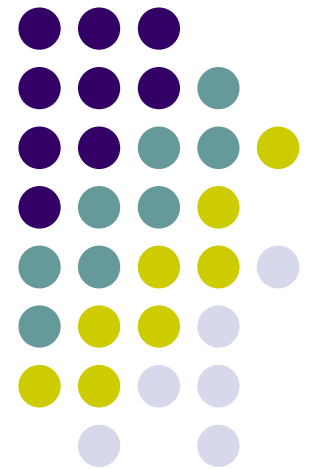
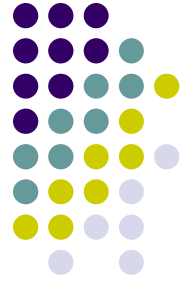


# Business Capability Modeling: Theory & Practice

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Leonard Greski

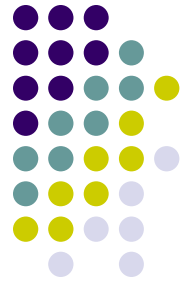




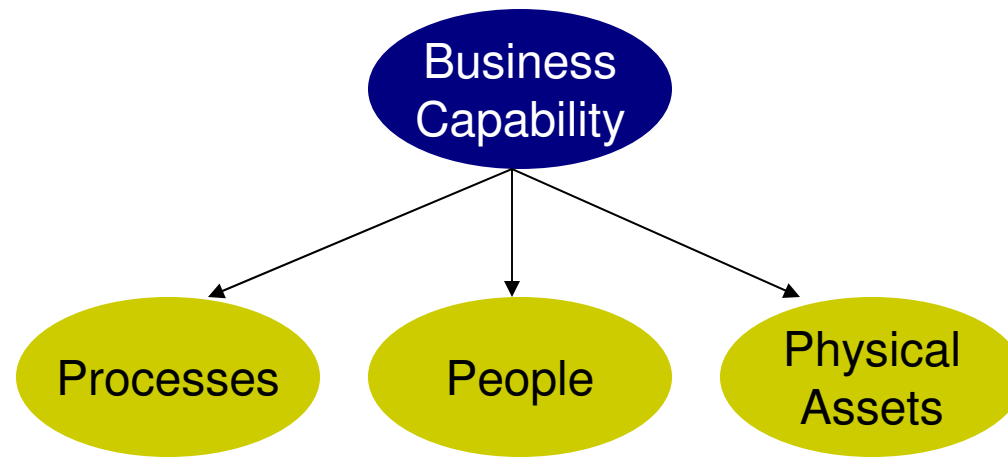
# Topics

- Theory
  - Business capabilities defined
  - Why business capabilities are useful
  - Characteristics of business capabilities
  - Role of business capabilities in strategy to results process
- Practice
  - Modeling capabilities in four easy steps
  - Using the model to make decisions
  - Common questions
- Q&A

# What is a “business capability?”



An ability or capacity a business has to deliver value to customers and / or shareholders.



A set of related business processes, people, and physical assets that deliver value directly to customers, or are needed to run the business.

# Two Types of Capabilities



Customer-Facing

Capabilities that deliver value directly to external customers

Operational

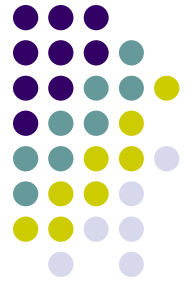
Capabilities that deliver value to shareholders, or are needed to operate the business

# Characteristics of Business Capabilities



- More detailed than strategy elements; less detailed than business processes
- Hierarchical: capabilities can be represented at multiple levels of abstraction
- Illustrate relationships between people, processes, and physical assets
- Managed as assets

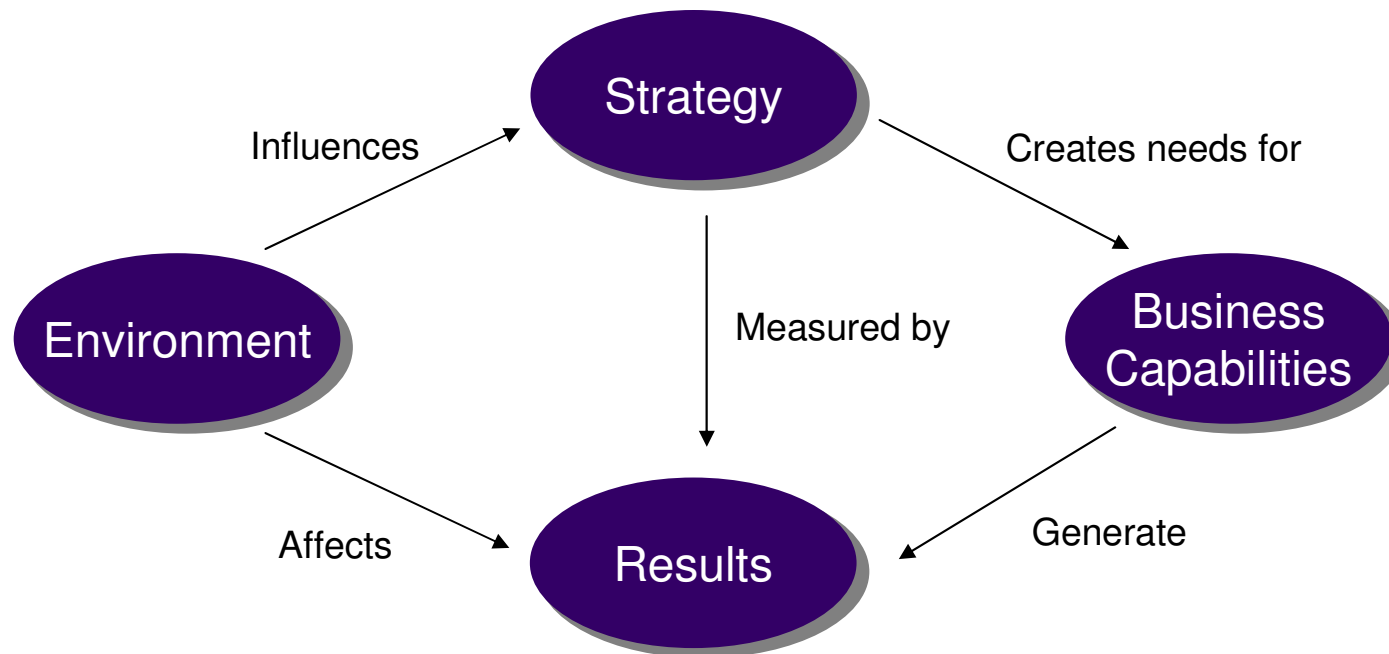
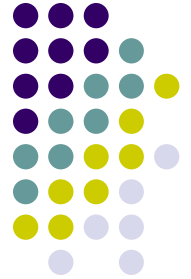
**Bottom Line:** Capabilities allow companies to create sustainable competitive advantage through unique combinations of people, processes, and physical assets



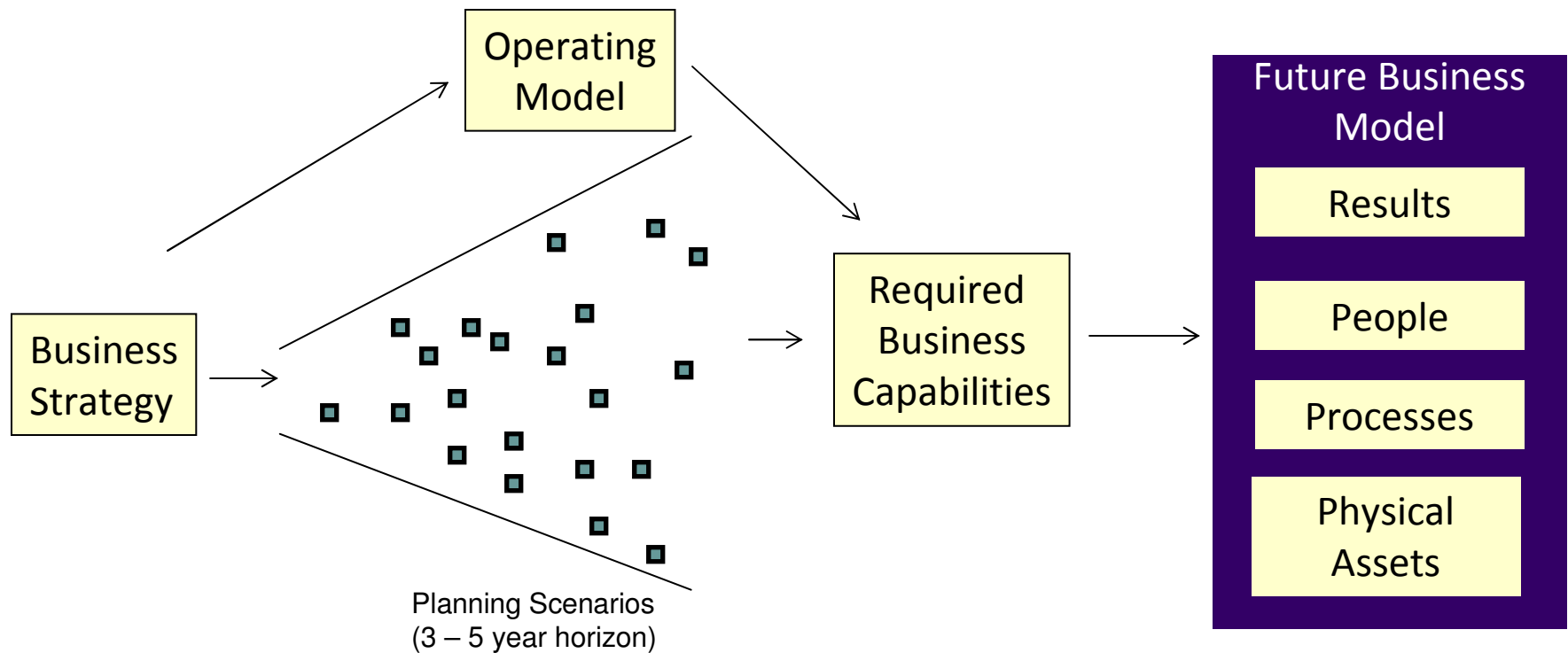
# Uses for Business Capabilities

- Visualize consequences of strategy
  - Impact to existing capabilities
  - Missing capabilities
  - Capabilities no longer needed
- Manage ongoing operation of a capability
  - Evaluate impact of changes in planning assumptions on costs & benefits
  - Forecast investments in increased capacity
- Support merger & acquisition activity
  - Evaluate capabilities of acquisition target(s)
  - Identify integration synergies
  - Identify capabilities to be lost through divestiture
- Manage investments across the portfolio of capabilities

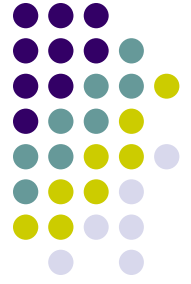
# Capabilities in Context: Strategy to Results



# Strategy to Future Business Model







# Topics

- Theory
  - Business capabilities defined
  - Why business capabilities are useful
  - Characteristics of business capabilities
  - Role of business capabilities in strategy to results process
- Practice
  - Modeling capabilities in four easy steps
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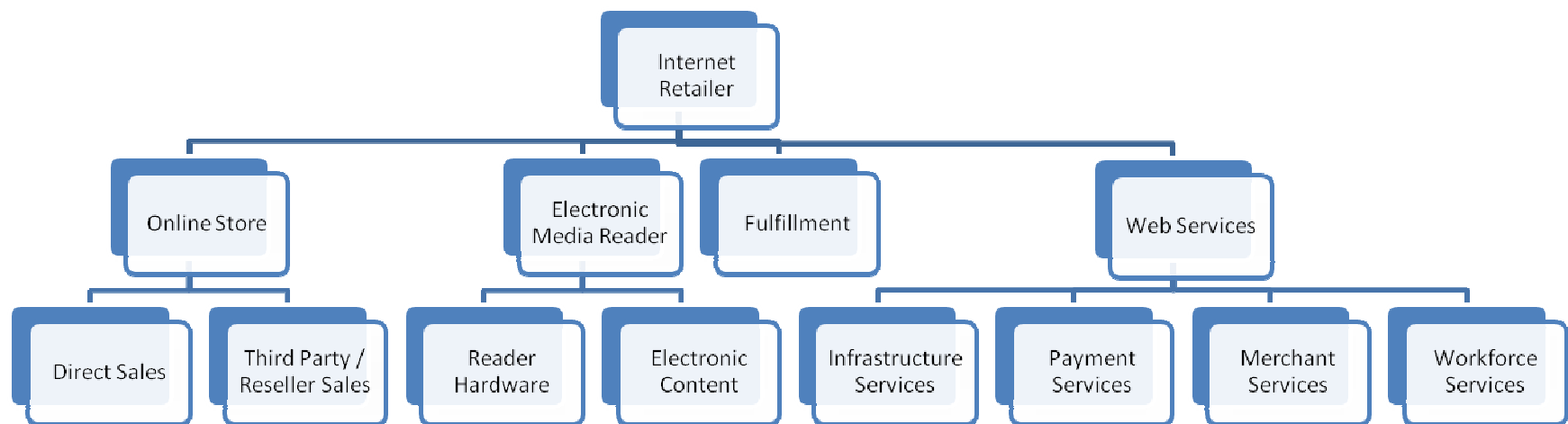


# Four “Easy” Steps

Step	Deliverable(s)
1. Develop the capability hierarchy	<ul style="list-style-type: none"><li>• Scope statement</li><li>• Capability hierarchy</li></ul>
2. Identify key relationships	<ul style="list-style-type: none"><li>• Association matrices</li></ul>
3. Develop utilization models	<ul style="list-style-type: none"><li>• List of demand sources: what generates utilization?</li><li>• Utilization model over time</li></ul>
4. Develop financial models	<ul style="list-style-type: none"><li>• Sources of benefits</li><li>• Sources of cost</li><li>• Cash flow statement</li></ul>

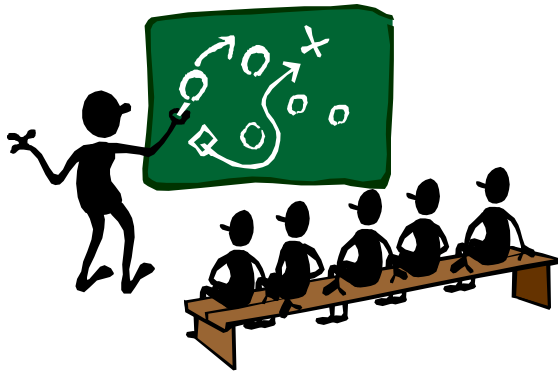


# Develop the Hierarchy





# Hierarchy: tips



- Engage your business partner(s) to identify starting scope
- Focus on breadth, not depth
  - 3 – 5 levels of hierarchy is sufficient
  - A capability should have more than one supporting process
- Start with customer-facing capabilities
- Make sure the team can explain how the capability generates value / benefits
- Use business partners' language to describe elements in the hierarchy



# Identify Relationships

Microsoft Excel - Internet Retailer Association Matrix.xls

File Edit View Insert Format Tools Data Window Help

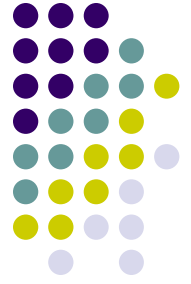
H18 fx

	A	B	C	D	E	F	G
1	<b>Internet Retailer Capabilities / Organization Unit Relationships</b>						
2							
3							
4							
5							
6	Online store						
7	Direct sales		x	x			
8	Third party / reseller sales		x	x			
9	Electronic media reader						
10	Reader hardware		x				
11	Electronic content		x				
12	Fulfillment						
13	Web services						
14	Payment services		x	x			
15	Merchant services		x	x			
16	Workforce services		x				
17							

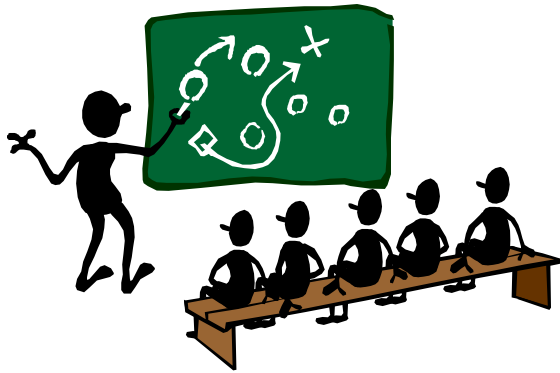
Sheet1 / Sheet2 / Sheet3 /

Ready

- Document relationships between capabilities and
  - Strategy elements
  - Organization units
  - Business processes
  - Physical assets
  - People (roles)



# Relationships: tips



- Use association matrices to find inconsistencies in the capability model
  - Capabilities not connected to strategy elements
  - Strategy elements with no capabilities
- Use numbers to measure strength of relationship where appropriate



# Create Utilization Model

Microsoft Excel - Internet Retailer Demand Model.xls

2007 - 2008 Internet Retailer Demand Model

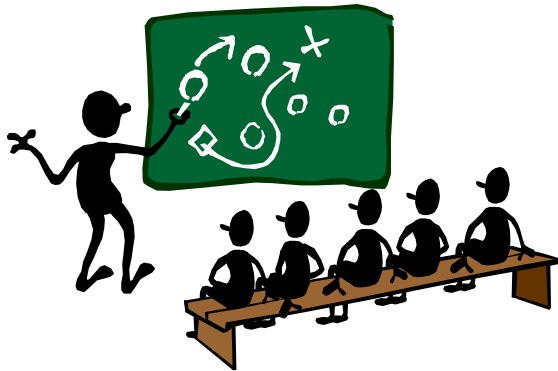
	A	B	C	D	E
1	<b>2007 - 2008 Internet Retailer Demand Model</b>				
2					
3					
4	Sources of Visits		Oct '07	Nov '07	Dec '07
5					
6		Total visits	316,422	303,656	26
7		Organic / Direct Load	269,596	240,980	20
8		Organic Search (clicks)	40,486	36,817	3
9		Paid Search (clicks)	6,339	25,860	2
10					
11	Sales Volume				
12		Retail website	7,459,879	6,670,954	5.84
13		Reseller sites	2,766,691	2,450,717	2.23
14					
15	Order Volume				
16		Retail website	26,939	23,571	2
17		Reseller sites	10,551	9,183	
20					

Demand Model / Summary

- Identify sources of demand
- Map demand to business process utilization
- Map demand to physical asset utilization
- Develop forecasting assumptions
- Forecast utilization into the future

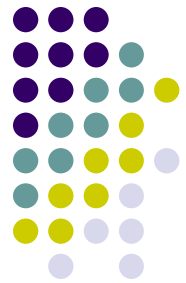


# Utilization Model: tips



- Use assumptions to discover stakeholder expectations about operation of capabilities
- The utilization model can alert the team to parts of a capability that won't scale with growth
  - Business processes
  - Physical assets





# Create Financial Model

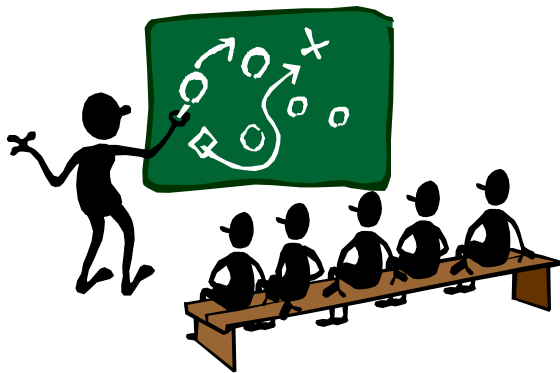
The screenshot shows a Microsoft Excel spreadsheet titled "DCF example.xls". The active cell is A19, which contains the formula for "Earnings Before Income Taxes". The spreadsheet displays a "Discounted Cash Flow Analysis" table with columns for Year 0, Year 1, and Year 2. The table includes rows for Net Sales, Cost of Goods Sold, Gross Profit, One-Time Expenses, Recurring Expenses, Expense Savings, Variable Expenses, Depreciation & Amortization, Total Expenses, Earnings Before Income Taxes, Income Taxes, Earnings After Income Taxes, Investments, Capital Investments, and Change in Working Capital.

	Year 0	Year 1	Year 2
Net Sales		\$56,268	\$1,397,764
Cost of Goods Sold		39,497	977,366
Gross Profit		16,770	420,398
One-Time Expenses		0	
Recurring Expenses		1,183,798	3,150,153
Expense Savings		0	0
Variable Expenses		4,117	101,866
Depreciation & Amortization		2,629,311	2,479,060
Total Expenses		282,757	5,731,080
Earnings Before Income Taxes		(265,987)	(5,310,682)
Income Taxes		(103,735)	(2,071,166)
Earnings After Income Taxes		(162,252)	(3,239,516)
Investments			
Capital Investments	166,939	192,037	219,444
Change in Working Capital		1,139	27,100

- Identify quantifiable sources of benefits
- Identify sources of cost
- Create statement of cash flows



# Financial Model: tips



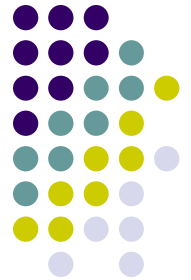
- The financial model helps your stakeholders explain how a capability converts benefits into cash
- Organizations frequently fail to account for process / labor costs to operate a capability, artificially inflating the returns on projects



# Defining Success

- Models help stakeholders see non-obvious patterns, assess impact of change
- Models allow stakeholders to perform “what if” analysis for different business scenarios
- Utilization and financial models focus stakeholders attention on:
  - Quantifiable benefits
  - Ongoing operation of capabilities

# Capabilities & Process Management



- Capabilities are the “missing link” in the strategy to results abstraction chain
- A single process may map to multiple capabilities, each having unique or conflicting requirements
- Demand and financial models provide top-down ways to evaluate effectiveness & efficiency of processes



# Questions & Answers



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<http://twitter.com/lgreski>



# References

## Architecture & Governance Magazine Articles

*Business Capability Modeling: Theory & Practice*

<http://bit.ly/mhJA8>

*Business Capability Modeling: Building the Hierarchy*

<http://bit.ly/8wtDpQ>

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