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Organizing Around Business Capabilities

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By Len Greski & Melissa Roberts

In *Getting Beyond Ourselves*, Len made the argument for a results-oriented architecture. That is, everything architects propose to an organization should be to increase the economic value of its business

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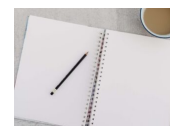
Organizing Around Business Capabilities

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capabilities. Organizations do two things with capabilities: build them and operate them. Many organizations develop operating models around a key product or service, and as that product or service is successful in market, the operating model ossifies around the business operations of the product or service. Other organizations, particularly those whose deliver software-based products to their customers, over index on building capabilities at the expense of their operations. Inattention to the operational aspects of capabilities results in products or services that go unused, or poor operational support that creates frustration for customers, leading to reduced usage and revenue.

Value and Other Structures

To maximize an organization's ability to change at the speed of markets and customers, leaders must balance the structures required to build capabilities with those needed to operate them. Since many large organizations find it difficult to add or modify capabilities once their operating models are entrenched around the operation of a limited set of products or services, the journey to business agility starts with defining a *value structure*.

A *Value Structure* is an idealized teaming structure illustrating how the organization delivers benefits to its customers. The idealized structure includes teams and roles to not only operate a capability, but also to build it. We call this structure the value structure to differentiate it from two other structures within an organization: formal structure and learning structure.

The formal structure represents the way an organization structures its activities into jobs and job families, manages compensation and other aspects of human resources. The learning structure represents the way an organization learns to improve its performance, including role-based learning, team-based learning, and establishing a culture of relentless improvement without guilt or blame.

Establishment of a value structure independent from formal and learning structures enables an organization to begin to change how it delivers value to customers without the overhead of changing formal reporting or job titles. The value structure makes impediments to the flow of value clearly visible so we can either eliminate them or explicitly orchestrate them. Creation of a learning structure enables the organization to improve its performance at multiple levels, starting with team members who have clear role-based performance



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expectations, mechanisms for teams to improve their performance, and the leadership support needed to make continuous improvement part of the organization's culture.

Organizing Around Capability

A business capability is a unique combination of people, business processes, and assets that generate measurable value. Teaming structures designed around business capabilities provide four significant sources of benefits, including:

- Stability,
- Adaptability,
- Accountability, and
- Value Maximization.

Stability

In *The Essential Advantage: How to Win with a Capabilities Driven Strategy*, Paul Leinwand and Cesare Mainardi argue that to be successful a company must establish coherence across three critical things: its market position, its most distinctive capabilities that work together as a system, and its product and service portfolio^[1].

Organizations have a fundamental set of business capabilities that are required for them to operate. This core set of capabilities is stable, that is, the essence of what the organization does not significantly change over time. Consider manufacturing organizations, they still have the same business capabilities of Order Management and Product Management as they did when they were founded. Since a set of distinctive capabilities can be leveraged across multiple products and services, the underlying capabilities are more stable over time than the products and services they support. Once a set of capabilities begins to work as a larger system where the whole is greater than the sum of its parts, the systems effect reinforces the stability of the capabilities, which makes capabilities a stable base for organizing teams.

Adaptability

This reads like a bit of a paradox. After making the argument that capabilities are stable, how can we also argue that capabilities enable adaptability?

Repeated use of a system of distinctive capabilities enables a company to quickly deliver new or enhanced products and services to market, as well as expand existing products and services in new markets or distribution channels. As an example, a U.S.-based industrial distributor adapted its e-commerce capability to interact with point-of-sale systems with a U.S. home improvement retailer and deployed the solution in two test markets within a period of 6 weeks. The solution generated over \$30 million in revenue its first month in operation.

The industrial distributor gained by accessing new consumer customers who were outside its traditional base of business customers. The home improvement retailer benefitted because more customers who walked into their stores were able to purchase the products they needed without the retailer having to add hundreds of thousands of slow-moving items into their product inventory. Not only did the retailer's in store conversion rates improve, but customer satisfaction also increased because fewer customers left the stores without a solution to the home improvement problem they brought into the store.

Accountability

Large organizations frequently struggle to manage allocations of cost from large, centralized cost pools across lines of business.

Centralized pools of cost can become magnets for waste and inefficiency. One large company's challenges with this problem led to a corporate split, forcing every dollar of cost to become visible as it was applied to one and only one of the successor companies. Three months before the date of separation, the CIO for one of these companies discovered that her technology cost as a percentage of sales jumped from 1.6% to 3.9% as the hidden centralized costs were assigned to her cost center. A frenetic scramble ensued to understand and eliminate as many of these costs as possible before the split date.

Organizing around capabilities allows a company to greatly reduce its reliance on centralized cost pools, increasing accountability for each business capability to deliver profitable results. When we understand how use of a capability generates costs and benefits, we can invest in the capability to increase its value over time, managing not only to its initial build cost, but also to its operational cost.

Value Maximization

When teams are structured around business capabilities, executives can view that capability through a capability-based investment analysis[2]. They can see what parts of the business or market require a solution, and how potential solutions might leverage the organization's differentiating capabilities to win in the market.

Having confirmed the value of a solution, executives can prioritize the work of existing teams needed to implement the solution, and they can create one solution that benefits multiple products, services, business areas and/or customers. This is how companies build differentiating capabilities that deliver competitive advantage across markets and customer segments.

The End Game

Organizing around capabilities enables us to achieve a compelling goal: the composable enterprise, where organizations can improve their speed to market with new products and services by as much as 80%[3].

An organization comprised of independent capabilities with stable teams can be managed as a set of assets, where growth in benefits generated by a capability as customers use it exceeds the growth in costs. When a capability has achieved independence, it can be managed as a profit & loss generator, enabling an organization to make decisions about the capability without negatively impacting other capabilities.

Effectively Managing the Change

We make progress towards the goal of composability through a series of iterative and incremental changes. These changes result in independent capabilities that have stable teams, clear interfaces to customers / end users and can therefore be easily combined into new products and services. We start by establishing an idealized end state structure where each business capability is independent of other capabilities and move towards that end state through a series of "next stable states," each of which increases the capability's ability to deliver benefits to its customers. The steps include:

1. Establish the idealized structure,
2. Establish the ability to predictably build and enhance capability,
3. Integrate technical operations into the capability, and

4. Integrate business operations into the capability.

Establish the Idealized Structure

The idea of an “idealized structure” is based on the thinking of Russell Ackoff as described in *Idealized Design: Creating an Organization's Future*. A leadership team envisions what its organization might look like if today's constraints didn't exist. A key step in this process is the establishment of the organization's capability map, which is used to determine the teams needed to build and operate its capabilities. We organize teams to encapsulate as much work as possible within a capability to minimize external dependencies. The teams are designed to be stably staffed, each with a clear backlog of work to be done. Having established a vision of “ideal,” we layer in key between-team dependencies that must be orchestrated as the organization builds or enhances a capability. This initial teaming structure provides the foundation for the next step, establishing build predictability.

Establish Build Predictability

Executives often express frustration about their organizations' difficulties in bringing new or enhanced products and services to market. In many companies the only thing that c-level executives agree upon about product development is that it's too slow, too expensive, and too unpredictable. This phenomenon leads to what we call the predictability principle – *if you're not predictable, nothing else matters*.

Establishing predictability for building capability gives the organization the ability to reliably determine when new or enhanced capabilities can be delivered to customers. The teams supporting a capability are coached plan and coordinate work, meet commitments, and improve their performance. As teams stabilize their throughput, the team of teams can establish a rolling backlog where value is frequently delivered to clients in a predictable manner.

Predictability becomes the foundation of all other changes needed to establish independence for a business capability.

Integrate Technical Operations

The next move, or “stable state” on the path to capability independence, is to integrate technical operations. By *technical operations* we mean the supporting technologies, infrastructure, and

processes needed to deliver new or enhanced capability to customers or internal end users.

Having identified the dependencies external to a capability that we addressed through orchestration or policy changes in the previous step, we create the conditions necessary to independently deliver by moving these technical dependencies to independently hosted infrastructure components that can subsequently be absorbed into the technical operations of the teams building a capability.

Once the conditions have been established and technical operations have been extracted to independent infrastructure, we migrate the responsibilities for building, testing, and deploying new capability into the capability team structure. At this point all the technical costs associated with building and operating the capability are within the control of the capability, facilitating its establishment as an independent asset.

Integrate Business Operations

This final step integrates the people and processes for day-to-day operations of the capability into the teaming structure for the capability. We establish the governance and measurement of operations required not only to operate the capability but also to continuously improve its service levels and efficiency. We add teams and roles to represent all the domains and skills necessary to operate the capability and support its customers. This enables the organization to manage the capability's total build and operate cost, enabling us to manage it as an independent asset to increase its value over time.

Conclusions

Organizing around stable capabilities provides companies with clear competitive advantages. An organization's most distinctive capabilities can be leveraged across multiple products and services to quickly respond to changing market conditions. Leinwand and Mainardi call this the *coherence premium* – the degree to which more market segments share the same critical capabilities, the greater its profits^[4]. This form of organization also enables an organization to manage each capability as an independent asset, growing the benefits it generates relative to its costs over time.

Since most large companies aren't already organized around capabilities they must be transformed: first by consolidating how they are built, and then by how they are operated. A base of distinctive capabilities improves an organization's ability to execute its strategy not only through superior performance of the capabilities, but also by helping the organization determine what to say "no" to, and that is the essence of strategy.[5]

[1] Leinwand, Paul and Cesare Mainardi, *The Essential Advantage: How to Win with a Capabilities-Driven Strategy*, Kindle Edition location 128.

[2] Business Architecture Guild, *A Guide to the Business Architecture Body of Knowledge v12.0*, 2023, Part 2, Section 2.2, page 67..

[3] Free, Don *The Composable Enterprise*, Gartner Inc. 2021.

[4] Leinwand, Paul and Cesare Mainardi, *The Essential Advantage: How to Win with a Capabilities-Driven Strategy*, location 510, Kindle edition.

[5] Porter, Michael, *What is Strategy?* Harvard Business Review, November – December 1996.

Len Greski has over 30 years of experience helping large organizations generate billions of dollars in economic value by building and operating differentiating business capabilities. He currently leads the Architecture practice at LeadingAgile, the leader in helping companies grow in value through business agility. He leads engagements with large clients to help them improve flow by restructuring value delivery around their business capabilities and quantifying the value of agile transformation. Len received Bachelor and Master of Arts degrees in Sociology from the University of Illinois at Chicago with concentrations in Organization Theory, Research Methods and Statistics.

**Len Greski**

Melissa Roberts is Strategic Business Architect at LeadingAgile. As a certified business architect from the Business Architecture Guild, she has helped organizations build successful business architecture teams. She has worked with various organizations to help them realize the full benefits of business architecture in their strategy realization. Melissa holds an MS in Organizational Leadership with a focus on Strategic Leadership from the University of Colorado at Boulder and a Bachelors in Psychology from the University of TN at Chattanooga.

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