BUSINESS PERFORMANCE ADVANTAGE

Nov/Dec 2002

What You Can Measure, You Can Manage

Why Performance Measurement Works

What is performance measurement? Isn't it simply the calculation and statement of profitability? Well, the short answer is yes and no! Performance measurement is the ongoing study of an organization's overall health. More specifically, it is the study of both financial and non-financial measurement results. Financial performance measurements, such as financial statements, are historical in nature. Non-financial performance measurements, such as a customer satisfaction survey or a time-and-motion study, allow an organization to look at its performance in real time. This allows immediate adjustments to be made based on results yielded. The study of measurable performance indicators is essential for an organization to achieve its short-term objectives as well as its long-term, strategic goals.

How many times have you seen a corporation's stock take a plunge when its quarterly earnings missed Wall Street's expectations by just a small percentage? This obsession with quarter-over-quarter profits seems to encourage many managers to focus on short-term results at the expense of investing for the long term. In other words, to many corporations, everything is viewed in terms of the "bottom line." Opponents of this school of thought claim this is a one-dimensional view. That is, financial indicators alone provide an incomplete set of management tools to corporate decision makers. Professor Robert S. Kaplan of the Harvard Business School states: "...if senior managers place too much emphasis on managing by the financial numbers, the organization's long-term viability becomes threatened."

So, what are these non-financial performance indicators? Are they different for different industries? A joint industry-government Benchmarking Study Report on Performance Measurement from the late 1990s stated, "Regardless of size, sector or specialization, organizations tend to be interested in the same general aspects of performance. Attention to, and establishment of, measurements in these areas is thus a significant part of a successful performance system." These areas include:

- customer satisfaction
- employee satisfaction
- internal business operations
- shareholder satisfaction

Customer Satisfaction. When it comes to mapping performance, many of the blue-chip corporations rely on customer- and employee-based measurements. Achievements in these areas are considered to be just as important to the success of the corporation as revenues, profits and other financial measures. Customer satisfaction relates to the overall customer experience, including price, quality, delivery, service, warranty. The business objective is to establish real-time performance measures to determine customer satisfaction in those areas that are most important to the customer. Such performance measures might include survey responses, post sale contacts, complaint lists, market share analysis, warranty claims and other such data that may be unique to the industry or organization.

Before deciding on specific measures, an organization should identify and thoroughly understand the processes to be measured. Then, each key process should be taken apart and analyzed to ensure a thorough understanding, and to ascertain that an appropriate process is chosen. In most cases, targets, minimums and maximums should be set for each measure. In some instances, performance measurements of customer service have resulted in customer satisfaction improvements of up to 50 percent! You can quickly see how this performance measure can dramatically impact the bottom line.

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Our mission is to provide information and strategies to business owners and managers for improvement in the effectiveness of its business management so that key objectives can be realized.

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Why Performance Measurement Works (cont.)

Employee Satisfaction. Employee-oriented measurements are designed to encourage innovation, mutual trust, teamwork and diversity. This allows the corporation to focus on excellence in the human elements that contribute to their joint success. Human capital development is not about keeping score. It's about learning how to motivate people and how to link those performance measures with both financial and non-financial incentives. Blue-chip corporations generally set challenging long-term goals and link the compensation of their employees more closely to the completion of those goals. Without motivated human resources, an organization will not achieve its strategic goals. Performance measure improvements in this area have shown average increases of up to 15 percent.

Internal Business Operations. Internal performance measurement is a particularly fertile area for achieving improvement in the organization's long term viability. The sheer volume, variety and complexity of the production process for tangible goods gives rise to a long list of indicators that might be measured and controlled. Such a list might include time and motion studies, production line efficiencies or down-time, inventory levels, product life cycles. Similar performance measurement indicators should be devised for all operational and supporting areas. The goal of such measurements is to ensure that products move smoothly through the production cycle to meet quality standards and customer delivery schedules.

Expense control, regulatory compliance, and quality control falls within every business in every industry. In a study published by W.B. Abernathy, PhD, Managing Without Supervising, these areas showed an average improvement of 9 percent, 54.7 percent, and 30.6 percent respectively. Each industry can, with guidance, develop effective performance measures that will achieve key objectives.

Shareholder Satisfaction. Any organization is ultimately accountable to its shareholders. In the owner's mind, the principal measure of successful performance is usually profit. However, many owners take a longer term view of the organization's future potential. In this regard, they may be interested in non-financial performance measurements as a basis for comparison with other organizations.

Most blue-chip organizations use performance measurement systems to determine whether they are fulfilling their vision, achieving their short-term objectives and meeting their customer-focused strategic goals. The measures and goals are narrowly focused on a critical few. It is neither possible nor desirable to measure everything. The focus should be on achieving organizational goals via performance measures, and not the measures perse. If a particular measurement cannot be linked back to strategic planning, it should be eliminated to avoid data overload. According to William Apler of the Hay Group, "The top organizations create performance measures that focus on all the drivers of their businesses – financial performance, shareholder value, employees and customers."

Unlike historical financial information, non-financial performance measurements allow an organization to make ongoing changes in real time. This provides the tools to look ahead and adjust according to circumstances. Excellence in all performance areas will result in the "bottom line" taking care of itself. That is the true value of performance measurement. Remember, if you can measure it, you can manage it. To learn more about how you can use performance measures to boost your company's profits, give us a call today.

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No Free Lunches

by Michael E. Duffy

I had lunch with a small business owner the other day, and we talked about the ways he's using technology in his business. Following our lunch, I sent him an e-mail with some questions that I thought might provoke his thinking. One of them was this:

What sort of daily aggravations exist for you and your employees? If you are repeatedly banging your head on a problem, it's sapping the energy of you and your organization. Best to deal with it immediately.

This is what he wrote back to me, edited only slightly to preserve his anonymity:
Increasingly, I am beginning to question the ability of technology to assist in running my businesses. At the very least, I feel we have reached a point of diminishing returns. The daily aggravations have just about demoralized us all.

- *I never dreamed what a can of worms e-mail would be.*
- *I never dreamed a set of Palm V's could lose two days per week, and take approximately 10 very competent IT man-days to troubleshoot synchronization problems, and be ultimately reduced to the relevancy of Rolodexes..*
- *I never dreamed my staff and I would have to move from a simple Excel Computer Problem log sheet to an elaborate email/outlook form reporting and categorizing system to try and understand where the underlying network and e-mail problems are coming from.*
- *I never dreamed my staff and I would be spending the amount of unproductive time and money on trying to band-aid systems that initially promised so much.*
- *I never dreamed we would buy two separate Retail Sales Inventory packages (one the leader in its industry) and end up trashing both in favor of developing our own paper and Excel spreadsheets to track the simple movement of [items] in and out of a single building.*
- *The only thing I can be proud of, or not ashamed of, is that we did not run pell-mell into an ill-fated Web site.*

Right now, ... I am being forced to question our increased application of technologies.

And you thought you were having a rough week! He went on to add this:
Technology had served us well previously. We were one of the first small businesses to develop our own in-house Inventory and Sales database management tracking systems, some 13 years ago. It has served us immeasurably. Although it may be somewhat clunky by today's SQL, 3-dimensional, approaches, we can get the facts we need to make informed decisions quite quickly, almost interactively, as we assess the need to buy from a particular [supplier]. Many have commented that they have seldom seen such an elegant and flexible approach to sales and inventory based knowledge. I have not found an off the shelf replacement yet that even comes close to what we can do.

So, here's a guy who used to be happy with technology who's about ready to throw in the towel. What went wrong? More important (to him, at least), where does he go from here?
This company started out on the right foot: they knew the basic information they needed to run their business effectively:

- Which items are selling well?
- How much do we have in inventory?

They hired someone to build a system to produce that information, using DataFlex, a DOS-based tool which allowed for more efficient development (and hence, produce the desired system at a lower cost).

For some period of time, all was well: They had a stable system which provided information invaluable to running their business effectively. This echoes my original point: eliminate day-to-day aggravations caused by technology. A stable system is generally better than an unstable system with improved features.

No Free Lunches (cont.)

Eventually, of course, Windows and Microsoft Office entered the picture. Of itself, this isn't a bad thing - I'm using Word to write this article (although I still prefer Eudora to Outlook). But the old DOS-based system and the new Windows-based systems didn't play well together in a networked environment. Rather than backing up and re-attacking the problem strategically, this company got into a tactical fire-fighting exercise with their existing problems, plus continued adding new features (like e-mail, Internet access, and handheld devices).

When you have to build a system to keep track of the problems you're having, alarm bells are ringing, whether you hear them or not. Although there's a logical desire to try and solve the problem yourself, it can be extremely cost-effective to get an outside opinion. And if the suggested solution appears to be costly, it's worth getting a second opinion.

One of the best questions to ask is: What problems like this have you encountered before, and how did you solve them? Don't settle for unclear answers with lots of jargon. Although there are exceptions to every rule, the person most likely to solve your problem has already solved it several times before. That experience is what you are paying for. There are no free lunches.

At this point, the key to my acquaintance's business recovery lies in reexamining the goals of his business, and the needs of its customers. In fact, I asked my lunch companion what customer benefits had resulted from all the new technology? Aside from sales people being able to e-mail potential customers pictures of items for sale, his answer was, "None."

So, my recommendation to this gentleman (and any of the readers facing a similar test of courage) is to simplify and stabilize before adding any more technology to the mix. Stabilize the systems which provide essential information about operations, and focus any remaining resources on those systems which provide direct benefit to the customer. Once your blood pressure has returned to near-normal, take a look at your business goals and unmet customer needs as a guide to what to do next. Of course, I'd also recommend you get a second opinion.

And sell those Palm Vs on eBay, before it's too late. Everyone knows that the PocketPC is the wave of the future!

By the way, there's a happy ending to the story. After spending several thousand dollars to test and replace network wiring, his network is running happily, and the morale of his employees has improved significantly. I wish I could claim credit for the outcome!

Michael Duffy writes the monthly technology column, Tech Talk, for Sonoma Business Magazine (http://www.sonomabusiness.com). His Web site URL is www.mikeduffy.com. ©2002 Michael E. Duffy & Associates. Reprinted with permission.

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Marketing on a Shoestring

PR Secrets for Free Press

When a spiraling economy pinches marketing budgets, it means marketing money goes away. It doesn't mean the need for marketing goes away. In fact, you may need to market even *more*.

Luckily, marketing – and that includes public relations – doesn't have to cost a lot of money. Keep in mind that what you don't spend in dollars and cents, you'll have to make up in energy, time and creativity. Simply put, you can make up for a small budget by rolling up your sleeves and putting your noggin to work.

So what does it take to *earn* free press? It's pretty simple, actually. Become newsworthy. Sounds too easy, right? It often is, and the fact that you aren't a PR person is a plus for you. The first thing you have to do is think like a reporter. For a moment, take off your owner/manager hat and put on a reporter hat. The reporter is looking for a scoop – a hot story. She/he's going to look good to the editor when she/he comes up with something that no one else is doing, right? This is your opportunity to be a reporter's resource.

Basically, you want to help the reporter do his/her job. You want to be on the lookout for stories that will help the reporter get the scoop. The stories may be from inside your company, but they could also be inside your clients' companies or they may even be inside a prospect's company. While getting PR for a client or a prospect may not sound like a direct route to getting attention for your firm, it is.

By offering information that is not self-serving, you earn reporters' trust. The best reporters have incredible memories. They work on tight deadlines and when they need a quote from a subcontractor about an issue, guess who they most likely will call first? You are developing a relationship with the reporter as a valued news source. Keep in mind that reporters are bombarded by PR people and others who want to selfishly exploit the press. You want to set yourself apart from those types. You want to appear as unbiased as possible and stick to the facts.

For example, if you are working on a project that is different, unusual, important to the community, or any of a handful of reasons why something is newsworthy, call the reporter that covers that beat and tell him/her about it. Then wait for him/her to ask for more information. That's the difference. You are looking out for him/her – not for yourself. Reporters know people and if you come at them with any other intention than that which is honest, they'll run in the other direction.

So, what could be news? A store opening? Well, yes. It is especially if the store is an oxygen bar (something different) or if the store is filling a critical need in the community or if the store caters to a sector of the community that is part of a trend. An Albertson's opening in the suburbs where there are plenty of grocery stores is not news. A Fiesta grocery store opening in a part of town that doesn't have any grocery stores and that caters to the booming Latino population is newsworthy. See the difference?

The other thing you want to remember about working with reporters is that they are busy. When you call, get to the point. You should practice what you are going to say so you can sum it up in about 30 seconds. Before saying anything, ask if it is a good time. If they are on deadline, they will tell you. When you hand off the idea, your job is done unless they need more information. Trust me; they will contact you if they are interested. If they aren't, don't bug them. The last thing they need is someone following up asking if they are going to cover the story. In the end, it's what they think is interesting that matters. If you study newspapers, soon you will be able to discern what is news and what isn't. You may think that your new service offering is the greatest thing since sliced bread, but will the paper's readers? Scrutinize your idea before you let the reporter take a crack at it.

Marketing on a Shoestring *PR Secrets for Free Press* (cont.)

The way you share your idea with a reporter is critical. Do the homework. Share why you think it's important; don't assume the reporter will come to the same conclusion. If you go to a reporter and simply tell him/her about what your company is doing, she/he may not think of it as news. However, if you explain how this new service is part of a trend or an answer to a pressing business issue, the reporter can then see that this is a hot topic affecting a lot more companies than just yours. All of a sudden, you are newsworthy!

So, think like a reporter. Learn how the newspaper works. Request editorial calendars. And start developing relationships with reporters. "How?" You may ask. Well, it's as simple as making a phone call or sending an e-mail. No magic. It's just plain ol' relationship building. It takes action. Don't be afraid. The fact that you aren't sure what to do helps you be honest. Simply tell them that you aren't sure what the correct methods are, but you think you could be helpful to them. Reporters have told me that they truly appreciate being able to trust a person's intentions.

Don't forget to take part in press "freebies." Is a new person joining your company? Did your company recently promote a person? Won a new contract? Send a press release to the local business paper. If you have new team members, announce it by sending one to the local newspaper as well. For personnel changes, try to include a picture.

If you develop your reporter contacts, you will be able to see your company name in print more often than you ever dreamed. Most companies spend $2,000 - $5,000 per month to have a PR company on retainer. If you spend a small amount of your time, you will be able to accomplish similar coverage for a lot less than that!

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Year-End Checklist for Business Owners

Looking toward the New Year can leave owners feeling exhilarated, exhausted or somewhere in between. As the year draws to a close, take time to ensure you've covered all the bases and are starting the New Year on solid ground. While our checklist in no way covers every important aspect of your business, we hope it will help you pinpoint areas that may be improved next year.

Operational Year-End Analysis

1. Did you meet your annual goals? If not, do you know why?
2. Is employee productivity up? Down? Is it a concern?
3. Are profits up? Down? Do you know why? Is there a correlation between an increase or decrease in sales to gross margins?
4. If you sell products, how much is each contributing to gross profit? Can you better manage the components of cost of goods sold for increased profits?
5. If you are in a services industry, do you know profit margins on each service you provide? Are your services cost competitive? Is your profit margin where you would like it to be?
6. Have you reviewed your property and casualty insurance coverages for adequacy? Are your rates still competitive? Is your broker doing his/her job?

Accounting and Finance

1. Has cash flow been a problem this year? Is it cyclical or ongoing? Do you try forecasting your business? When was the last time you reviewed your billing and credit policies?
2. Where does your annual budget stand? Does your budget process allow for key manager input and buy-in?
3. Are you maximizing your supplier/vendor relationships? Do terms need to be renegotiated?
4. Have you considered taking full advantage of donating unneeded business assets to charity?
5. If you are leaving the company or selling the company in the next two years, do you have an exit strategy? Have you taken the necessary steps to maximize company value?
6. If your company has outstanding debt, have you ensured that you have chosen the most appropriate vehicle for financing? Is this an appropriate time to refinance?
7. Is your accounts receivable situation secure? Are you prepared in case primary customers don't/can't pay?
8. Have you reviewed internal controls to ensure your financial concerns are secure? For example, are duties appropriately segregated to negate the opportunity for embezzling?

Human Resources

1. If profits are down, have you explored the relationship between employee performance and profit?
2. Have you hit any milestones (for example, the number of employees) in the past year that would impact regulatory compliance?
3. Are incentive compensation plans strategic and aligned with company goals?
4. If employee attrition has increased, do you know why? Is it a concern? Have you implemented a recruiting plan?
5. Do all employees know what's expected of them? Do they have the proper materials, technology and equipment to do their work right?
6. Are employees aware of company goals and how their performance impacts the realization of those goals?
7. In the past year, have you reviewed your insurance and health policies to ensure you are paying for only the options that benefit you, your employees and the company?
8. Are employee benefits cost-effective for the company?
9. Have you taken the opportunity to show employees how much their total salary (salary + benefits) is really worth?
10. Are position descriptions, employee handbooks, safety manuals and other company communications up-to-date?

Year-End Checklist for Business Owners (cont.)

Strategy and Performance

1. Are you achieving the anticipated annual revenue and profit growth? If not, do you know what obstacles are in the way? Do you plan your growth? Is it written down?
2. Have you arranged a planning session with your key managers to review (or set) the company's strategies and goals for the coming year?
3. Is the production line as efficient as possible? Is down-time higher than last year?
4. Can you reduce the average collection period on your receivables to improve cash flow?
5. Do inventory levels need to be reviewed? Are you storing (and capitalizing) more than needed?
6. Are internal systems affecting profitability? Do employees need to be better trained or educated?
7. Does the company's performance depend on a few key people? Is there any way to cross-train and change this?
8. Is the company operating at or above industry standards?
9. Are you and your employees working harder, yet not realizing the return you expect? What critical performance activities are causing this?
10. Are there new competitors in your market that are impacting your business? Do you have a strategy for this? When was the last time you did a competitive comparison?
11. Are you minding the business of your business? Is your strategy in place to take you through the next year? What worked during the past year? What didn't work?
12. Do you have a disaster plan in place and business interruption insurance in case of a disaster?

This short list offers areas to consider to ensure your business operates successfully. Give us a call so we can discuss these and others that may be affecting your company. We can help you make changes now that are sure to make improvements in the way you operate your business in the coming year.

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Make the Move to Dynamic Forecasting

Is your budget obsolete in two months? The traditional corporate budget process focuses on what managers are allowed to spend to accomplish their goals and not what resources they require. Budget plans can be costly to prepare, starve departments that have valid needs, incorporate last year's inefficiencies and fail to identify waste and respond to a business' strategic objectives. However, companies can develop more realistic, dynamic budgets based on predictive planning. One way to do this is to use activity-based costing (ABC)—basing company plans on fluctuating needs related to demand rather than on historical data.

Here are some budgeting tips to keep in mind that incorporate ABC principles.

- Don't limit yourself to the current situation defined by predetermined spending limits. Begin the budget equation with the outcomes you expect—profit, for example—measured against customer and management demands that vary in mix and volume over time. Don't let your budget stay frozen; revisit it as needed in response to marketplace conditions.
- Budget management and cost management are not synonymous, so don't confuse them. Formulate budget strategies according to two questions: What should we be doing, and how should we do it?
- Then inject costs into the equation. Using activity-based-cost estimating helps you relate what-if scenarios over time to the overall impact of expenses on the organization. For example, are you going to open a new warehouse? To estimate the level of spending required in the future, you should match future capacity (what's currently available vs. what's required) with estimated needs (forecasted customer demand).
- Activity-based-cost management is not a replacement for general ledger accounting. But if your general ledger software does not convert spending into useful managerial information, use an ABC model—based on resources, work activities, process costs and final cost objects—to reflect market, product, service-line, channel and customer-oriented decisions.
- No one knows in advance how simple or complex a company's first ABC model needs to be. Many make the mistake with their initial ABC system of plugging in too many details before learning how to apply the data or what the accuracy requirements are. Instead, improve the usefulness of the results by understanding that such predictive planning depends on constructing a cost-assignment network that traces how outcomes—such as products or orders—consume resource expenses with a cause-and-effect relationship.
- Organizations always want to understand where they make and lose money. To get a better picture of this, design budgets that do not inhibit managers' flexibility to meet objectives. Develop plans that are feasible, determine what specific resources are needed to execute them, then compare the plans' projected results with current performance to manage profit margins.
- Successfully implementing ABC depends to a large degree on managing organizational behavior. Avoid resistance from employees and managers that can jeopardize the acceptance of the new methodology or technology by following these rules:
  - Use a rapid prototyping pilot program to quickly implement a summarized ABC model. Don't necessarily start with your most technologically sophisticated employees; this will stigmatize the project by making it look like it's for tech gurus only.
  - Get the support of an executive sponsor and find a champion to create interest in ownership of the information and its uses.

Make the Move to Dynamic Forecasting (cont.)

– Make sure there are end-users who really need the data—design the system with the ends in mind.

– Don't be afraid to combine art, craft and science in constructing your ABC model. One that is successfully prototyped can quickly be redone with more detail and accuracy so users readily begin to see how the ABC data relate to the problems they are trying to solve. ABC models can provide valuable insights within weeks that aren't visible from traditional data

***Gary Cokins** is the author of Activity-Based Cost Management—An Executive's Guide, John Wiley & Sons Inc., Hoboken, New Jersey, 2001. His e-mail address is gary.cokins@sas.com.*