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Discussion Board Articles on Performance Measurement and Balanced Scorecards

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The above articles were originally posted to the Financial Management Discussion Board which can be found on the internet at www.exinfm.com/board

The Basic Foundation Behind a Performance Measurement System

A good performance measurement system can change your entire organization. However, your organization must be willing to accept change. If upper-level management supports long-term improvement and your company is receptive to change, than a performance measurement system needs to be considered. A performance measurement system is based on measuring areas that are critical to your future success.

A good performance measurement system strikes the right balance or mix of key performance indicators. This requires that you properly identify those things that need to be measured on an enterprise-wide basis. The mix of performance indicators should not be so extensive that your system will be overly complicated. Try to keep your indicators to four or five main areas, such as customer service, market share, innovation & development, and financial performance.

Once you have the right mix of performance indicators, than ask yourself two very important questions: Can we measure the indicator and can we report the indicator? You have to be able to measure the critical area to control it. And you must be able to report your measurement results if you expect to take action in the area being measured. If your system cannot pass these two questions, than you run the risk of a system whose costs exceeds the benefits. If your system has passed these two critical questions, than it's time to start building a prototype for testing and refinement.

It is extremely important to get feedback from users in the design of your system. In order to ensure users are happy, it is sometimes better to work backwards; i.e. design the outputs for the users first and than work backwards designing the actual system. The best performance measurement systems distribute results on-line and facilitate user interaction (such as On-Line Analytical Processing). But even if you cannot have an automated system, remember a basic performance measurement system in the form of reports is a lot better than no system at all.

- Matt H. Evans, www.exinfm.com

Design Steps in Building a Performance Measurement System

If you have decided to implement a performance measurement system (PMS), here are six basic steps you will need to consider in designing the system:

1. Bring together all stakeholders; i.e. everyone who has an interest in the PMS. The purpose of this first step is to build consensus on what should be accomplished

from the PMS. What are the needs of your organization? A cross-functional team needs to be formed for directing the design of the PMS.

2. Next, your cross-functional team will need to formulate a plan for analyzing activities, collecting data, communicating to users, etc. Your main objective is to identify areas that need to be measured. Start by looking at how your business is organized. For example, if your business is organized around assembly plants, than your PMS should follow this path.

3. Once you have an understanding of what needs to be measured, you have to collect the data that will be used for decision making. It is usually best to have one member of the cross-functional team for each area that will be measured. For example, if you are collecting operating data, you should have an operating person on your cross-functional team. The purpose of step 3 is to determine how you will manage the data within your PMS. How often will the data be needed? Can it be measured and reported within the PMS?

4. The cross-functional team must select a test site within your company. Here you will run pilot tests to determine the feasibility of a PMS. When you select a site, make sure you are dealing with activities that can be measured. You should select a site that has room for improvement and current employees are not happy with the current system. However, you need a test site that can generate reliable data. So the existing system must be reasonably sound.

5. At the test site, you will need to collect lots of data. Several questions must be addressed. How easy is it to collect the data? How big should the test area be? How many people should be involved? Once again, you need to determine the feasibility of a PMS, the costs versus the benefits. Make sure you have support from users at this stage of the process. If not, you may need to go back to the drawing board.

6. Once you have collected and analyzed the data at the test site, you need to present the results of your performance measurements to management. Make sure you present the outputs in a useable and easy-to-understand format. For example, operating people will want performance information presented differently than marketing people. You must tailor the information to fit the user.

Obviously a lot more planning and detail goes into designing a new system. This article has touched on the very basic steps within the process. Finally, keep in mind that many new projects will fail due to:

- Lack of support from upper-level management (single biggest reason for failure).
- Inability to form a good cross-functional team.
- The PMS does not fit the organization.
- The organization is not willing to change.

- Matt H. Evans, www.exinfm.com

Matching Financial Metrics with Strategies and Cycles

Traditional financial performance measurements are often applied uniformly to all business operations without regard to variations in strategies and / or stages within the business cycle. For organizations with diverse operations and different units or divisions, there is a need for different performance measurements since each unit has a different strategy. Forcing a one size fits all approach to performance measurement results in erroneous comparisons. Start with strategy and build measurements to fit strategies, not the overall organization.

Additionally, financial performance measurements need to consider the life cycle of a business unit. For early stages in the cycle, there is high growth, large investments and little or no working capital. Performance measurements need to focus on sales and market growth as opposed to immediate profitability. As the business stabilizes, growth slows down and the focus shifts to maintaining market share and sustaining the organization. Traditional financial performance measurements will now be employed, such as return on equity, return on assets, etc. The next stage in the cycle is maturity. All major investments have been made. Most investments are short-duration for maintaining the existing organization. The main emphasis is on cash flow, especially operating cash flows. Thus, performance measurements tend to emphasize cash flows for mature business units.

Performance measurements are not static. You have to review and revise measurements in relation to strategies and business cycles. The best-managed companies seem to understand that some measurements are emphasized over others in relation to strategies and cycles within the life of an organization.

- Matt H. Evans, www.exinfm.com

What are Critical Success Factors?

There are things that your organization must do right if you expect to survive in the future. These critical areas require constant care and attention on the part of management. According to John F. Rockart in the Harvard Business Review: "Critical success factors for any business are the limited number of areas in which results, if they are satisfactory, will ensure successful competitive performance for the organization."

Therefore, critical success factors represent performance areas that must meet expectations if the organization is to flourish. Measurements are used to track performance in each critical success area. Critical success factors are both internal and external. For example, comparison of budgets to actual would be internal while percent of market share would be external.

One way to identify critical success factors is to go through a strategic planning process. A second or complimentary approach is to conduct competitive intelligence research. Look at the success factors of your competition. Collectively, you will need to develop a set of critical success factors which serves as the foundation for your performance measurement system. Consequently, critical success factors are an important link between strategic plans and performance measurement systems.

- Matt H. Evans, www.exinfm.com

Examples of Key Performance Indicators

Key Performance Indicators (KPI) are used in performance measurement systems such as the Balanced Scorecard. Examples of KPI's for specific measurement areas include:

Measurement Area => Customer Service (Price, Delivery, Support, Satisfaction)
Examples of KPI's => Price comparisons to competition, number of on-time deliveries, response times, customer complaints, number of product returns, customer survey results, service awards, etc.)

Measurement Area => Internal Operations (Efficiency, Costs, Production, Inventories)
Examples of KPI's => Cycle times, inventory turnovers, defect rates, plant utilization, targets met, unit cost compared to competition, overhead trends, etc.

Measurement Area => Innovation (New Products, Technology, R & D)
Examples of KPI's => Number of new products, number of patents, new technologies adopted, system improvements implemented, etc.

Measurement Area => Financial (Profitability, Growth, Value)
Examples of KPI's => Return on Equity, growth rate compared to industry growth rate, EVA, levels of operating cash flow, etc.

The ultimate purpose of KPI's is to drive future performance. The Balanced Scorecard provides the framework for capturing and reporting this performance.

- Matt H. Evans, www.exinfm.com

The Balanced Scorecard: Measuring Real Sources of Value

The dilemma facing most financial managers today is how do I drive value-creation within my organization? Many managers have decided to hang their hat on something called Economic Value Added. But can we really drive value by measuring only the financial parts of our organization? The answer is a resounding NO!

The real sources of value; i.e. those things that result in higher capacities for generating cash flow come from many things. They include great customer service, great products, extremely efficient operations and ultimately the greatest source of value resides in your ability to innovate. As Tom Peters has pointed out in his book The Circle of Innovation, innovation is what separates the men from the boys when it comes to value-creation.

So now that you understand the sources of value, how do you go about doing all of these things (great customer service, great products, innovation, etc.)? Well you have to measure it and the way you are going to measure it is on something called the **Balanced Scorecard**. The Balanced Scorecard is a "balanced" approach to measuring those things that are critical to your future success. Key Performance Indicators (KPI) are established for your critical success factors, such as customer service. KPI's are reported in a dashboard format that resembles the dashboard a car.

Because balanced scorecards provide simple visual output, they often receive wide acceptance throughout the organization. For example, most balanced scorecards report results on gauges or dials with red indicating problems, yellow indicating caution, and green indicating acceptable performance. A series of needles on the gauge will show trends in the KPI. Comments can be added by users to help explain results and indicate what actions will be taken to improve performance.

By the year 2005, over half the Fortune 1000 companies in the United States will have implemented a Balanced Scorecard. If you want to measure and drive value, a Balanced Scorecard is possibly the best measurement system you can implement.

- Matt H. Evans, www.exinfm.com