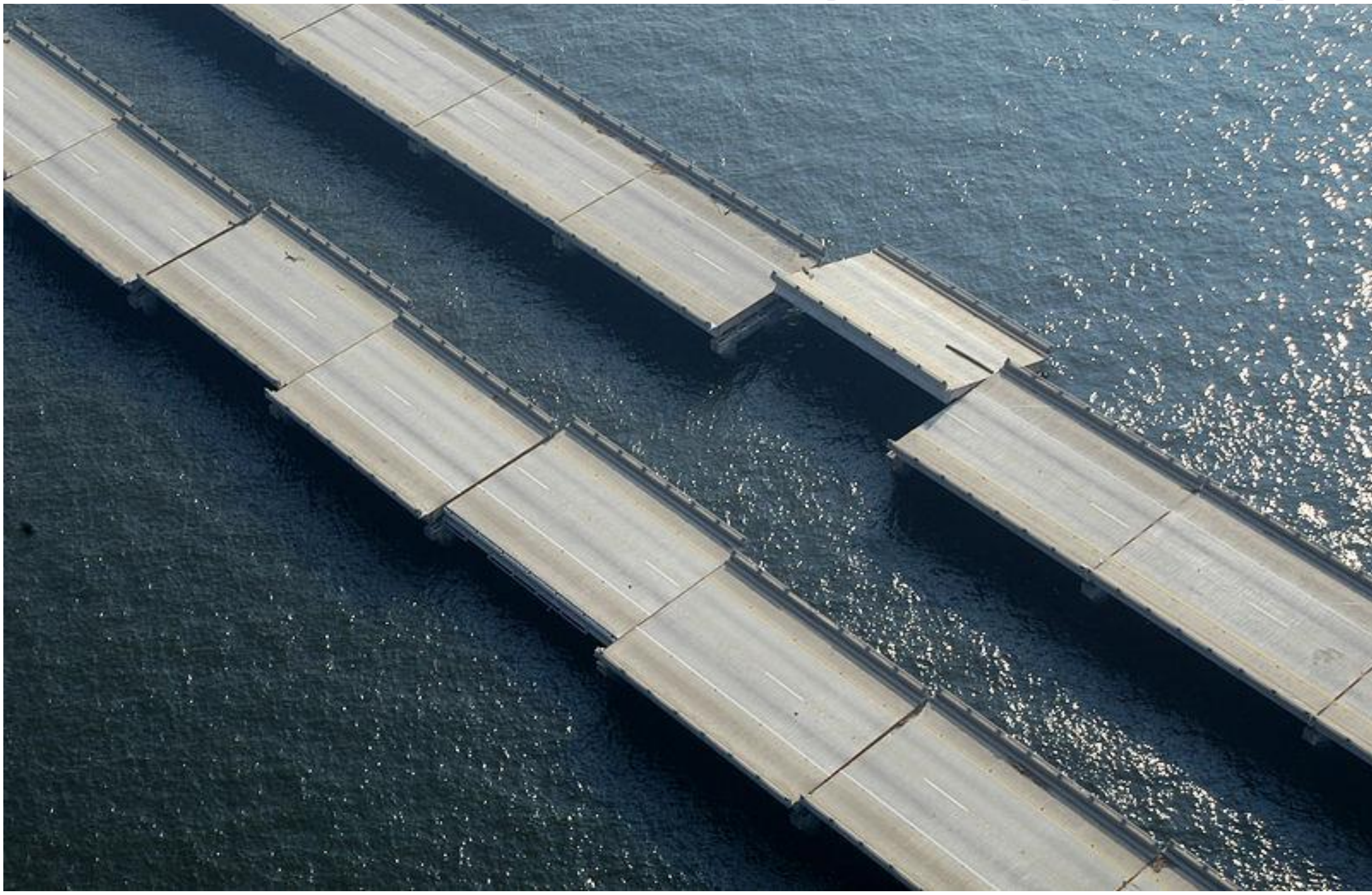
STRATONOMICS



THE STRATEGY ALIGNMENT GAP: WHY CEOS MISJUDGE IT AND HOW THEY CAN FIX IT?

"Are we all agreed the goal of our family vacation is to relax, spend time together, and have fun?" asks Mom. "Yes," agrees everyone. "We will use an experienced travel agent to meet our family's goals," says Dad.

The family returns from the vacation exhausted and less happy than imagined.

Dad: "It wasn't much of a vacation. I wanted golf time but didn't."

Mom: "We never got to spend much time together, I wanted to spend time with my daughter at the spa. Get pampered. But we spent most of the time sightseeing."

College-age son: "It was ok. I didn't mind hanging out and playing videogames."

Daughter in 9th grade: "This was more of a kid's vacation. I hung out with mom but would have preferred to spend time as a family."

How did this happen? Like any senior executive, the family:

- Agreed on a small set of goals: to relax, spend time together, and have fun
- Had professional help to assist with implementation
- Understood each other's individual preferences and goals
- Was open and flexible to change.

Like this family, well-meaning CEOs fall prey to the strategy alignment gap. Their teams have high levels of *perceived strategy alignment* about strategy goals but very low *actual alignment* about the specifics.

The strategy alignment gap drags down the organization toward mediocrity. Politics proliferates, implementation suffers, and employees become disengaged.

Perceived and Actual Strategy Alignment

Since 2017, C-CUBES™ has measured perceived and actual strategic alignment among 4,361 frontline employees, middle managers, and senior executives at 53 national and global companies with $2 million to $6 billion in annual revenue and 20 to 20,000 employees. They span many industries:

- Educational software
- School districts
- Oilfield services
- Facilities management
- Parts distribution
- Outsourcing services
- Executive recruiting
- Transportation services
- Healthcare services
- Valve manufacturing
- Heavy equipment manufacturing
- Branding and advertising services
- Coffee sales
- Website development services

Perceived Strategy Alignment: This is the extent to which employees believe and perceive they agree about their company's strategy.

Employees rate the level of strategy agreement they believe exists within their company from 0% to 100% (0=complete disagreement, 100=complete agreement).

Actual Strategy Alignment: This is the extent to which different employees' actual description, analysis, and explanation of their company's strategy overlaps with each other. Using natural language processing, a machine-learning technique, C-CUBES™ calculates the actual linguistic and conceptual overlap between everybody's text. The overlap ranges from 0% to 100% and provides a measure of actual strategy alignment.[i]

For a firm, perceived and actual strategy alignment ranges from 0% to 100%.

What do you think is your company's actual and perceived alignment score? Write it down before you read any further.

Write down what you think is your company's alignment score:

Perceived strategy alignment (0 to 100): ___________________

Actual strategy alignment (0 to 100): ___________________

Perceived and Actual Strategy Alignment Gap

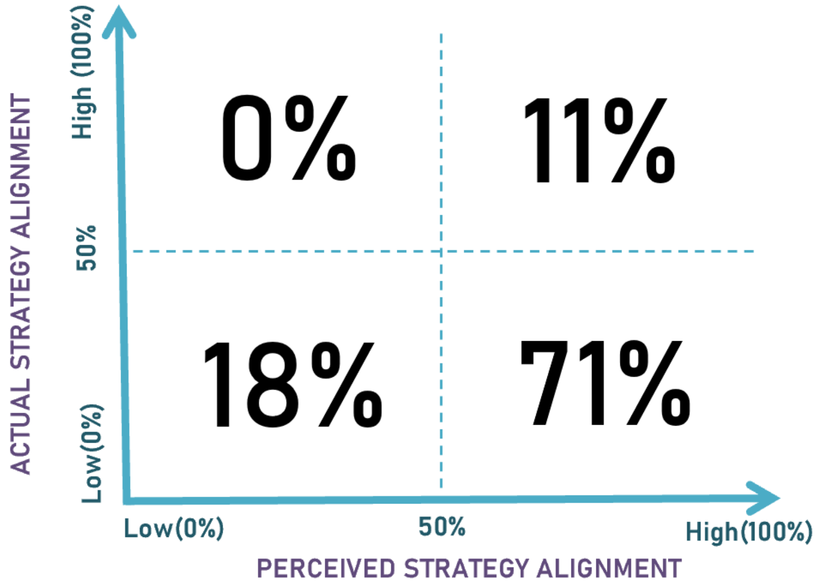
On average, the sample of 4,361 managers rated the perceived strategy alignment at 82% and actual alignment at 23%. Perceived alignment was roughly 3.5 times higher than actual strategy alignment.

As shown in Figure 1, perceived strategy alignment was higher than real strategy alignment in 71% of the firms. Only 11% of the firms showed high levels of perceived and actual strategy alignment. Why?

Too often, senior executives and middle managers find themselves in an echo chamber, assuming that everyone shares the same understanding of the company's strategy. This leads to very high levels of perceived alignment. In reality, they pursue divergent or even clashing goals.

One of the firms in the 71% quadrant was an executive recruiting firm with about 100 employees and $60 million in annual sales—perceived strategy alignment was at 90%, yet actual alignment was just 30%. Everybody believed that the firm was aligned around key strategies of "retention," "sales growth" and "differentiation." Yet, actual descriptions of strategy listed priorities as unrelated as product diversification, adding value to the community, and building a powerful platform as the company's primary strategic objective. In some cases, different employees' understandings of their strategy were in direct conflict: One respondent described a strategy of focusing on complex, more-expensive services, while another described a strategy of investing in higher-volume, simpler projects that would be easier to deliver quickly.

Figure 1: Where Firms Fall on the Strategy Alignment Gap



Financial Consequences of the Alignment Gap

The gap between perceived and actual strategy alignment can affect a company's performance. As shown in Figure 2, companies with:

- High levels of real and perceived strategic alignment had a 23% sales lift relative to their industry cohort.
- Low levels of real and perceived alignment performed 20% below industry.
- High perceived but low actual alignment delivered average performance; always within ±1% of their industry cohort.

In summary, 71% of the firms delivered average results because they had a wide gap between perceived and actual strategy alignment. In these firms, executives, middle managers, and frontline employees:

- Were skeptical about the effectiveness of their company's strategy.
- Reported strategy implementation was both slow and lower quality.
- Agreed on high level goals but pursued widely divergent individual initiatives.
- Spent more than two-thirds of their time on politics, firefighting, arguing with each other, communicating back and forth, and in unproductive meetings. **Only 34% of their time was spent on their primary job, the job they were hired to do**! See Figure 3.

Figure 2: Financial Performance Relative to Industry Cohort (sales lift)

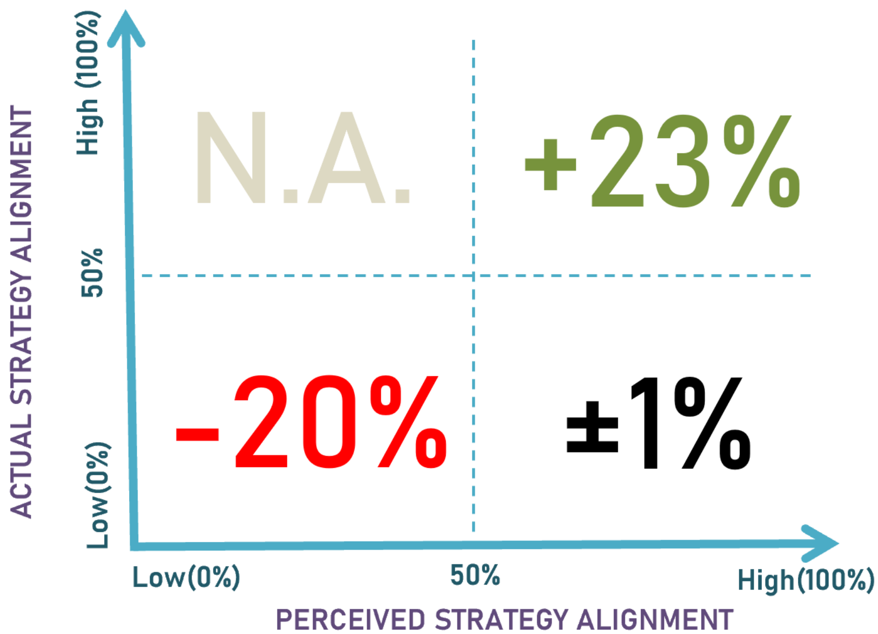
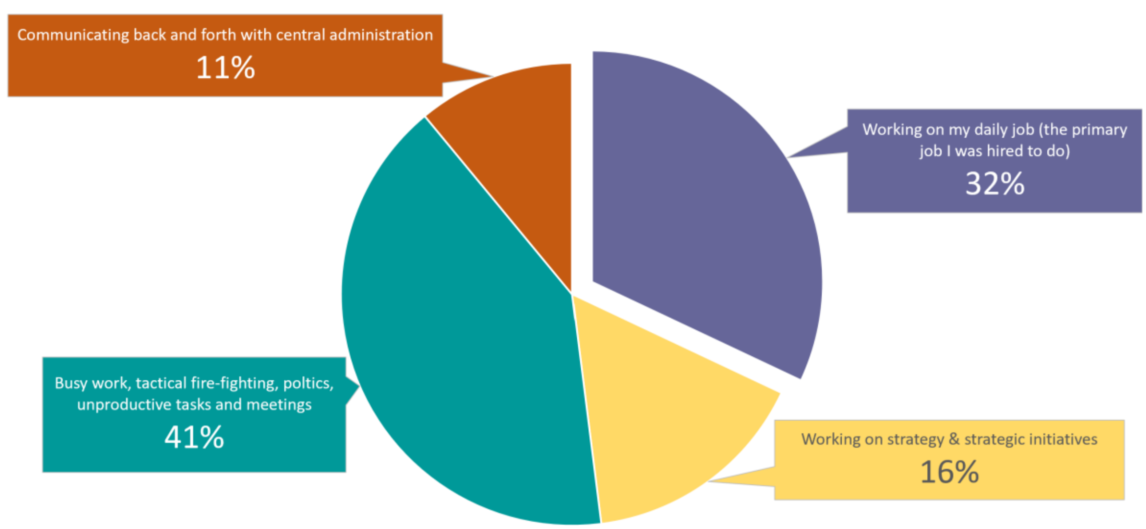


Figure 3: A Wider Strategy Alignment Gap Affects How Employees Spend Time



Addressing the Strategy Alignment Gap

Measure the alignment gap: Most CEOs at the two dozen companies had a nagging sense that actual strategy alignment in their company was low. They also recognized that the echo chamber of executives surrounding them created a false sense of high perceived alignment.

Yet, these CEOs had no way of measuring and quantifying the perceived and actual strategy alignment gap. Without measuring the gap, they operated in a vacuum.

To succeed, the first step for a CEO would be to measure the strategy alignment gap and gain a realistic view of the work that lies ahead.

Ideally, actual and perceived strategy agreement should be around 70-80%, high enough so everyone rallies behind a strategy, while leaving room for dissent.

Ineffective strategies for bridging the strategy alignment gap: Many well-meaning CEOs resort to persuasion and communication as a way to “get everyone on the same page.” They use mission statements and strategy pillars to rally employees. Usually these are aspirational statements (e.g., integrity, trust) or lofty goals (e.g., increase sales, higher customer retention).

In townhall meetings CEO explain the company’s mission and goals. Simultaneously, communication floods employees with motivational emails, while HR reinforces the company’s mission and vision with posters and stickers. In many companies a small minority of employees can even recite the core tenets by heart. “Integrity above all; increase sales by 15%; capture new markets.”

Yet, these vague and overarching tenets lack specifics. They create a false sense of perceived strategy alignment for the C-suite. Middle managers feel talked down to. Frontline employees feel confused and irritated, asking: *how does “the strategy” create value for customers or relate to my daily work?*

Lacking clarity, middle managers and frontline employees interpret the tenets to suit their individual purpose. Senior executives, eager to expand their strategy-initiative portfolio shoehorn strategy initiatives in the strategy tenets. Everyone is doing more work. Its *not* work they were primarily hired to do, its “strategy work.”

Ironically, communication and persuasion only widen the strategy-alignment gap.

Bridge the alignment gap through a customer-based strategy: A strategy based on customer value provides frontline employees with higher engagement and individual purpose because it is specific and concrete. They feel more satisfied with their job when they know how and why their daily work satisfies customers.

Supporting this, a 2023 review of 245 academic papers found firms that increase customer value perform better across a wide variety of outcomes that matter to shareholders: sales, profits, cash flows, stock price, and firm value.[ii]

When CEOs ignore a customer-based strategy they become inwardly focused. They treat their company as an input-output machine. Customers are a source of cash flow and employees are a way to wrest efficiency. They don’t see their company an enterprise that should channel employees to satisfy their customers’ most important value drivers and create shareholder value.

Take the case of a professional services company with $180 million in annual sales.

The CEO was inwardly focused thinking of his company as an input-output machine.

On the sales front, the CEO competed on low price and the measured qualifications of its operations team. It drove sales, but did it drive customer value? No one knew.

Internally, the COO focused on efficiency by increasing billable hours and getting employees to maximize output in the time allotted. Employees had no idea how their daily work created value for customers. They felt like cogs in a machine.

Although the CEO conducted townhalls to reinforce key strategies and corporate values, it seemed most of the employees paid little to no attention.

Though sales increased in some quarters, they essentially tracked the peer cohort—the company was mediocre in the absence of customer-focus. The gap between perceived and actual strategy alignment remained unmeasured, and the CEO continued believing that "fixing" managers and executives to wrest efficiencies from frontline employees would improve results.

Use science to develop your customer-value equation. Then, derive your strategy from it: Even after they decide to develop a customer-based strategy, CEOs can make the mistake of relying on anecdotal evidence from sales teams, customer lunches, or conversations frontline employees may have had with customers. This non-scientific approach only uncovers superficial, top-of-mind ideas because employees report what they *believe* drives customer value.

Figure 4 shows the disconnect between executives' beliefs about customer value drivers and actual drivers.

The middle column shows what CEOs believed created customer value and used it in their company's strategy. They relied on customer conversations and feedback from sales team. The last column shows actual customer needs that provide a 60-70% lift in customer value. These were derived using a statistical analysis.

The mismatch is eye opening.

In every company, CEOs misjudged the actual drivers of customer value because they relied on anecdotal conversations. This led them to develop a strategy using the classic *non*-differentiators: low price, high quality, and faster delivery. Strategy implementation was inwardly focused and relied on the well-worn playbook: reduce costs, increase efficiency, and bid more at lower price to win business!

Take the case of the facilities management company in Figure 4. The strategy was to win business through low price and new products and services introductions. Yet, sales stagnated as it remained undifferentiated from competitors. Margins also stagnated because of the cost of introducing new products and services while competing on low price.

No one knew the one customer need providing the biggest lift in customer vale.

Using statistical science, the CEO discovered that resolving on-site issues through improved daily operations lifted customer value by 42%. This focused the company's strategy on the most important customer need, which helped employees to more clearly understand how they should be spending their time. By focusing employees on improving daily operations to minimize onsite issues the company increased customer value. Customer retention increased 18%, and sales increased 24%.

Figure 4: Senior Executives' Perception versus Reality of Customer Value

Company	Executives Based their Strategy on…	…But Actual Customer Value was Based on
Contract Manufacturing	• High product quality • Company's experience	• Weekly updates about project • Sales and bidding process
Automation Parts Distributor	• High product quality • Competitive price	• Ability to obtain a quote within a day • Issue resolution
Facilities Management	• Low pricing • Sustainability • New products, branded products	• Issue/complaint resolution • Keeping client informed about issue resolution
Engineering company	• Technical credential (Patents, Technical White Papers) • Digital automation of facilities	• On-site project manager to manage daily operations • Ability to manage cost-overruns
Valves Distributor	• Products meet specs • Low price	• Online ordering • On-time delivery
Commercial Bank	• Low fees • Variety of products and services	• Secure online banking • Easy to do business in the branch

Case Studies[iii]: Closing the Strategy Alignment Gap

Case Study 1: In 2020, actual strategic alignment at the Houston-based supply chain services firm ITI Manufacturing was less than 20%, while perceived alignment was at 80%. Guided by feedback from its sales team, ITI had pursued a strategy of lower prices and meeting technical specs. It had never measured how it could increase customer value.

Three years later, perceived and actual alignment increased to 82%, closing the strategy alignment gap. Sales increased 23% relative to their industry cohort. Employees were spending more than 50% of their time driving of customer value.

What happened? Using science, ITI discovered the one strategic area that provided more than 30% lift in customer value: weekly status updates on customers' projects.

As the CEO explained, "Starting from customer value helped focus me and my team on the one thing that mattered most to our customers: providing weekly updates. It seemed so simple, even trivial at first. But today, the results speak for themselves. We can differentiate our pitch to new customers and prospects, and current clients love referring us to new clients."

Case Study 2: Automation parts distributor Swagelok Southeast Texas, attempted time and again to increase strategy alignment. The company was doing everything in the name of strategy — except for improving customer value.

In 2021, the organization identified that rapid quoting provided more than 36% lift in customer value. Making rapid quoting its strategy, the company paused or deferred all unrelated internal initiatives, focusing everybody's attention and effort on it.

The rapid quoting strategy was implemented through increased investments in customer service reps, an updated and streamlined computer interface, more training, and 42 different initiatives to support rapid quoting. Rapid quoting, and only rapid quoting, became the centerpiece of strategy implementation. As a result Swagelok decreased average quoting time from 18 hours down to 5 hours, and more than 95% of our customers are satisfied with quoting time.

Previously, sales team members spent more than 30% of their time following up on quotes even as customers went elsewhere if they did not get a quote on time. Weaving a customer-based strategy into the day-to-day operations of the business enabled workers, managers, and executives to stay aligned, ultimately creating value for both customers and the company. The company is on track to increase sales by more than 15% relative to its industry cohort.

Author Bio

Vikas Mittal, Ph.D., has published more than 100 articles on customer-focused strategy and worked with senior executives at more than 200 organizations. He is the co-author of a 2021 book: ***FOCUS: How to Plan Strategy and Improve Execution to Achieve Growth*** and a 2023 book: ***Market-Based Management, (7th edition)***.

Suggested Citation

Mittal, Vikas (2023), "The strategy alignment gap: Why CEOs misjudge it and how they can fix it," *STRATONOMICS© Insight Series,* July, 1-9. **Free download: https://ccubes.us/k12/briefs/**

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[i] This involves the use of machine learning to calculate linguistic overlap in the text. For reference see: Bosukonda, Narendra and Singh, Sonam and Sridhar, Shrihari and Mittal, Vikas and Malshe, Ashwin, Return On Strategy-Customer Alignment (June 24, 2022). Available at http://dx.doi.org/10.2139/ssrn.4145954

[ii] Mittal, Vikas, Kyuhong Han, Carly Frennea, Markus Blut, Muzeeb Shaik, Narendra Bosukonda, and Shrihari Sridhar (2023), "Customer satisfaction, loyalty behaviors, and firm financial performance: what 40 years of research tells us." *Marketing Letters*, 34(2), 171-187. Available at: https://link.springer.com/article/10.1007/s11002-023-09671-w

[iii] These case studies are summarized in an online Harvard Business Review article: Mittal, Vikas, Alessandro Piazza, and Ashwin Malshe (2023) "Is your company as strategically aligned as you think it is," May 1, 2023. Available at: https://hbr.org/2023/05/is-your-company-as-strategically-aligned-as-you-think-it-is