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Performance Measurement: Connecting Strategy, Operations and Actions

by R. Michael Donovan

A strategic plan must specify goals, strategic objectives and actions and the final performance measures by which management and the stockholders will gauge success. Top management's performance can usually be measured in terms of sales volume, marketshare, cash flow, profit, ROI, dividends and market value. For operating management, however, there is often a big disconnect from the strategic plan. The disconnect is due to the lack of alignment and proper measurement of the business processes and activities that drive financial results. This misalignment of performance measurement between goals, strategy, processes and activities is often poorly understood, and so does not get the emphasis and priority it should from management.

What management defines as critical success factors at the strategic level must be linked clearly to the business process and activity level. Successfully linking the real drivers of business performance is a prerequisite to effective performance measurement.

A primary purposes of measurement is to assess performance levels and to analyze what is happening and where. The most beneficial aspect of performance measurement, however, is pinpointing problem areas and focusing attention on

actions that will have the best impact on overall business performance.

Without good performance measurements, it is easy to fall into the common trap of having people busy with all kinds of activities, but achieving few measurable results. Effective performance measurement is the compass that guides management in a direction that will produce meaningful results at the process level, results that will tie directly to your company's goals.

Many manufacturers focus on the wrong performance issues. The fact is, it is very difficult to improve what you don't properly measure. The pressure to focus energy on activities that really matter must come from the highest levels of the manufacturing enterprise. Top management can talk about the need for making improvements, but unless the right performance factors are measured and rewarded, nothing will change. Today's world-class manufacturers are continually tracking process performance factors that ultimately impact business success, such as order-to-delivery cycle time, throughput, inventory levels, operating expense and customer satisfaction.

Wrong Measures Can Cause Havoc

Inappropriate measures will often lead managers to respond to situations

incorrectly, and continue to reinforce undesirable behavior. For example, when manufacturing's goal is to keep absorbing overhead, the result is often a bloated inventory and decreased customer service. Measuring and driving toward a singular measure, such as purchase price variance, often leads to higher overall costs that are invisible in traditional accounting systems. Getting the lowest possible price is important, but insuring an uninterrupted supply of needed material to maintain the production schedule and meet customer deadlines is more important. Just think about the real cost of material shortages. The best purchased material value is a result of price, quality and on-time delivery.

Keeping an entire organization focused on the right targets and moving in the right direction is no easy task. Of course, what managers think their superiors consider important through the formal or informal measurement system is what is going to get done. For example, if something like cycle time gets good words from top management, but answering for the result is of minor consequence, cycle time essentially becomes a secondary issue, if it exists as a real performance measure at all. And if the performance measurement system does not focus on a clear direction, the measurement system itself will enforce the wrong actions.

If your company has conflicting performance measures, you are certain to have differing values and directions, many of which will be disconnected from the company's strategy. Without uniform expectations, it is virtually impossible to keep an organization marching toward the same goals. This, by itself, makes re-evaluating how you measure business performance a very high priority.

Managers must strive to direct all levels of their organization to focus on the right

priorities. World-class companies have learned (many the hard way) that effective performance measurement that will drive improvement and continue to encourage the right response and behavior requires linking strategy with day-to-day actions.

Financial results are the ultimate measures, but not drivers, of business success. As a result, the need to link day-to-day activities to financial results is necessary. Waiting for a fiscal month or quarter to close is far too late for numbers that would appropriately influence day-to-day actions. For example, asking manufacturing management to explain almost unexplainable variances that occurred weeks ago can be a waste of time. What are desperately needed are the right measurements and fast feedback that let a manager adjust, correct and guide an area of the company to be more synchronized with the overall business strategy while at the same time keeping near and longer-term financial measures on course.

For a quick assessment of whether your organization is on the right track with operational performance measurement, realistically consider the following five questions. The questions are intended to help you develop a perspective on your company's performance measurement situation.

1. Do your performance measures put pressure in the right directions for improvement?

Yes Sometimes No

2. Does management understand that some micro performance measurements can decrease overall performance?

Yes Sometimes No

3. Has management defined success by identifying critical measurements by function, process and activity?
- Yes Sometimes No
4. Does your current performance measurement system help to integrate your company's people, processes and activities for a better overall performance?
- Yes Sometimes No
5. Does your performance measurement system drive improvement by providing early warning signals that supports a proactive management style?
- Yes Sometimes No

If you answered sometimes or no to any of these questions, you're in good company. Most manufacturers could benefit from a more careful look at performance measurement.

What performance factors are most closely linked with improvements in your informational and material flow processes? For most manufacturing companies, this is not an easy question to answer. That's because management has not defined the ways in which the activity and process level are linked to overall business results.

In operations there is often an over emphasis on measures such as labor efficiency, purchase price variance and output just to absorb overhead. As a result, poor performance is apt to appear as longer lead times, decreased on-time delivery, increased inventory investment, higher operating costs and decreased throughput.

Defining what drives your company's overall business success from the activity and process level to financial and marketplace success should be one of management's highest priorities. Once this definition is completed, understood and accepted, a performance measurement system with clear up, down and across linkages that provide a balanced perspective on course correction can be developed.

Developing a Successful System

As you design, develop and implement your new performance measurement system, keep in mind that successful measurement systems share some common traits. Here are some of the critical traits that are common to successful performance measurement systems:

- Designed to meet real business needs and expectations
- Driven by customer requirements
- Success factors that drive results and improvement are defined
- Expressed in numbers that enable performance to be tracked and the right action taken
- Fast feedback so action is quick and meaningful
- Specific quantification of performance factors that are not open to multiple interpretations.
- Proper balance and emphasis are clear
- Understandable to the people who have to use the measurement system or be evaluated by it.
- Promotes company-wide involvement in continuous improvement
- Clear linkage to cause and effect up, down and across the company

Performance measurement systems should enable managers to precisely communicate performance expectations to subordinates for several reasons: so they know how the organization is really performing and can identify performance gaps; and, to effectively make and support decisions regarding resources, plans, policies, scheduled, and business process redesign.

A good performance measurement system also benefits the entire organization by letting people know exactly what is needed and expected. This is accomplished by providing a way for individuals and teams to monitor their own performance and create their own feedback to identify areas for improvement. This fast feedback will shorten decision and correction cycle times. The result will be improved operating performance.

World-class manufacturers have had to achieve success on many fronts to reach their levels of performance. A cornerstone of world-class status is that management recognizes the paramount importance and made the commitment to develop a highly disciplined planning and measurement process. The essential and common characteristics of a world-class process includes:

- A highly focused, effective planning process based on clearly defined goals and strategic action plans
- Clearly defined functions, process and activity level critical success factors that truly drive business performance
- Feedback mechanisms that quickly let the decision-maker know what they need to know and, most importantly, when they need to know it.

World-class manufacturers have a competitive edge because they approach improvement activities differently and more effectively. These world beaters have refocused their organization by measuring and rewarding the performance factors that really count. Certainly, you can't just measure your way to world-class performance, but world-class performance cannot be achieved without a superb performance measurement system and a highly focused management team.

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