategic analysis.

Our work on strategy execution over the past 15 years has generally assumed the organization had a strategy in place. We've viewed the strategy development process as a "black box" that produced a strategy to be implemented using strategy maps and Balanced Scorecards. After much additional experience, we have now observed the strategy development practices followed by the most successful organizations. While the actual selection of a strategy remains an art, it is an art that should nonetheless be governed by a systematic process—one that defines the organization's purpose and goals and carefully examines the external and internal environment to identify opportunities and constraints regarding that strategy.

A 2006 McKinsey survey reported that over 75% of the 796 companies polled had a formal strategic planning process. Among those claiming to have one, more than half said that the process played a significant role in helping develop corporate strategy. Of those who are satisfied with their strategic planning process, fully 79% believed planning significantly affects strategy development.[1]

Most successful companies, in our experience, follow the systematic strategy development process shown in *Figure 1*. They start by developing or reaffirming their mission, vision, and values. Next, they determine the concrete goals and outcomes that would represent the achievement of their vision. From this flows the identification and analysis of key issues, including the external and internal forces that affect the company's strategy. This is followed by the formulation of the new strategy and—especially for new, transformational strategies—creating the case for change throughout the organization. These four strategy development steps address the following four questions:

1. *What business are we in and why? (Mission, vision, and values)*
2. *Where are we going? (Strategic goals)*
3. *What are the key issues that our strategy must address? (Strategic analysis)*
4. *How can we best compete? (Strategy formulation)*

Step 1. Crafting Mission, Vision, and Value Statements

The *mission* is a brief, typically one-sentence, statement that defines the fundamental purpose of the organization. It should include what the organization provides to its clients and inform executives and employees about the overall goal they have come together to pursue.

Examples of excellent mission statements include:

- "To provide society with superior products and services by developing innovations and solutions that improve the quality of life and satisfy customer needs, and to provide employees with meaningful work and advancement opportunities, and investors with a superior rate of return." (Merck)
- "To organize the world's information and make it universally accessible and useful." (Google)[2]

The *values* (often called "core values") of a company prescribe its desired behavior, character, and culture. Whole Foods, on its corporate Web site, not only states its core values—including "Selling the highest quality natural and organic products available," "Supporting team member excellence and happiness," and "Caring about our communities and our environment"—but also explains their importance:

> Many people feel Whole Foods is an exciting company of which to be a part and a very special place to work. [Our] core values are the primary reasons for this feeling, and they transcend our size and our growth rate. By maintaining these core values, regardless of how large a company Whole Foods becomes, we can preserve what has always been special about our company. These core values are the soul of our company.[3]

The *vision* is a concise statement that defines the mid- to long-term (three- to ten-year) goals of an organization. The vision should be external and market-oriented and should express—preferably in aspirational terms—how the organization wants to be perceived by the world. "We will be among the top three transporters of goods and people in North America by 2012" provides a clear, specific aspiration; so does "We will become the respected leader in financial services with a focus on seamless customer relationships and satisfaction, producing financial returns in the top quartile of the industry."

Quantifying the Vision

If vision statements are to guide strategy development, they must be not only aspirational and inspirational—they must also be measurable. Many organizations' visions are too vague, such as: "To be our customers' preferred provider." While describing a laudable objective, it provides no guidance for developing strategy. A quantified vision statement provides a clear focus for the strategy by including a measurable outcome and a targeted value.

The vision statement of CIGNA Property & Casualty (spun off in 1999) in just nine simple words—"To be a top-quartile specialist within five years"—contains the three essential components of a good vision statement:

1. *A quantified success indicator:* "top quartile" in profitability
2. *A definition of niche:* "a specialist," not a general-purpose underwriter
3. *A time line for execution:* "five years"

The vision statement thus provides a clear set of directions and expectations within which the entire strategy can be framed.

Vision statements for nonprofit and government organizations are more complex, in that the organization's mission replaces financial performance as the success measure. In 1961, U.S. President John F. Kennedy offered one of the most famous and effective public-sector vision statements: for the U.S. space program "To land a man on the moon and return him safely to earth before the end of the decade." In addition to the vision's inspirational power, it described a clear measure of success—"land a man on the moon and return him safely to earth"—and a specific time frame—"by the end of the decade."

Another excellent example of a well-crafted vision statement is that of Leeds University (UK): "By 2015, our distinctive ability to integrate world-class research, scholarship, and education will have secured us a place among the top 50 universities in the world." It contains the three requisite quantifying components:

1. *Quantified success indicator:* "Be ranked among the top 50 universities in the world"
2. *Definition of niche*: "Integrate world class research, scholarship, and education"
3. *Time line:* "by 2015"

By incorporating these three components, a vision statement increases the clarity of the message, adds a discrete definition of success that can be cascaded to lower organizational levels, and establishes a time frame in which the success will occur. It also sets an ambitious target for the strategy at the highest organizational level—and early in the planning process.

The organization's mission and core values typically remain stable over time. Its vision paints a picture of the future that clarifies its direction over the next three to ten years, and helps individuals understand why and how they should support the organization. Even though mission, vision, and values statements remain more or less stable, most organizations still begin their annual strategy development process by reviewing and reaffirming them. As one chief executive has noted, "It is important that the executive team constantly remind itself

Figure 1. The Strategy Development Process Model

Strategy Development Process	Objective	Platform Issues	Representative Activities
Mission, Vision, and Values (What business are we in, and why?)	To reaffirm the highest-level guidelines about organizational purpose and conduct	• Establish the vision in terms that are conducive to execution	• Mission analysis • Vision statement • Core values • Enhanced vision
Strategic Goals (Where are we going?)	To clearly define the highest-level financial or mission goals that will drive the strategy	• Establish the economic model that will be used throughout the strategy management process	• Macro mission–measure • Value gap decomposition • Strategic themes • 3- to 10-year goals • Financial model
Strategic Analysis (What are our key issues?)	To identify, through structured analysis, the events, forces, and experiences that impact and modify the strategy	• Define the linkage between the influencing forces and the process of value creation	• Environmental scan (PESTEL) • Internal scan (SWOT) • Strategy of record review • Key issue identification
Strategy Formulation (How can we best compete?)	To define where and how the organization will compete	• Ensure that changes in strategy are linked to changes in the planning and execution processes • Establish the boundaries of permissible change	• Where to compete (niches) • Differentiators (value proposition) • How to compete (strategy map) • Financial model/Stratex • Strategic change agenda

This four-step process is followed by most successful companies that have a strategic planning process. The first three steps—defining mission, vision, and values; setting strategic goals; and performing analysis—set the stage for the last step, formulating the strategy.

of the foundations for what we are doing."

Enhancing the Vision

Organizations can now use the four perspectives of the strategy map to develop an enhanced vision that is more comprehensive than a traditional vision statement and easier to translate into an achievable strategy. The enhanced version moves the vision beyond a simple outcome statement of the vision ("to become the preferred provider") to a more comprehensive picture of the enabling factors with which to achieve the vision, including key processes and intangible assets such as people and technology. The enhanced vision bridges vision and strategy.

Nemours, a nonprofit foundation dedicated to the health and medical treatment of children, developed an enhanced vision as the basis of its strategy. Founded nearly 70 years ago as the Alfred I. duPont Institute, Nemours is considered the world's leading treatment center for children with complex orthopedic conditions. Over the past 25 years, it has expanded its scope of services and geographic reach to have an even greater impact on the health and well-being of children. Nemours developed a strategic plan to deliver on its vision: "Freedom from Disabling Conditions." In Nemours's 2008–2012 Annual Plan, CEO David Bailey, an MD and MBA, described the objective of the Nemours strategic planning process:

> [Our] approach...was not to identify opportunities for improvement. Rather, the effort was directed at what must be done in the future to have an even greater impact on children, to deliver measurable results, and to further enable Nemours's influence on issues affecting children by developing broad recognition [that] would also honor Mr. duPont's transformational act of philanthropy.

Nemours built its strategy map with its vision and mission at the top, defining the ultimate objective and accountability of the enterprise, and its core values at the bottom, recognizing that they were foundational for everything it did. Its vision simply and succinctly describes Nemours's desired destination. This simple vision statement, however, provided little guidance for shaping the strategy. Nemours thus created an enhanced vision (which it calls its "highest-order strategy map") to facilitate the transition from vision to strategy. The enhanced vision described four critical goals: (1) "To be a leader in improving children's health through our integrated health system—becoming a preeminent voice for children"; (2) "To care for each and every child as if he or she were our own"; (3) "To be effective stewards of all of our assets, continually improving them to advance our mission"; and (4) "To be a great place to work." These goals then became the foundation of the strategy map's four strategic themes—Impact & Community, Service & Quality, Efficiency & Environment, and People & Learning—and led naturally to the three remaining strategy development steps, culminating in strategy formulation with a complete strategy map representation of the Nemours strategy.

Step 2. Strategic Goals: Define and Decompose the Value Gap

Quantifying the vision makes it possible to integrate target setting with the exploration of feasible strategies. The vision's quantified success factor becomes the reference point for judging the feasibility of strategies. The success factor defines the desired outcome from successful strategy execution (e.g., "achieve top-quartile profitability," "rank among the top 50 universities in the world"). One of the key characteristics of a strong leader is the ability to rally an organization around achieving a stretch target objective—to challenge the organization to become much better. Without strong leadership, an organization becomes complacent and, at best, will only achieve incremental improvement. As Collins and Porras note, "Visionary companies may appear straitlaced and conservative to outsiders, but they're not afraid to make bold commitments to BHAGs, 'Big Hairy Audacious Goals.'"[4]

With a stretch target for success now embedded in the vision, the executive team defines a value gap—the difference between the desired outcome and what could be achieved by maintaining the status quo with the existing strategy. The value gap represents the difference between aspiration and reality; it becomes the goal for the new strategy to fulfill.

CIGNA P&C

A key financial measure for property and casualty insurers is the "combined ratio" (CR), which equals the ratio of cash outflows from expenses and claims payouts to cash inflows from premiums. At the start of CIGNA's journey, the CR for a top-quartile performer was 103; CIGNA's was 140. Thus, the new strategy had to close a CR value gap of 37 points within five years.

Figure 2 illustrates how CIGNA addressed two broad questions: *where* the CR improvements would come from, and *when*. The executive team decomposed the overall strategy into four strategic themes, each representing a relatively independent value-creation process. It then estimated how much each of the four themes could contribute to closing the value gap. The team also estimated how quickly each theme could achieve its value gap target during the designated five-year time frame. At this point, these were informed estimates; they were not yet based on a detailed strategy. This first pass at determining how a strategy would close the value gap, however, showed the feasibility of the overall strategy and laid the groundwork for more detailed thinking within each of the four strategic themes.

CIGNA's approach illustrates the power of linking vision to strategy early in the strategy development process. It ensures that the vision is taken seriously and can, in fact, be linked to actionable, accountable results—both important components for successful strategy execution. Establishing the vision and setting stretch targets at the front end of the strategy development process establishes the framework for subsequent steps of strategy development.

Step 3. Strategic Analysis

With a clear picture of what it needs to achieve, the company must now perform an external and internal analysis that includes assessing the impact of industry trends and its own performance and positioning relative to competitors, as well as developing a detailed understanding of how it presently delivers value.

External Analysis

The executive team needs to understand the impact of macro- and industry-level trends on the company's strategy and operations. The external analysis assesses the macroeconomic environment of economic growth, interest rates, currency movements, input prices, regulations, and general expectations of the corporation's role in society. Often this is called a PESTEL analysis, reflecting its political, economic, social, technological, environmental, and legal components.

The external analysis should include an industry-level examination of industry economics using frameworks such as Michael Porter's Five Forces: the bargaining power of buyers, the bargaining power of suppliers, the availability of substitutes, the threat of new entrants, and the intensity of industry rivalry. The Five Forces model calibrates the attractiveness of an industry and aids in identifying specific forces that are shaping it, favorably or unfavorably.[5] The industry analysis should also include a summary of the company's performance on multiple financial ratios relative to its industry competitors.

Finally, the external analysis includes competitor assessments. One approach is to plot all the competitors in the industry on a two-by-two table, with the axes representing some combination of key competitive dimensions such as product scope, technological capabilities, and geographical reach. The dimensions can be changed to provide different screens of performance. Additional information can be depicted on the table by identifying each competitor with a circle whose size is proportional to its performance on a key indicator such as market share, profitability, or sales.

Internal Analysis

The internal analysis examines an organization's own performance and capabilities. Companies that have not yet developed a Balanced Scorecard will rely heavily on financial information to assess recent performance. A widely used analytic tool is value chain analysis, also introduced by Michael Porter,[6] which identifies the sequence of processes necessary to deliver a company's products and services to customers. In addition to the primary activities of creating a market, producing products and services, and selling to customers, the value chain can encompass secondary or support activities, such as research and development, human resource management, and technology development, which facilitate the primary value creating processes. The value chain model helps a firm identify those activities that it intends to perform differently or better than competitors to establish sustainable competitive advantage.

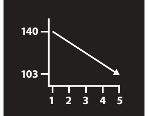
SWOT Analysis

After performing the external and internal analyses, the strategic

Figure 2. How CIGNA P&C Decomposed the Value Gap

CORPORATE GOAL

Reduce combined ratio by 37 points in five years



	Operational effectiveness	Customer management	Innovation		
STRATEGIC THEME	Improve agents' productivity	Focus on target markets	Align underwriting and claims	Upgrade under-writing	Total
Year 1					
Year 2	–11	– 6			–17
Year 3			– 4	– 2	– 6
Year 4			– 4	– 5	– 9
Year 5			– 2	– 3	– 5
					– 37 pts.

Executives decomposed the strategy into four strategic themes. They then estimated how much each theme could contribute to closing the 37-point value gap, and how quickly it could do so, within their five-year time frame.

planning participants conduct a SWOT analysis. Perhaps the earliest and most fundamental of all strategy analysis tools, SWOT analysis identifies the company's existing *s*trengths and *w*eaknesses (internal attributes) and emerging *o*pportunities and worrisome *t*hreats (external attributes).

A well-conducted external and internal analysis generates a host of information for a management team, much of which can be confusing when examined in totality. SWOT analyses help summarize this information into a succinct list that helps the executive team understand the key issues that the organization must contend with when formulating its strategy. For example, strengths can be leveraged to pursue opportunities and to avoid threats, and managers can be alerted to internal weaknesses and external threats that need to be overcome by the strategy. Within each SWOT dimension, the list can be prioritized to reflect each element's overall importance to the organization.

Traditional SWOT analysis can be combined with the BSC framework to set objectives critical to the organization's future success. The BSC SWOT matrix, created by performing a SWOT analysis for each of the BSC perspectives, provides a framework that integrates the SWOT strategy planning tool and the Balanced Scorecard strategy execution framework. The resulting single-page summary provides a valuable reference point for managers to assess the issues that must be addressed by their strategy, organized by results for shareholders or customers, processes, and people. ■

Part II: Formulating and Launching the Strategy

Authors' note: We would like to recognize the important efforts of Ed Barrows in developing this work.

1. "Improving Strategic Planning: A McKinsey Survey," McKinsey & Co. (September 2006).

2. See http://en.wikipedia.org/wiki/Mission_statement (accessed July 25, 2007).

3. See http://www.wholefoodsmarket.com/company/corevalues.html.

4. Jim Collins and Jerry I. Porras, *Built to Last: Successful Habits of Visionary Companies* (HarperCollins, 1994).

5. Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (Free Press, 1980).

6. Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (Free Press, 1985).