

Excellence in Financial Management

Discussion Board Articles – Performance Measurement

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Performance Measurement

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 can't 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 can't have an automated system, remember a basic performance measurement system in the form of reports is a lot better than no system at all.

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's 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 doesn't fit the organization.
- The organization is not willing to change.

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.

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.

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.

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.

The Power of the Scorecard

The Balanced Scorecard implies a performance measurement system. However, as Kaplan & Norton have pointed out, the Balanced Scorecard is a management system, not a performance measurement system. The reason is due to the fact that the Scorecard deals with strategies, the real source of increased values for an organization. The problem is that most organizations fail to successfully implement their strategies.

Most people within an organization are way too focused on tasks and activities with little or no focus on strategizing. Even upper level managers fail to spend sufficient time on strategizing. According to one study, executive managers spend less than 50% of their time on strategic planning type activities. When you poll workers within an organization, you will find that less than 10% have any understanding of the organization's strategies. Is it no wonder that most organizations fail to create value through strategizing.

Enter the Balanced Scorecard. The Balanced Scorecard transforms an organization into a knowledge driven organization. Strategies are now communicated throughout the entire organization in a very precise and specific metric format. This allows people to easily identify with the strategies of the organization. Everything is now linked together, working from the same plan as opposed to scattered pockets of knowledge working in all directions. When you embed everyone into one system, the organization can respond quickly to changes in the marketplace. And since strategy is everyone's business, you have a tool for communicating strategy in terms that people can relate to. Balanced Scorecards unlock and release many of the solutions that people have for meeting strategic goals and objectives. This is why Balanced Scorecards are so powerful in helping an organization create higher values.

A case in point often cited by Kaplan & Norton is that of Mobil Oil. In 1993, Mobil adopted the Balanced Scorecard as a tool for integrating and communicating its strategies. Mobil's performance was ranked dead last in 1993. Two years later, Mobil launched its strategies in conjunction with the Balanced Scorecard. By 1996, Mobil Oil had reached record performance. This performance was repeated in 1997 and once again in 1998. As long as organizations have the ability to develop good solid strategies, the Balanced Scorecard can be the tool for implementation. If you want to create higher values, you must engage in strategizing and once of the best ways to implement strategies is through the Balanced Scorecard.

Balanced Scorecards for Non Profits & NGO's

Since strategies are critical to the success of non profit organizations (NPO) and non governmental organizations (NGO), balanced scorecards represent the central management system for running the NPO / NGO. One of the biggest difficulties for NPO / NGO's is to restrict the scope of strategic objectives. NPO & NGO's will typically have an overall strategy that tries to do too many things with too few resources. Therefore, the first step for building an NPO / NGO Balanced Scorecard is to make strategic choices about what the NPO and NGO can realistically hope to accomplish. Remember, it is better to have a few successes than a lot of failures.

Additionally, existing legacy systems are often riddled with numerous measurements and reports, making the organization focus on the wrong things. Although some of these controls may be important, they should not be part of your balanced scorecard. The Balanced Scorecard should be based on the vital areas within the strategic plan. Once a realistic strategic plan has been developed, you can establish perspectives for the scorecard.

Perspectives for NPO / NGO's can differ significantly from private sector scorecards. For example, the Customer Perspective is usually the most important perspective for an NPO / NGO. Customers represent the essence of why an NPO / NGO exists. Additionally, many NPO / NGO's will have two customer perspectives; customers who contribute resources to the NPO / NGO and customers who receive the services and products of the NPO / NGO. In some cases, customers who receive services will not pay for the services. Payment is made from another source. Also, customers can under-score every perspective within the Balanced Scorecard. For example, the City of Charlotte, North Carolina has a balanced scorecard that includes Community Safety, Transportation, and Economic Development as perspectives. All of these perspectives have customers. Therefore, the customer perspective for NPO / NGO's is considerably different than commercial businesses.

Whereas the Financial Perspective tends to be important for commercial businesses, financials is not as critical for NPO / NGO's. For example, United Way's balanced scorecard places the customer perspective at the top. Internal processes, such as improving efficiency, increasing capacities of local United Way's, and delivering services, fall below the customer. The Financial Perspective is listed at the bottom since it does not represent a major strategic objective; financial activity is the lubricant or enabler for operations, but not a critical strategic objective.

Probably the biggest challenge for NPO / NGO's is to align existing resources with the strategic themes that have emerged from the strategic planning process. Alignment will usually flow in a similar fashion to commercial business scorecards. You start at the top where overall organizational management and strategies occur. Second, you move down to the operating units that will deliver the products and services in accordance with the strategic plan. Next, support services must design

their scorecards to meet the needs of the operating units. Finally, scorecards are developed at the individual level based on the three layers above.

Since NPO / NGO's are facing more and more demands with fewer resources, it has become increasingly important for NPO / NGO's to be very selective in their strategies; focusing on those areas that will have the biggest impact. Balanced Scorecards are only as good as the strategic themes of the NPO / NGO. And the Balanced Scorecard will tell the NPO / NGO how well it is doing with its strategic themes. If performance is poor, it may be necessary to re-strategize and decide which initiatives should be continued and which should be discontinued. Balanced Scorecards represent a system of communication, providing feedback in relation to the strategic map of the NPO / NGO. The better the strategic map, the better the results you will get from the Balanced Scorecard.

The Basics of Benchmarking

The use of benchmarking can provide an objective way of measuring performance against the competition. Benchmarking is based on finding a comparable activity and determining how well you are doing. Comparisons can be both internal and external; i.e. you can compare performance between similar departments or divisions as well as compare internal to external benchmarks.

Benchmarking provides several benefits, including better understanding of the competition, better performance, and objective evaluations of performance based on real examples. One way to leverage benchmarking is to develop cost data and cost the process or activity that is being benchmarked. This provides a "perfect world" view of the activity since all costs not related to the activity are removed; especially any abnormal or unusual costs. This view of costs is becoming increasingly important since management must understand costs under a perfect scenario if the company expects to compete in the global marketplace. Additionally, management and investors are starting to push for perfection because of programs like Six Sigma.

The basic process for setting up benchmarks will usually consist of:

1. Identify and understand the function or process that needs to be benchmarked. Determine end-user requirements for benchmarking.
2. Organize a benchmarking team for design and implementation of benchmarking.
3. Understand the process and related activities. You need to make sure have comparability; otherwise you may end up comparing apples to oranges. The goal is to find relevant benchmarks for improving performance.

4. Research and gather "best in class" performance data. This may require interviews, research, analysis and other tasks. For small companies on a tight budget, outside services may have to supply the benchmark data. Larger companies will develop their own in-house benchmark data.
5. Analyze the data and determine performance gaps between your company and "best in class" benchmarks. Identify the causes for the gaps and establish future attainable performance.
6. Obtain senior management support for benchmarking. Finalize the benchmark standards and assess their impacts.
7. Apply the benchmarks and continuously update the benchmark data.

The best types of benchmarks focus on critical functions or processes in the business, such as production efficiency or customer service. A solid understanding of the function or process is critical to finding the right benchmark. You are trying to pull out the right performance data for external benchmarking. External benchmarking is considerably more difficult than internal benchmarking.

Finding financial related benchmark data is not too difficult. Financial benchmarks are widely available from service bureaus, market reports, financial reports, and published surveys. Financial benchmarking can help you determine the costs of a process or activity based on perfect cost conditions. The key to benchmarking is to make sure you have a good comparison. Once you have this out of the way, you should find the appropriate benchmark and allow the benchmark to help guide your performance. Always remember to benchmark against "best in class" and not averages. You are not interested in average performance; you want to move towards best in class.

Integrated Performance Measurement

A fully integrated approach is now considered a standard approach to performance measurement; especially with the advent of the Balanced Scorecard. An integrated approach recognizes that measurement should be process oriented and cut across functional areas. It also recognizes that a balanced set of measures, both financial and non-financial, is needed for a complete picture of what is going on.

The best types of measurements provide more than score keeping; they help you understand what changes are needed to improve the score. Good measurements usually start with the core competencies of the organization. By focusing on core competencies, you are measuring the strategic areas that give the organization a competitive foothold in the marketplace.

Typically a set of performance measurements will rely on Key Performance Indicators (KPI's). The best KPI's tend to be simple. Here is an example of KPI's at General Electric:

<u>Performance Area</u>	<u>Key Performance Indicator</u>
Profitability	Residual Income
Productivity	Output
Human Resources	Number of Promotable Employees
Market Position	Market Share

As you can see from this example, the primary drivers behind performance are very visible within the performance measurement system. Areas that are selected for measurement are critical to the business. Therefore, the best place to start in the design of an Integrated Performance Measurement System (IPMS) is by simply understanding how the organization works. Based on this understanding, strategic themes emerge to help you identify what areas of the business should be measured. The objective behind the design phase of the IPMS is to come up with a set of KPI's that are both measurable and reportable.

The design phase of the IPMS should be both top-down and bottom-up. The top view is needed to help ensure that design is based on major strategic issues confronting the organization. The bottom-up view is needed since you need to identify barriers and issues that must be resolved for implementation of the IPMS. The preliminary design of the IPMS will often consist of eight steps:

1. Executive Management buy-in and support for the IPMS.
2. Forming the Design and Implementation Team(s).
3. Developing a clear and concise set of strategies.
4. Drafting a prototype model for testing and refinement of the IPMS.
5. Defining the Critical Success Factors or Areas that need to be measured.
6. Defining the Key Performance Indicators that will serve as the measurements.
7. Finalize the Prototype Model.
8. Develop a plan for full implementation.

The biggest reason behind failure of a performance measurement system is lack of senior management support. In order to gain management support, an "ABO" approach is sometimes useful:

1. Awareness: Management shows an interest in the project, learns more, and becomes passively involved.
2. Buy-In: Management now seeks more information, they commit time and money to the project, and they openly support the idea behind performance measurement.
3. Ownership: Management assumes responsibility for success of the project, they recruit people to participate, and they sell others on the idea of performance measurement.

Once you have ABO from upper-level management, you can proceed to Step 2, forming a design and implementation team. Since the IPMS cuts across the entire organization, the team should have representation from areas that will be measured. For example, a beverage company has identified marketing and production as critical areas that need to be measured. The design team consists of five key people: Marketing Manager, Sales Manager, Operations Manager, Quality Control Manager, and Chief Financial Officer.

This article has touched on the very basics of trying to get a comprehensive performance measurement system started. A very important aspect with any project like performance measurement is to spend sufficient time with planning and design. One of the biggest mistakes with most projects is to move too quickly into implementation. A good IPMS should evolve through a process of planning and design. And don't forget to prototype test each and every idea within the IPMS. This will save a lot of grief down the road when it comes time to implement.

Balancing the Balanced Scorecard

Too many measurements, too much emphasis on financials, too few leading indicators, disregard for human resource capital, etc., etc., etc. All of these attributes represent fundamental reasons why so many Balanced Scorecards are "out-of-balance." One of the biggest problems to emerge with many balanced scorecards is excessive measurement. As Mark Graham Brown points out in his book *Keeping Score*, it can be worse to have too many measurements than to have no measurements at all. Brown recommends that the overall organization have no more than 20 measurements. Brown also suggests the following:

- Measurements should be based on the needs of stakeholder groups - shareholders, customers, employees, etc.
- Measurements should provide a mix of past, present and future.
- Measurements should flow from the top down to all levels of the organization to ensure linkage. Kaplan and Norton reiterate this point in their four-layer approach to deployment of scorecards (Organization > Operations > Shared Services > Individual).

One way of reducing the number of measurements is to combine several related measurements into one single index. Weights are assigned to individual measurements based on importance with a weighted average index serving as the metric within the Balanced Scorecard. One problem with the use of an index is the fact that individual measurements can get buried within the index. Therefore, the best approach is to have a few solid key indicators as opposed to an index that combines numerous indicators. However, if your scorecard is overloaded with measurements, indexing can help streamline the Balanced Scorecard.

Financial measurements will often dominate a Balanced Scorecard since many executives are addicted to earnings as a value-driver. One of the problems with financial measurement is that it tends to be a lagging indicator; i.e. it looks back at past performance. Financial metrics within a balanced scorecard should cover three perspectives:

Historical - How did we do last period?
Current - How are we doing right now?
Future - How will we do next period?

For example, the number of customer contracts executed is an indication of future revenues and thus, this would be a leading indicator as opposed to revenues for the quarter (lagging indicator). Measurements should also look at things from a long-term perspective. Long-term strategic thinking should flow into the Balanced Scorecard. Examples of long-term measurements are customer service, human resource development, and product innovation.

Another challenge within the Balanced Scorecard is Detail vs. Summary. How much detail to include depends upon what is required for decision making. Balanced Scorecards should provide sufficient information so that people can act on unacceptable performance. The ability to drill down and see what is going on is important for problem solving.

Balanced Scorecards should reflect a balance between generic types of measurements and measurements that are unique to the organization. Most organizations have similar generic measurements, such as financial and customer service. However, each organization is unique and therefore, balanced scorecards should include measurements that are specific to the organization based on what drives value. Measurements should relate to critical areas for future success, such as maintaining your competitive edge. For example, if your competitive edge resides in innovative products, then you will need to have some measurements focused on product innovation.

No one metric should dominate the scorecard; after-all it needs to be balanced in many areas (operations, customers, financial, etc.). You also need to change your measurements with changes in strategy. Strategies should be changing all the time due to marketplace changes, technological changes, etc. Finally, see if you can answer yes to the following questions about your Balanced Scorecard:

1. Do our measurements reflect the critical strategies of the organization so that we will grow and remain competitive in the future?
2. Everyone within the entire organization, from employee on up to CEO, is not evaluating more than 20 measurements each period within their balanced scorecard?
3. Measurements throughout the organization flow together and no set of

measurements is floating alone, separate from the remainder of balanced scorecards in the organization?

4. We have a set of measurements that is balanced - Mix of past, present, and future; mix of unique and generic; balance within categories (operations, customer, human resources, financial, etc.); and balance between detail vs. summary.

Once a strategic map has been developed, balancing the Balanced Scorecard is perhaps the most challenging goal in building the scorecard. Indexing, time dimension, integration from top to bottom, and an emphasis on stakeholder groups can all help ensure that your balanced scorecard is balanced.

The E2K Metric

One of the most significant challenges facing finance is to provide information faster and faster to end-users. By acting on information as it is produced, decisions are more effective and the costs associated with the information declines. To help drive this mandate for finance, the Event to Knowledge Metric or E2K Metric is applied.

E2K measures the time between when an event occurs and when the knowledge can be acted upon. The objective is to reduce the E2K time so that decisions are made as close to the event as possible. For example, it may take 5 days before all allocation entries are posted to a series of accounts, providing income information by cost center. By integrating all centers into a new automated system, this time is now reduced to 3 hours. Operating managers can now act on sales targets the same day the information is produced.

One place to look in reducing E2K time is internal reporting. Most companies are preoccupied with cranking out report after report with no regard with how the information is used. Transforming information into knowledge and reducing the inordinate amount of time on reporting are two fundamentals steps to cutting down on E2K times. Another obvious way of reducing E2K is electronic distribution of information to end-users. In some cases, quick flash reports can serve as preliminary sources of information before final reports are prepared and released.

In his article titled Event-to-Knowledge¹, Frank Potter describes four basic strategies for reducing E2K time:

1. Increase the material threshold for accrual and other adjusting entries.
2. Pre-calculate your monthly adjustments ahead of time, such as monthly depreciation.
3. Post more frequently to sub-ledgers and make correcting entries before month end closings.

¹ Event to Knowledge by Frank Potter, Strategic Finance Magazine, July 2001

4. Review the allocation and distribution process; making sure it is streamlined and efficient.

For labor-intensive businesses, getting your accounting cycles in sink with your payroll cycles can yield big results. No more payroll estimates, accruals, and reversing entries. And labor costs are now reported in the financials every two weeks or weekly.

However, the biggest step towards cutting E2K times is gained through “just in time accounting.” Just in time accounting provides accounting and financial information on a daily basis. At the heart of just in time accounting is the Virtual Close. Under the virtual close, the accounting records are closed by 2:00 p.m. the following day as opposed to the traditional close, which takes place once a month:

<u>Event</u>	<u>Traditional Close</u>	<u>Virtual Close</u>
30-day monthly period	30 days	1 day
Month end closing process	5 days	1½ day
Generate / Distribute Financials	4 days	½ day
End User acts on information	2 days	½ day
Total E2K	41 days	2 ½ days

The Virtual Close was popularized by Cisco Systems, which integrated all of its systems and technologies over an eight-year period. Web based applications are often deployed for virtual closings since they provide the infrastructure for instantaneous sharing of information. According to Cisco CFO Larry Carter, “We can literally close our books in hours. More important, the decision makers who need to achieve sales targets, manage expenses, and make daily tactical operating decisions now have real-time access to detailed operating data.”²

According to Mark Kruger of AnswerThink, all of our clients are moving toward the virtual close, cutting between a third to one half of their closing cycles.³ Kruger suggests many larger companies can simply cut their E2K’s by consolidating all of their companies – “Every legal entity costs around \$ 250,000 to \$ 500,000 to maintain because people spend money to account and consolidate those transactions.”⁴

Getting to the virtual close can be a monumental task because of the diversities that exist within a business. Everyone needs to get the right information to the right location on time with minimal errors. Once you have the system in place, you begin to reap the benefits. According to KPMG Consulting, the real benefits of a virtual close are not generating consolidated financials within hours or days, but giving decision makers instant access to critical information so they can be more pro-active.

² Cisco’s Virtual Close, Harvard Business Review, April 2001

³ A Virtual Close: as Easy as One, Two, Three? CFO Magazine, March 2001

⁴ A Virtual Close: as Easy as One, Two, Three? CFO Magazine, March 2001

One final point about E2K and the Virtual Close concerns the balance for accuracy. In light of the Enron collapse, the rush to “optimize” the financial function must be balanced with the goal of producing accurate financials. Therefore, as you move towards optimization, don’t forget to balance optimization with controls that ensure high levels of accuracy in financial reporting.

It’s Time to Start Measuring Leadership

Over the last few years there has been enormous interest in the subject of leadership. In the last three years alone, over 5,000 books have been published on leadership. There is little doubt that leadership is a critical catalyst for driving value. However, one thing that seems to be missing is some form of measurement. If we fail to measure leadership, how can we understand if it exists and to what extent does it influence and drive performance.

The good news is that many of the characteristics of leadership are well documented, giving us a relatively easy model for measurement. Since leadership tends to be very intangible, our approach to measurement will be more casual and soft when compared to traditional measurements such as financial metrics. For example, simple feedback may suffice over hard measurements, such as a peer review survey. However, just like any measurement process, we will look for consistent trends to flag action items for improvement.

Before we embark on measuring leadership, let’s make sure we understand what we want to capture. Leadership is basically the capacity of someone to bring about change. Using this definition, we need to make sure we cast a wide net with our measurement of leadership. This helps ensure that we recognize where the real leadership is at which in turn allows us to leverage it for greater organizational performance.

One of the most accepted models for measuring leadership comes from James M. Kouzes and Barry Z. Posner, authors of the book *The Leadership Challenge: How to Keep Getting ExtraOrdinary Things Done in Organizations*. Kouzes and Posner have devised the so-called Leadership Practices Inventory or LPI. The LPI Measurement Model uses a series of questions to assess leadership effectiveness. People under a designated leader are observers, evaluating leaders on a series of qualities, such as:

- Discusses future trends on how I can change my work
- Provides positive feedback on accomplishments
- Follows through on promises
- Treats others with respect
- Solicits feedback and opinions from others

The leader is also required to assess his or her leadership based on several behaviors, such as:

- Sets a good personal example
- Actively listens to other viewpoints
- Supports others in their decisions
- Willing to take certain risks and experiment

Collectively we can take these answers and assess leadership effectiveness. The LPI Model also establishes several best practices in leadership, such as:

- Challenge an existing process in a positive way
- Share your knowledge and power, enabling others to act
- Openly recognizing performance so as to encourage others to perform

For organizations not interested in formal models such as LPI, you might want to fall back on self awareness tests such as Meyers Briggs or evaluation forms for assessing Emotional Intelligence. Regardless of how you approach measuring leadership, the key is to have some basis for measurement. Leadership is way too important to ignore and given all the published materials available about leadership, there's no excuse for not measuring it.

Finally, don't restrict your leadership assessments to just management positions. The overall goal should be to capture and report the essence of what leadership is – the capacity to produce change. Using this broad definition, you may want to measure leadership at several organizational levels since all types of positions can qualify. By casting a wide net, you will leverage and maximize the benefits of measuring leadership.