

BUSINESS PERFORMANCE MANAGEMENT

Michigan Association of CPAs

Current Accounting Issues Conference

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FAILURE TO IMPLEMENT STRATEGY

9 out of 10 Companies Fail to Implement
Their Business Strategies.

.... Kaplan & Norton



HOW DO COMPANIES IMPLEMENT STRATEGY?

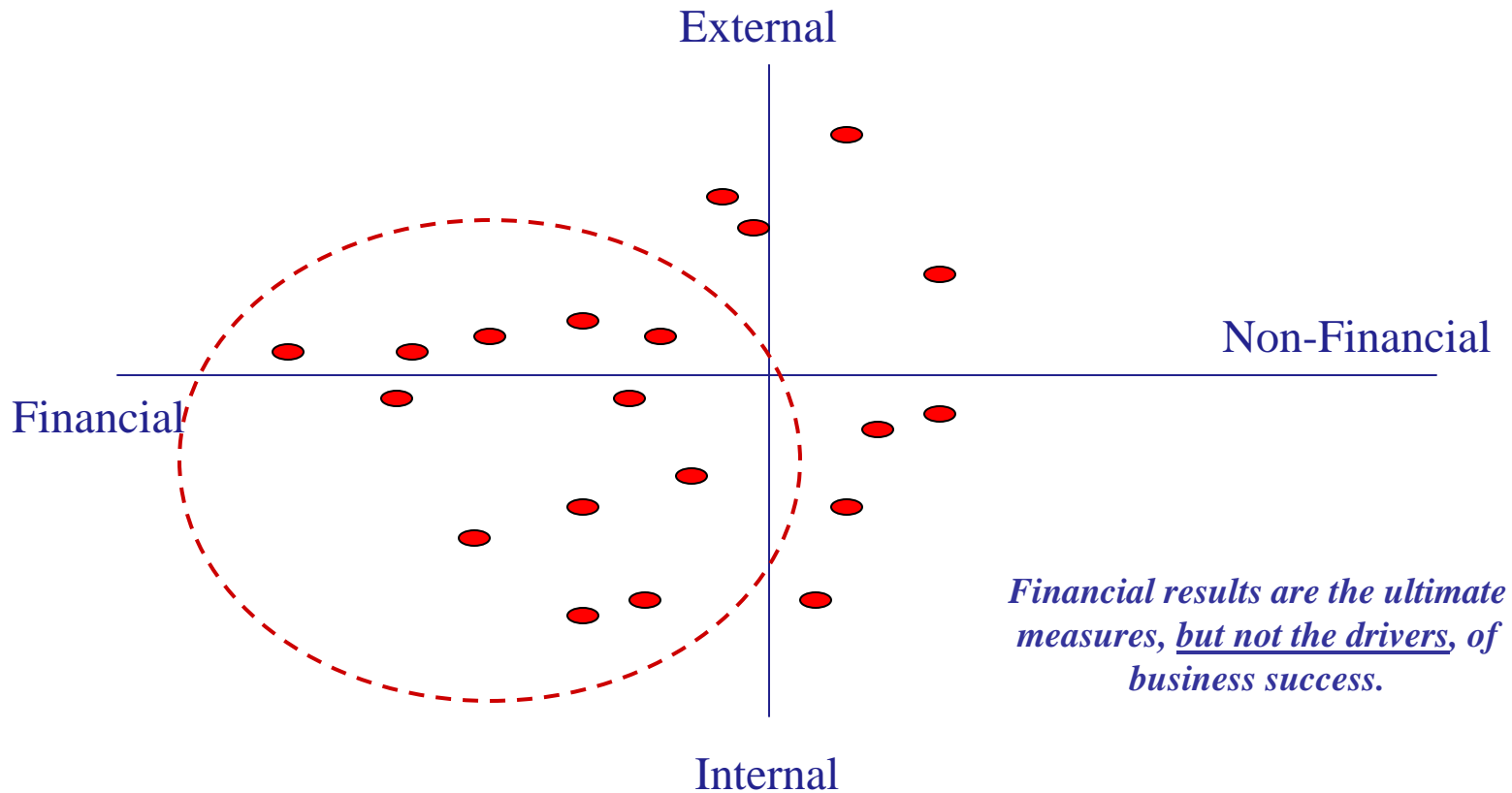
“Round up the usual suspects.”

-Captain Louis Renault

Prefect of Police – Casablanca, Morocco



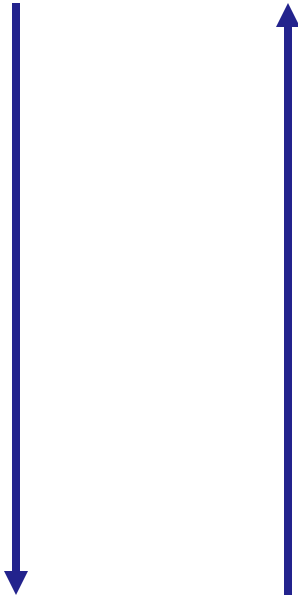
HOW DO COMPANIES IMPLEMENT STRATEGY?



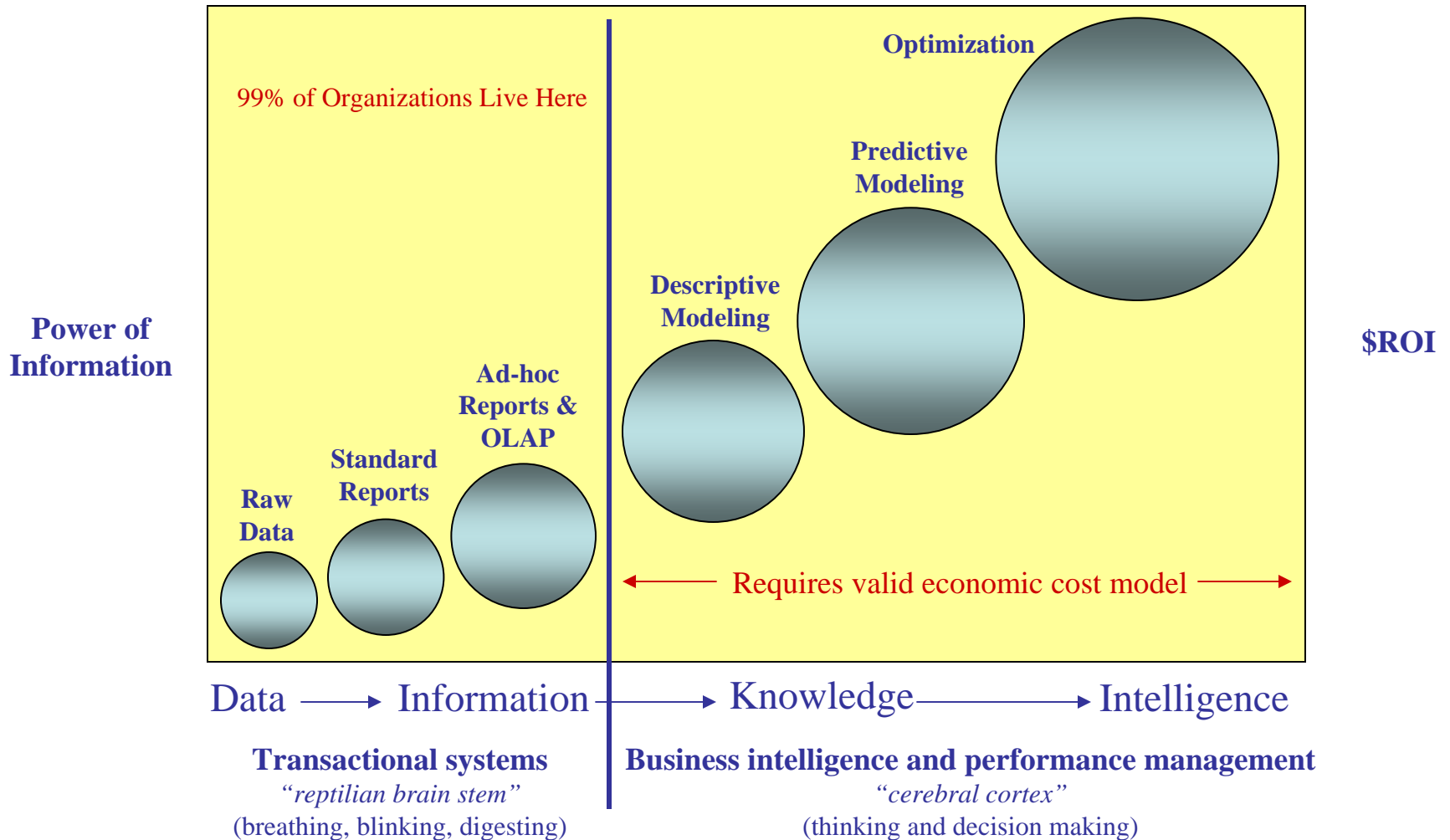
ISSUES WITH TRADITIONAL PERFORMANCE MANAGEMENT

- Overemphasis on Financial Metrics
- Disconnect with Company Strategy
- Measurement Obscured by Inappropriate Allocations
- Isolated Tracking of Specific Metrics
- Very Little Emphasis on Futures
- Late Reporting of Results

CHALLENGES FACED BY COMPANIES TODAY

- Measurement
- Priority Cause & Effect
- Profitability Squeeze
 - Lower Sales Volume
 - Higher Cost of Operations
 - Cash Management and Credit
 - New Customer Acquisition
 - New Product Innovation
- 

INTELLIGENCE HIERARCHY



CRITICAL SEQUENCE OF EVENTS

First, develop a valid economic cost model of the organization and quantify costs as directed by that model.

Second, develop an economically sound business strategy that will enable the organization to meet its economic goals.

Then, and only then, identify the critical success factors and key performance indicators that will motivate employees to move the organization towards its strategic goals.

PERFORMANCE MEASUREMENT FUNDAMENTALS

- Performance measures need to be directly related to the strategy of the company
- Non-financial measures need to be considered
- Measures need to be customized for each company location

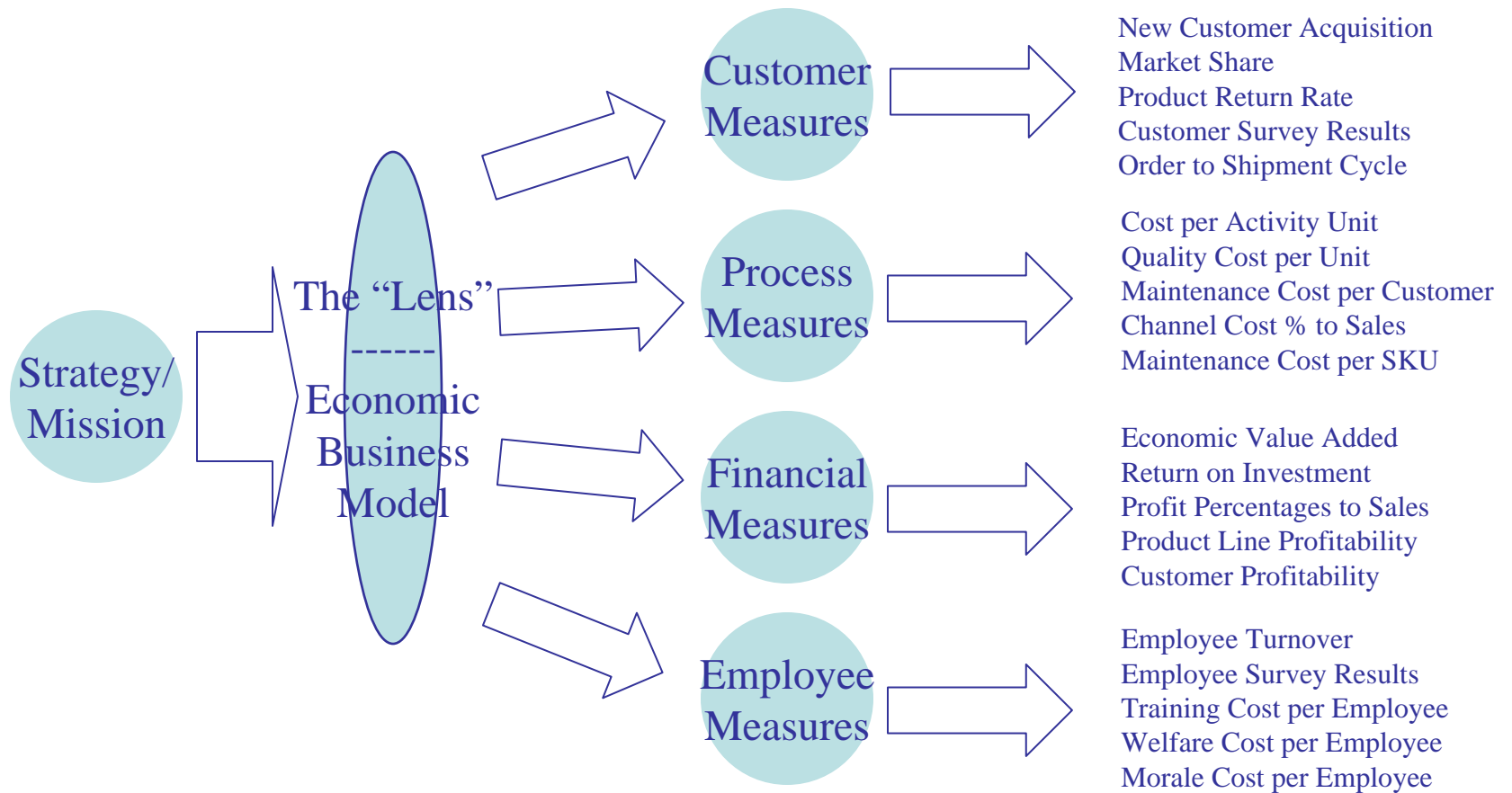
PERFORMANCE MEASUREMENT FUNDAMENTALS

- Measures can change over time as management objectives change
- Measures need to be simple and easy to track
- Fast feedback to operators and managers is important
- Intention needs to be continuous improvement and not just monitoring

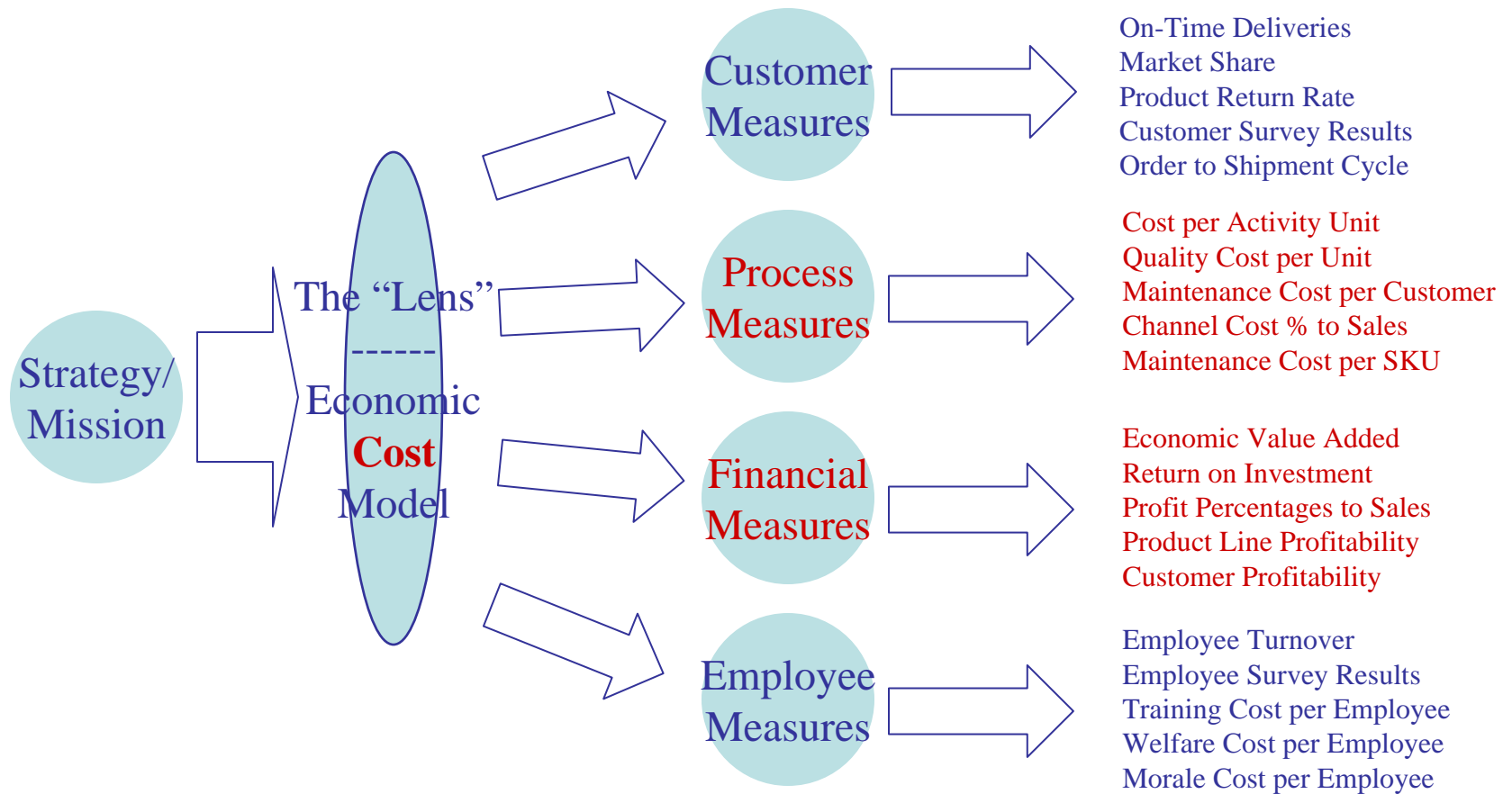
PERFORMANCE MEASUREMENT & MANAGEMENT

- PM&M embraces methodologies, metrics, processes, software tools, and systems that manage an organization's performance.
- PM&M translates strategic plans into results. It is execution. PM&M is the process of managing your strategy.
- There is no single PM&M methodology because it spans the complete “closed loop” management planning and control cycle.

PERFORMANCE MEASUREMENT & MANAGEMENT



PERFORMANCE MEASUREMENT & MANAGEMENT

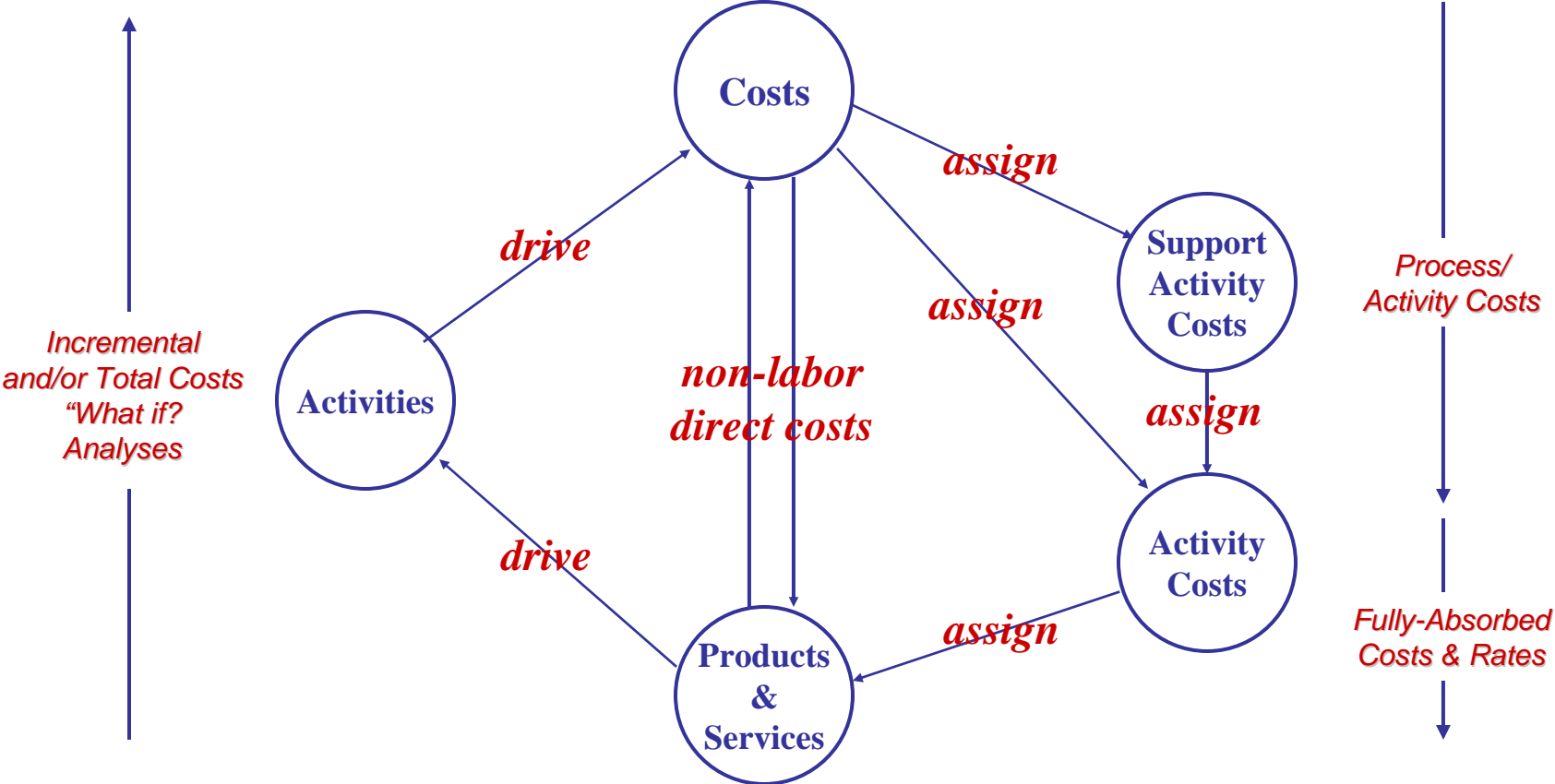


THE ECONOMIC COST MODEL

ACTIVITY-BASED CONCEPTS ARE...

the “lens” through which management can view the company to develop a valid economic model of the organization

BASIC “ACTIVITY-BASED” COST MODEL



UNDERSTANDING THE ORGANIZATION'S "COST ECONOMICS"

- Throughput or Direct Cost Support Activities
- Direct or Value-Adding Activities
- Event or Transaction Activities
- Market or Customer Support Activities
- Product or Product Line Support Activities
- General and Administrative Activities

THE COST MODEL IN PERFORMANCE MEASUREMENT & MANAGEMENT

- Support the development of an effective strategy
- Provide measurements that help guide an organization toward the execution of its strategy
- Provide feedback to determine how well the organization's strategy is being executed and whether that strategy or its measurements need to be modified

THE COST MODEL IN PERFORMANCE MEASUREMENT & MANAGEMENT

Forward Looking

- Support the development of an effective strategy
- Provide measurements that help guide an organization toward the execution of its strategy

Backward Looking

- Provide feedback to determine how well the organization's strategy is being executed and whether that strategy or its measurements need to be modified

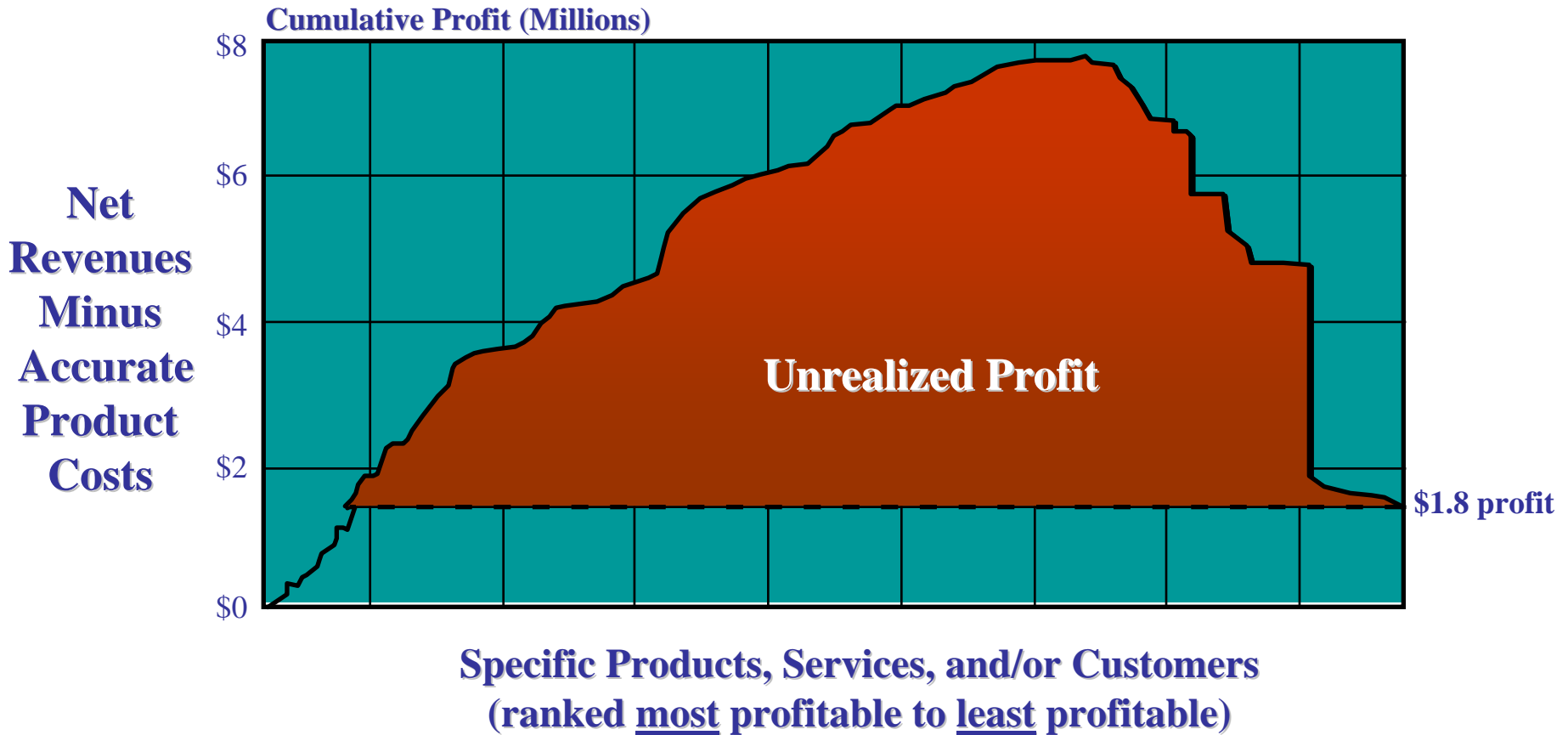
SUPPORTING DEVELOPMENT OF AN EFFECTIVE STRATEGY

The Importance of Knowing
Where the Profit Comes From

*How can a company develop an effective
strategy if it doesn't know its "profit zones?"*

TYPICAL PROFITABILITY ANALYSIS

The “Fishing Pole” Diagram



SUPPORTING DEVELOPMENT OF AN EFFECTIVE STRATEGY

The Ability to Accurately Project the Impact
of Alternative Company Strategies

PERFORMANCE MEASUREMENTS

PROVIDING MEASURES TO “GUIDE” THE ORGANIZATION

Identify the Organization’s Critical Success Factors (CSFs)

*The things a company must do well if it is to
satisfy customers and earn an acceptable
return for shareholders*

PROVIDING MEASURES TO “GUIDE” THE ORGANIZATION

Critical Success Factors (CSFs)

Market Related
Product/Service Related
Operations Related

CRITICAL SUCCESS FACTORS

- EXAMPLES -

- Continually upgrade or replace our product lines
- Attract new customers at a rate twice that of customer attrition
- Maintain an effective distribution system
- Use our leverage to reduce purchase costs
- Generate sufficient gross margins to fund product development and internal growth
- Keep working capital investment well below our industry average

KEY PERFORMANCE INDICATORS (KPI)

Measurable characteristics of products, services, processes, and operations of the company that can be used to track and improve performance

KEY PERFORMANCE INDICATORS (KPI)

- Must be consistent with organizations CSFs
- Measures both day-to-day performance and long-term trends
- Are consistent with the size, complexity, and structure of the organization
- Are directed at factors that make a difference
- Don't just monitor performance, but encourage improvement
- Are geared to real time feedback

FINANCIAL MEASURES

- EXAMPLES -

- EBITDA (Ugh!)
- Return on Equity or Assets
- Economic Value Added
- Value Added as a % of Value Adding Cost
- Profitability:
 - Gross Margins
 - Net Profit
- Ratios:
 - Current
 - Debt/Equity

“COST-BASED” PROCESS MEASURES

- EXAMPLES -

- Purchased Material Related costs
 - “Total Cost of Ownership (TCO)” per unit by category
- Direct/Value-Adding costs
 - Maintenance Cost per Machine/Cell/Line Hour
 - In-Process Movement/Storage Cost as a percent of value-adding cost
 - Quality cost as a percent of value-adding cost

“COST-BASED” PROCESS MEASURES

- EXAMPLES -

- Fulfillment costs:
 - As a percentage of product cost
 - Cost per line item picked
 - Cost per order processed
- Marketing costs:
 - Channel cost as a percentage of channel sales/margin
 - Individual channel support process cost per channel customer
 - Maintenance cost per customer

NON-COST-BASED PROCESS MEASURES

- EXAMPLES -

- Purchased Components measures:
 - Component SKU/Finished Product SKU ratio
- Direct Value-Adding measures:
 - Cell or Line Capacity Utilization
 - Value-Added per Employee

NON-COST-BASED PROCESS MEASURES

- EXAMPLES -

- Customer measures:
 - Average Order to Shipment Days
 - % On-Time Deliveries
 - Product Return Rate
- Employee measures:
 - Absenteeism
 - Employee turnover
 - Employee morale index (survey)

A BALANCED APPROACH TO MEASUREMENT

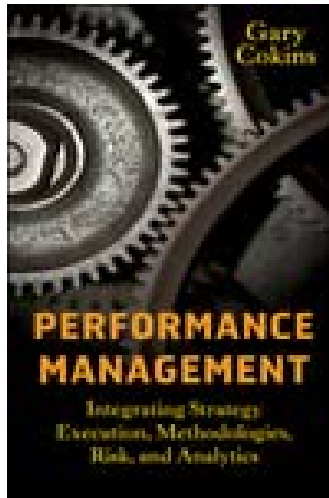
Use of multiple measures of economic success to prevent achieving objectives through dysfunctional methods

- Financial as well as Non-Financial
- External as well as Internal
 - Stakeholders, Customers
 - Business Processes, Potential
- Leading as well as Lagging
 - Performance Drivers
 - Outcome Measures
- Subjective as well as Objective
- Long-Term as well as Short-Term

PERFORMANCE MEASUREMENT AND MANAGEMENT

- LINK MEASUREMENTS TO STRATEGY
- MEASURE WHAT REALLY MATTERS
- KEEP IT SIMPLE
- DON'T LIMIT YOURSELF TO FINANCIAL MEASURES

RECOMMENDED READING



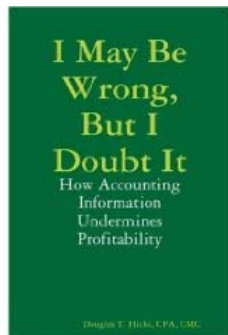
PERFORMANCE MANAGEMENT:
Integrating Strategy, Execution, Methodologies,
Risk and Analysis
By Gary Cokins

MANAGEMENT vs. LEADERSHIP

Management and leadership are not the same thing. Management copes with complexity, relying on budgets, plans, targets, and organizational charts. Managers tend to follow rules and are risk adverse. In contrast, leaders cope with change – change that is accelerating. Leadership requires vision, direction-setting, inspiring employees, and intelligent risk management.

Gary Cokins

Performance Management (2009)



I May Be Wrong, But I Doubt It: How Accounting Information Undermines Profitability

By Douglas T. Hicks, CPA, CMC

It may be effective in reporting historical results to outsiders, but relying on the information generated by a GAAP-based accounting system when making management decisions seriously undermines a company's ability to grow into a profitable future. The case is presented in Doug Hicks' new book *I May Be Wrong, But I Doubt It: How Accounting Information Undermines Profitability*

Included in the sixteen essays that comprise this book are arguments describing why:

- Profit as a percentage of sales is an incomplete and misleading measure of product or service profitability
- Depreciation is not only totally irrelevant for decision makers, it can be one of the most damaging concepts in accounting
- Evaluating management performance using financial accounting turns managers into “game players” whose actions are directed at generating the best short-term scores at the expense of long-term success
- Popular solutions to today's cost information problems (ABC/M, Lean Accounting, GPK, Resource-Driven Accounting, etc.) are so narrowly focused as to be irrelevant for a majority of decision makers
- The phrase “Management Accountant” might qualify as an oxymoron and true management accountants may be as rare a Boston Red Sox fan living in New York
- Traditional accounting has trouble distinguishing among a cost, an investment, and a profit
- The discipline of accounting is so focused on arbitrary rules and regulations that accountants may be incapable recognizing economic reality when they see it
- The best solution may be to relieve accountants of their duties as providers of decision support information and assign those duties to individuals whose thought processes have not been tainted with GAAP.

Does your company's accounting information guide or misguide management? Does it promote or undermine your company's profitability? Does it result in management making decisions based on fiction instead of on reality? Find out how your company stacks up by reading *I May Be Wrong, But I Doubt It: How Accounting Information Undermines Profitability*.

You can purchase a copy at www.lulu.com/content/5145295 or by visiting www.amazon.com.

PERFORMANCE MEASUREMENT & MANAGEMENT

Questions?

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