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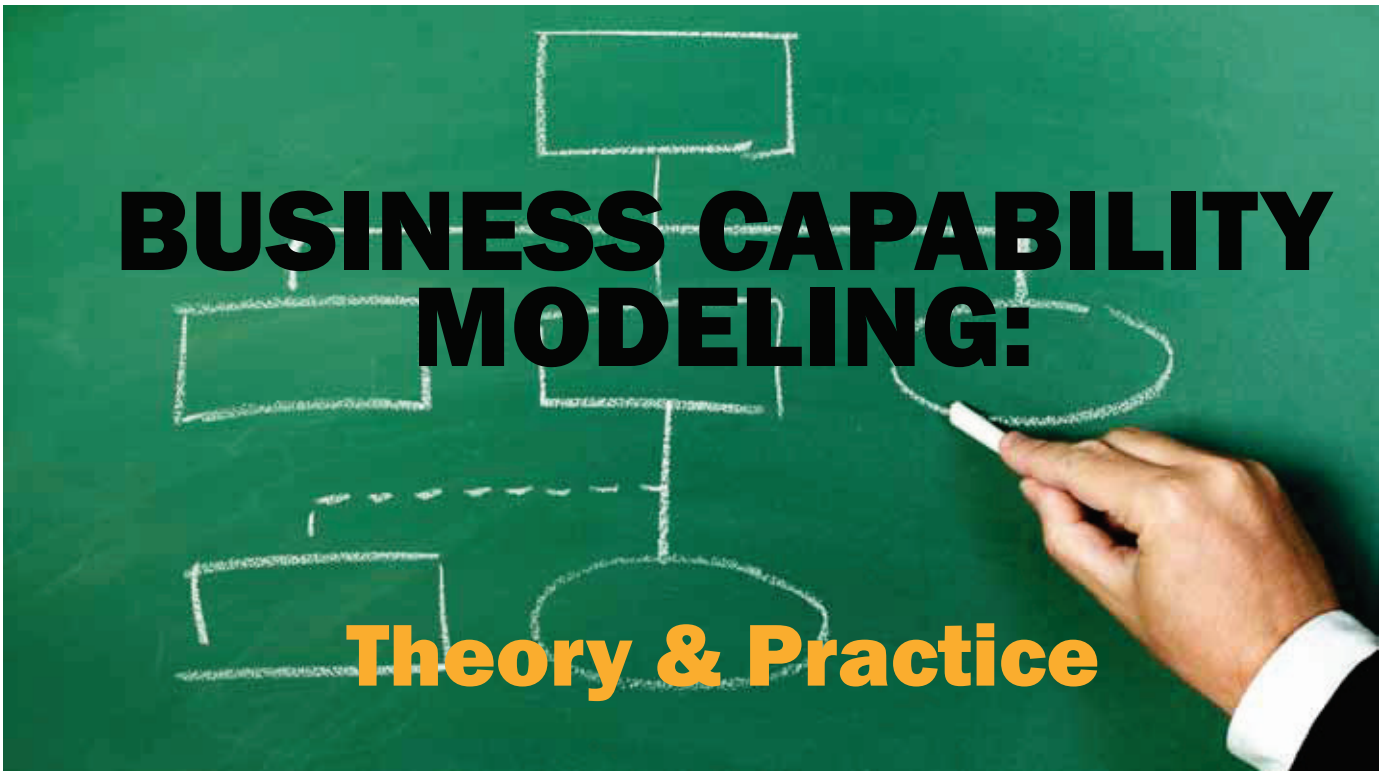

BUSINESS CAPABILITY MODELING:
Theory & Practice

By Leonard Greski

THEORY: WHAT IS A BUSINESS CAPABILITY?

A business capability is an ability or capacity for a company to deliver value, either to customers or shareholders. Business capabilities are a useful abstraction because they represent the next level of detail beneath the business strategy. A business capability consists of three major components: business processes, people, and physical assets.

There are two kinds of capabilities: customer-facing and operational. Customer-facing capabilities directly deliver value to customers. A network of retail stores, a product or service offering, or a transportation service such as rail or air are all examples of customer-facing capabilities. Operational capabilities deliver value to shareholders instead of customers. Examples of operational capabilities include strategic planning, mergers and acquisitions, and financial planning.

Business capabilities are extremely valuable as a mechanism to translate strategy into action. First, they represent discrete ways a business generates measurable value, so we can associate benefits and costs with them.

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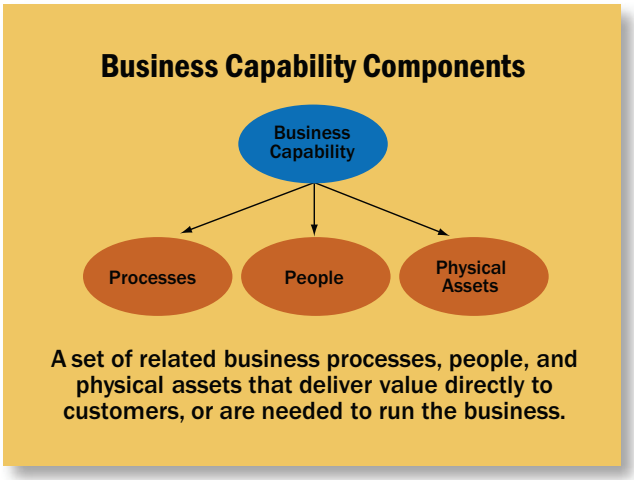
ART DIRECTION & DESIGN
BNewton Associates

Architecture & Governance
8601 RR 2222
Building 3, Suite 300
Austin, TX 78730
512-536-6270
www.ArchitectureandGovernance.com

Second, capabilities are hierarchical. They can be modeled using parent/child relationships, allowing us to understand them at multiple levels of detail. Third, they can be managed as assets. We can think about them as a portfolio of investments and proactively manage them to meet or exceed a target return on investment. Finally, business capabilities allow companies to create sustainable competitive advantage through unique combinations of people, processes, and physical assets.



PRACTICE: BUSINESS CAPABILITY MODELING TECHNIQUES

Business capabilities can be modeled using a variety of simple techniques, using low-cost tools. There are four steps to create a capability model:

1. Develop the capability hierarchy.
2. Identify key relationships between capabilities and other planning elements.
3. Develop demand models for the capabilities.
4. Develop financial models for the capabilities.

Develop the Capability Hierarchy

To complete the first step, collect information about the organization's capabilities starting with customer-facing capabilities. Since most companies do not use the term "business capabilities" to describe the capabilities they bring to market, the architect may have to derive the capabilities from other kinds of information. Useful sources of information about capabilities include annual reports, interviews with business planners and line-of-business leaders, strategy documentation, business process models, product/service marketing materials, and the company's organization chart.

Review the collected information and identify the capabilities, stating them as nouns. For customer-facing capabilities, they will likely describe product or service offerings. Draw the hierarchy with an organization chart diagramming tool, or build it as a team exercise using Post-It® notes and a large, empty wall to display the hierarchy. The root (or parent) node of the diagram represents the entire company. The first level below the root lists

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the major ways the company generates value to customers and shareholders. Additional levels of decomposition break down the major capabilities into subcomponents.

See the example on this page, which illustrates some of the capabilities of an Internet retailer, organized into a hierarchy.

Identify Key Relationships

After drafting the capability hierarchy, using a set of association matrices, define the hierarchy's relationships with other planning elements. List the capabilities on the row dimension of the hierarchy, and the other planning element on the column dimension. Display the capabilities at the most detailed level of granularity or include all levels of the hierarchy in an outline format. Start with matrices to cover the three components of a business capability: business processes, people, and physical assets. These matrices will be used as inputs to the demand and financial models. As needed, you can also document relationships between capabilities and business units and/or strategy elements.

Business processes should be listed in the matrix at a level of detail that is consistent with the detail level in the capabilities hierarchy. The people side of the capabilities/people matrix can be a list of roles that are associated with the business processes, or the different departments that support the capabilities. Instead of using an "X" in the cells to mark a relationship, enter the head count (or total cost of head count) in each department that directly supports a capability. For the capabilities/physical assets matrix, group the physical assets into categories that are meaningful to the business stakeholders, and use the annual expense cost or the asset value to represent the relationship between a capability and associated physical assets.

Develop the Demand Model

The next step in the capability modeling process is developing a demand or utilization model for the capabilities. Work with the business partners to identify the things the business does to generate demand or usage for a specific capability, such as advertising or promotions. Use known conversion factors (e.g., shoppers entering a store converting to orders) to relate the demand generating activities to utilization of the capability and its component business processes. Enter this information into a spreadsheet, illustrating the relationship between demand generation activities and frequency counts of the business processes on a monthly basis.

Another approach to generating the demand model for customer-facing capabilities is based on historical trending of a capability's business processes. Gather the revenue growth forecast for a capability and frequency counts for its business processes over a 12– to 24-month period. Identify relevant conversion factors between the revenue forecast and the business processes, and model the process utilization on a monthly basis, using the historical data and growth factor to project past utilization into the future.

Develop the Financial Model

Organize the information collected in previous steps into two categories: benefits and costs. Create a statement of cash flows to illustrate the relationship between benefits

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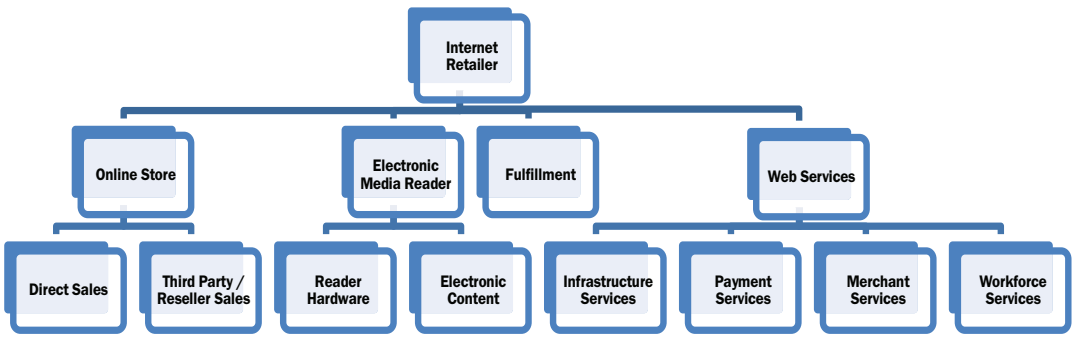
Example

Internet Retailer Capability Hierarchy



- Capability modeling helps business people visualize consequences of business plans and decisions by highlighting the things that are impacted by changes in the business.

and costs associated with the capability. Both ongoing and one-time benefits and expenses (e.g., capital investments, gain from sale of assets, etc.) associated with the capability should be included in the model.

USING THE CAPABILITY MODEL TO MAKE DECISIONS

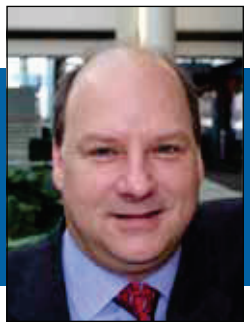
Capability modeling helps business people visualize consequences of business plans and decisions by highlighting the things that are impacted by changes in the business. For example, if a company changes its strategy, it can evaluate the impact of strategy change on the existing portfolio of capabilities. What capabilities must change to support the new strategy? What capabilities are no longer needed? Are there any new capabilities that must be developed in order to execute the strategy?

The capability model can also be used to manage ongoing operation of a capability. Using the demand and financial models, one can estimate the impact of changes in planning assumptions on the business processes, people, and physical assets associated with the capability. For example, as demand grows, what processes or assets are at risk of failure? Where will costs increase at a level greater than acceptable levels as demand grows? If demand falls, where will fixed costs jeopardize profitability of the capability?

Capability models are also useful to support merger and acquisition activity. Acquisition targets can be evaluated in terms of the capabilities they provide and the overlap between target and acquirer. What capabilities must be integrated to generate sufficient synergies to make the acquisition profitable? Conversely, a company can review the capability model and identify the processes, people, and assets that would be lost through a divestiture.

Finally, managers can use the model to evaluate investments across capabilities. By knowing the returns generated by each capability, managers can focus investments on the highest performing capabilities and restrict investment in lower performing capabilities. **A&G**

LEONARD GRESKI is the director of eCommerce Architecture at W.W. Grainger, Inc. He can be reached at leonard.m@greski.com.



A&G CALENDAR

Gartner Enterprise Architecture Summit
September 14–15, 2009
London (Royal Lancaster Hotel)
www.gartner.com/it/page.jsp?id=778115

Strategic IT Planning Forum
September 14–23, 2009
Various European cities
www.rubiksolutions.com

Technology Solutions and Asset Management
September 15, 2009
New York City
www.tsam.us

Business Process Management Conference Europe 2009
September 28–30, 2009
London
www.irmuk.co.uk/bpm2009

Gartner Enterprise Architecture Summit
October 7–9, 2009
Orlando, FL (Hyatt Regency Grand Cypress)
www.gartner.com/it/page.jsp?id=849312&tab=partners_v2

12th International Business Rules Forum
November 1–5, 2009
Las Vegas, NV (Bellagio)
www.businessrulesforum.com/index.php

Data Management, Information Quality and Data Warehouse & Business Intelligence Conference
November 2–4, 2009
London
www.irmuk.co.uk/dm2009/

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