

Chapter 14

Contemporary approaches to measuring and managing performance

The purposes of performance measurement

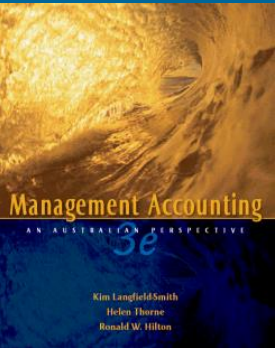
- ◆ Communicate the strategy and plans of the business and align employee's goals
- ◆ Track performance against targets
- ◆ Identify problem areas
- ◆ Evaluate subordinates' performance and as a basis of rewards
- ◆ Guide senior managers in developing future strategies and operations

Problems with conventional performance measures

- ◆ They are not actionable
- ◆ Financial measures emphasise only one perspective
- ◆ Financial performance measures provide limited guidance for future actions
- ◆ May encourage actions which decrease shareholder and customer value

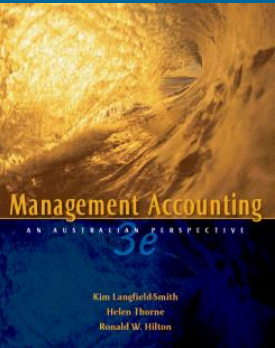
Contemporary performance measurement systems

- ◆ Include non-financial and financial measures
- ◆ Have a strategic orientation—directly measure areas that provide competitive advantage
- ◆ Use external benchmarks
- ◆ Emphasis continuous improvement



Non-financial measures for operational control

- ◆ Non-financial measures reflect the drivers of future financial performance
- ◆ More actionable
- ◆ More understandable and easier to relate to



Non-financial measures

- ◆ Customer satisfaction
 - ▲ Measured by survey administered to customers
- ◆ Defect measures
 - ▲ Measurement of faults in a product that occur during manufacturing process
 - ▲ Support a high quality strategy
- ◆ Quality
 - ▲ Periodic inspections or testing of products

continued

Non-financial measures

- ◆ Productivity

- ▲ The ratio of outputs produced per unit of input

$$\text{Labour productivity} = \frac{\text{Number of units produced}}{\text{Number of direct labour hours}}$$

$$\text{Total factor productivity} = \frac{\text{Number of units produced}}{\text{Cost of all inputs to production}}$$

continued

Non-financial measures

- ◆ Stock status
- ◆ Accident report/safety reports
- ◆ Multiskilling
- ◆ Machine down time
 - ▲ Number of hours, or percentage of total production hours that machines are unable to operate
- ◆ Delivery on time

Problems with non-financial performance measures

- ♦ Wide choice of non-financial measures available
- ♦ Their development can be ad-hoc and undirected
- ♦ Managers must necessarily make trade-offs
- ♦ Some measures lack integrity
- ♦ Some measures not easily translated into financial outcomes

Measuring performance with a balanced scorecard

- ◆ A performance measurement system that identifies and reports on performance measures for each key strategic area of the business
- ◆ The Kaplan and Norton model translates an organisation's mission and strategies into objectives and performance measures
- ◆ Four perspectives

continued

Measuring performance with a balanced scorecard

- ◆ Financial perspective
 - ▲ Reflects perspective of the shareholder
 - ▲ Summarises the financial outcomes of decision and actions
 - ▲ Measures include various cost and product measures, return on investment, cash flow measures, shareholder value measures

continued

Measuring performance with a balanced scorecard

- ◆ Customer perspective
 - ▲ Measures of the company's success in achieving customer value
 - ▲ Outcome (lag) measures include customer profitability, market share, number of new customers
 - ▲ Lead indicators include on-time delivery, number of defects

continued

Measuring performance with a balanced scorecard

- ◆ Internal business processes
 - ▲ Objectives relate to specific processes that contribute to achieving customer and financial objectives
 - ▲ Processes critical to delivering products to customers and achieving financial strategies
 - ▲ Product design, operations, marketing, sales, customer service processes
 - ▲ Measures of cost, product quality, time-based measures, new product development

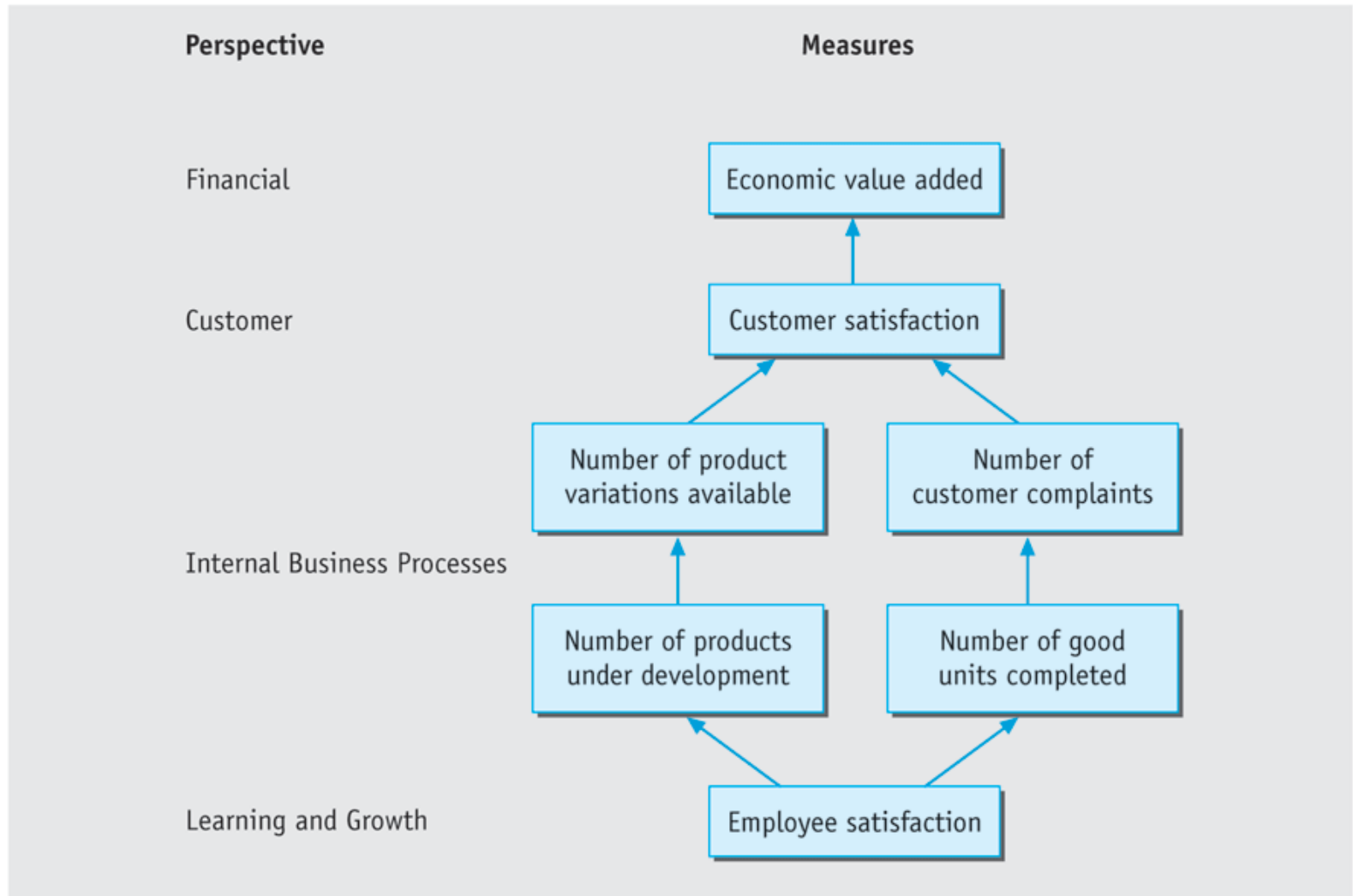
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Measuring performance with a balanced scorecard

- ◆ Learning and growth
 - ▲ Focuses on the capabilities of the organisation to achieve superior internal processes that create both customer and shareholder value
 - ▲ To deliver long-term growth and improvement
 - ▲ Measures focus on employee capabilities, information systems capabilities and organisational climate
 - ▲ Employee satisfaction, training, skills, employee suggestions

continued

EXHIBIT 14.3 Causal linkages in the balanced scorecard



Measuring performance with a balanced scorecard

- ◆ Lag indicators
 - ▲ Monitor progress towards the organisation's objectives
 - ▲ Difficult to monitor directly
 - ▲ Summary financial measures, market share, customer satisfaction
- ◆ Lead indicators
 - ▲ Measures that driver the outcomes and provide information that is actionable and management
 - ▲ Relate to the processes and activities of the business

Measuring performance with a balanced scorecard

- ◆ Measures in the balanced scorecard provide balance between
 - ▲ Short-term and long-term objectives
 - ▲ Financial and customer measures, and measures of business processes and learning and growth
 - ▲ Outcome measures and drivers of those outcomes
 - ▲ Objective and easily quantified measures and subjective performance measures

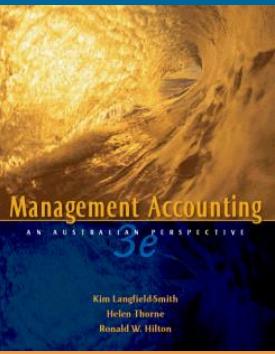
Linking non-financial measures to financial performance

- ◆ Improvements in non-financial measures will not result in improved profits if:
 - ▲ Management has selected the wrong critical success factors
 - ▲ Management fails to utilise freed up resources
 - ▲ The performance measurement system is incorrectly designed

continued

Linking non-financial measures to financial performance

- ◆ Du Pont chart
 - ▲ Identifies the linkages between key performance drivers, key performance indicators and financial performance measures



Benchmarking

- ◆ A process of comparing the products, functions and activities in an organisation against external businesses
 - ▲ Identify areas for improvement
 - ▲ Implement a program of continuous improvement

Steps in the benchmarking process

- ◆ Identify the functions/activities to be benchmarked, and performance measures
- ◆ Select benchmarking partners
- ◆ Data collection and analysis
- ◆ Establish performance goals
- ◆ Implement plans

Forms of benchmarking

- ◆ Internal benchmarking
 - ▲ Benchmarking operations that are internal to the larger business group
- ◆ Competitive benchmarking
 - ▲ Benchmarking with other companies within the same industry
 - ▲ Identify the strengths and weaknesses of competitors

continued

Forms of benchmarking

- ◆ Industry benchmarking
 - ▲ Comparing against companies that have similar interests and technologies within an industry
 - ▲ Performance measures and practices may be directly comparable
- ◆ Best-in class or process benchmarking
 - ▲ Benchmarking against the best practices that occur in any industry

Benchmarking against competitor cost structures

- ◆ Costs can be inferred by using publicly available information, such a sales volume, market share , product mix
- ◆ Industry-sponsored databases
- ◆ Stockbroking firms
- ◆ Specialist benchmarking consulting firms

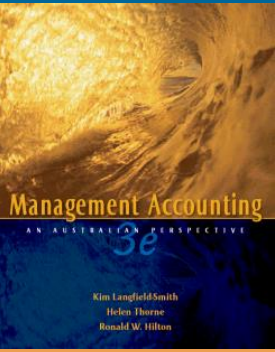
Inadequate performance measurement system

- ◆ Performance is acceptable on all dimensions, except profit
- ◆ Customers do not buy, even when prices are competitive
- ◆ No one notices when performance reports are not supplied

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Inadequate performance measurement system

- ◆ Significant time is spent debating the meanings of measures
- ◆ Measures have not changed for some time
- ◆ The business strategy has changed



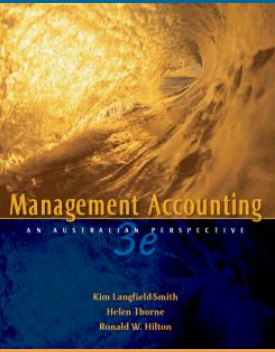
An effective performance measurement system

- ◆ Linked to strategy and goals of the organisation
- ◆ Simple
- ◆ Recognise controllability
- ◆ Emphasises the positive
- ◆ Timely

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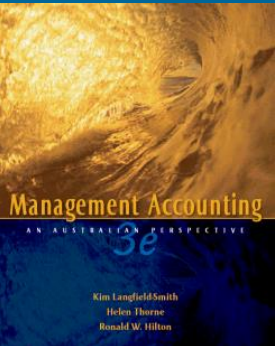
An effective performance measurement system

- ◆ Includes benchmarking
- ◆ Embraces participation and empowerment
- ◆ Includes only a few performance measures
- ◆ Links to rewards



Designing measures for continuous improvement

- ◆ Continuous improvement can be built into performance measurement systems by
 - ▲ Selecting relevant performance targets
 - ▲ Defining and re-defining the measure
 - ▲ Making the performance target more challenging



Behavioural implications of changing performance measures

- ◆ Resistance to change
 - ▲ Individuals consider targets unfair or unachievable
 - ▲ Individuals' pay is involved
- ◆ Changes are most likely to succeed if
 - ▲ Supported across the entire organisation
 - ▲ Not seen as an 'add on' to an inadequate performance measurement system