

Cost and Performance Management: Driving EVA / Value Based Management with Performance Architecture

Presented by

Focused Management Inc.

Facilitating Performance Improvement Through
Better Use Of Information And The Application
Of Decision Support Tools



3/3/2002



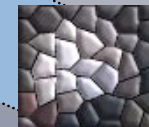
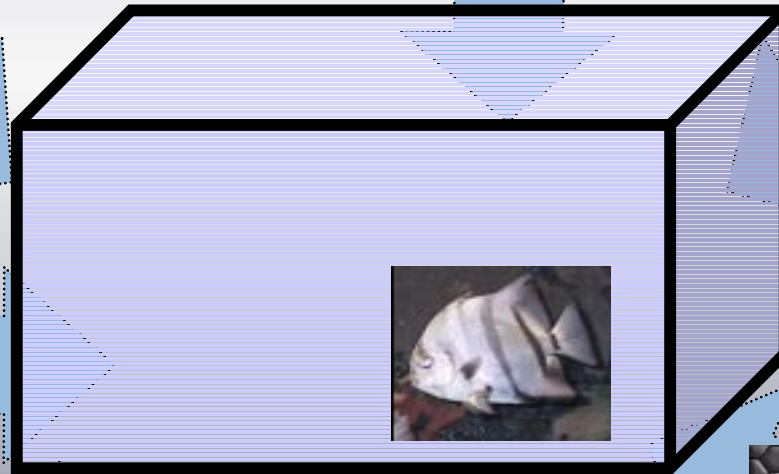
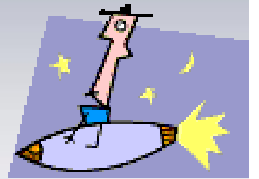
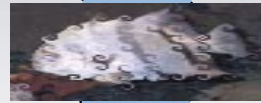
At Issue

- Every organization needs to measure and manage performance to satisfy the demands of stakeholders
- Today's measurement and management methods are much better than in the past but need to be connected together
- The speed of change and information age computing and communications leave little margin for errors
- Decision making needs facts

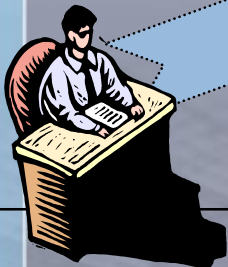
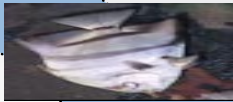


The Fish Tank Syndrome

If each person described what they saw, would it be the same description?



Perspectives vary!
– Which is correct?





Implications of The Fish Tank Syndrome

- We need a variety of perspectives from which to obtain a balanced, disciplined and dynamic view of our businesses
- We need to develop a common / agreed understanding of the business and all of its characteristics
- We need a constantly available set of reference points to which we can return
- We need a living repository where we locate and maintain knowledge





Result – What Is At Stake

- Inappropriate measurement systems can be costly experiments
 - Sobeys' \$50m ERP write off
 - Boeing's production problems in the late 1990's
 - Malcolm Baldrige winner, Wallace Co' bankrupt
- Fortune 500 companies will face a \$31.5 Billion knowledge deficit next year
- By how much can profit be increased by changing your product/market mix to focus on your most profitable products



Performance Architecture

- A combination of a business logic methodology, relevant software and systems capability. The links between the tools are as important as the tools themselves.



Value Based Management: Performance Architecture

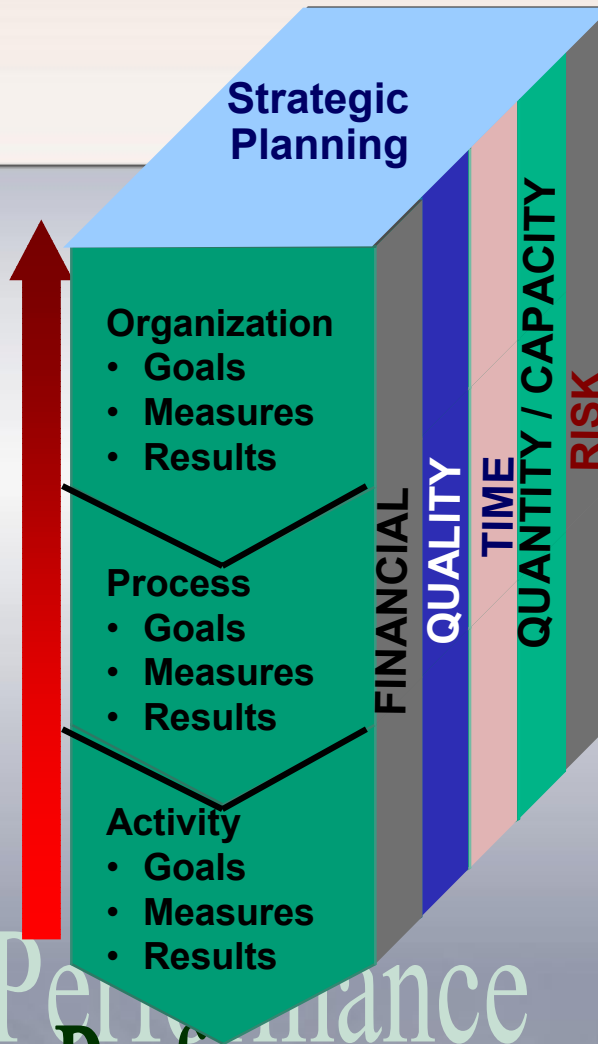


Change Leadership

Stakeholder Need/Values Analysis

Process Improvement and Management

Human Performance / Roles & Responsibility



Performance Measurement "BSC"

Organization Design and Compensation

Best Practices

Activity Based Costing / Budgeting

Performance Performance

Systems Facilitated

➤ = Analytic Methodology





Understand the Organization



Value-Based Management

- “VBM is a holistic management approach that encompasses redefined goals, redesigned organizational structures and systems, rejuvenated strategic and operational processes, and even revamped human resources practices”.
- “This holistic practice of VBM is in sharp contrast to the finance-driven appearance that VBM has taken on in the past ...”

INSEAD Working Paper, Are you (Really) Managing for Value?





Value Creation is an Operational Issue!

- Creating shareholder value requires intense focus on:
 - Delivering benefits to customer in most efficient way
 - Hiring/retaining motivated workforce
 - Maintaining excellent supplier relationships
 - Good citizen in local communities

Linked to Seven Value Drivers:

- ❖ Sales growth rate
- ❖ Operating profit margin
- ❖ Cash income tax rate
- ❖ Working capital
- ❖ Fixed capital
- ❖ Cost of capital - (WACC)
- ❖ Growth duration period



Processes are where the work is done

“If you can’t describe what you are doing as a process, you don’t know what you are doing.”

W. Edward Deming

- Process’s are connected to the appropriate knowledge and learning elements. All focused on the successful performance of a single task.
- Processes link organization goals and measures to human performance and activities.

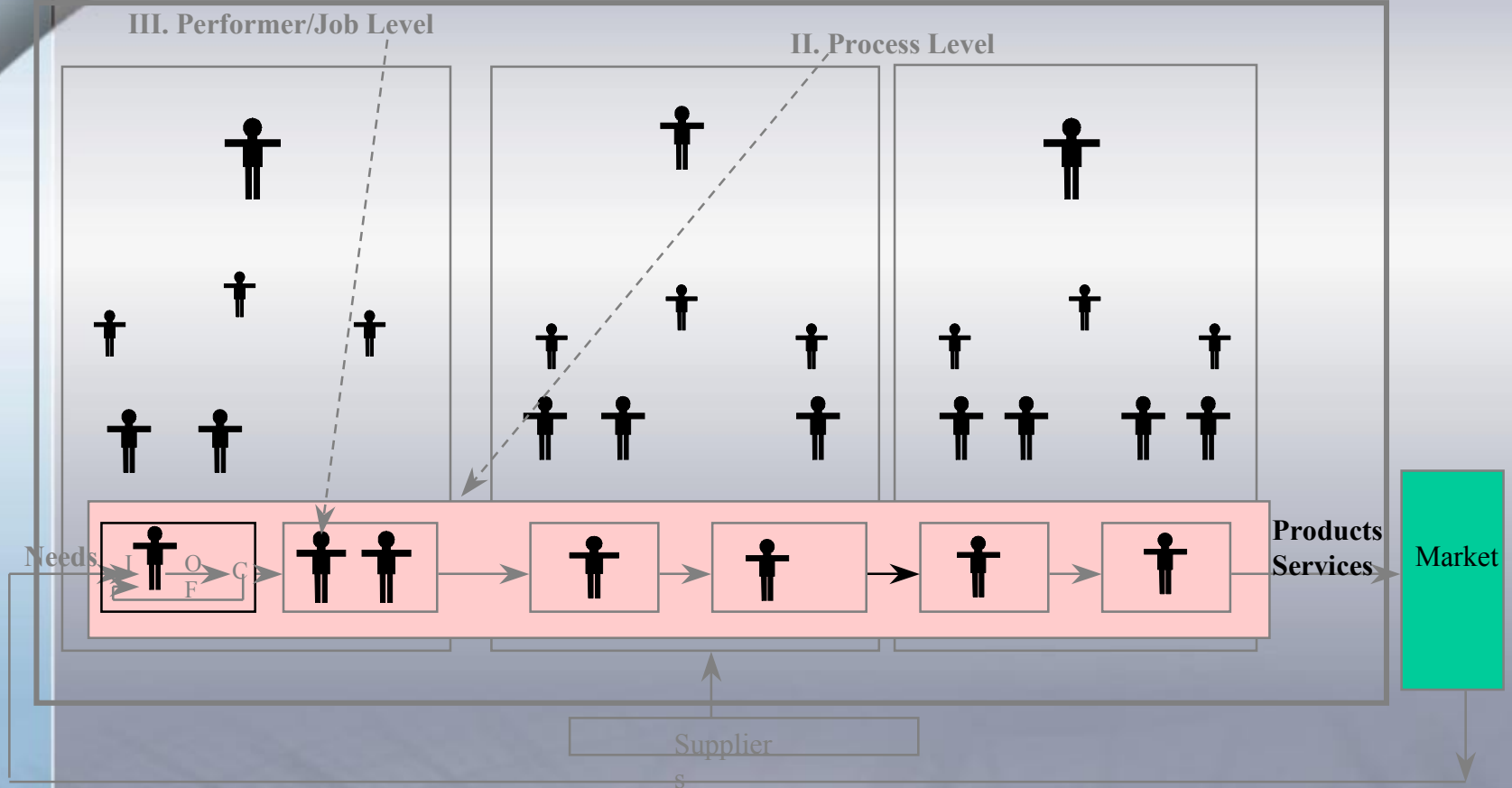




How We Organize Ourselves

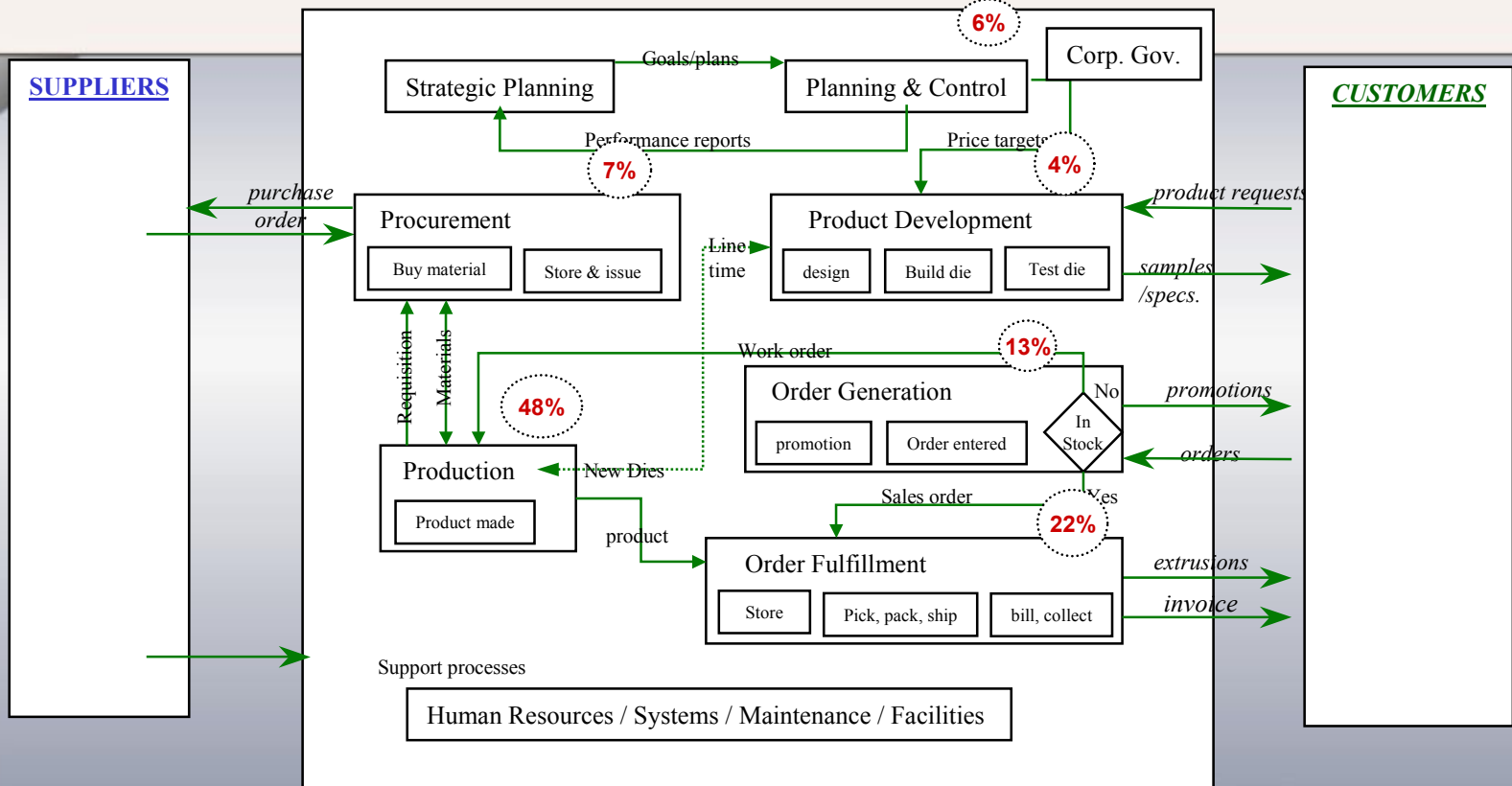
The Three Levels of Performance

I. Organization Level





Organization Work is Performed by Systems of Processes

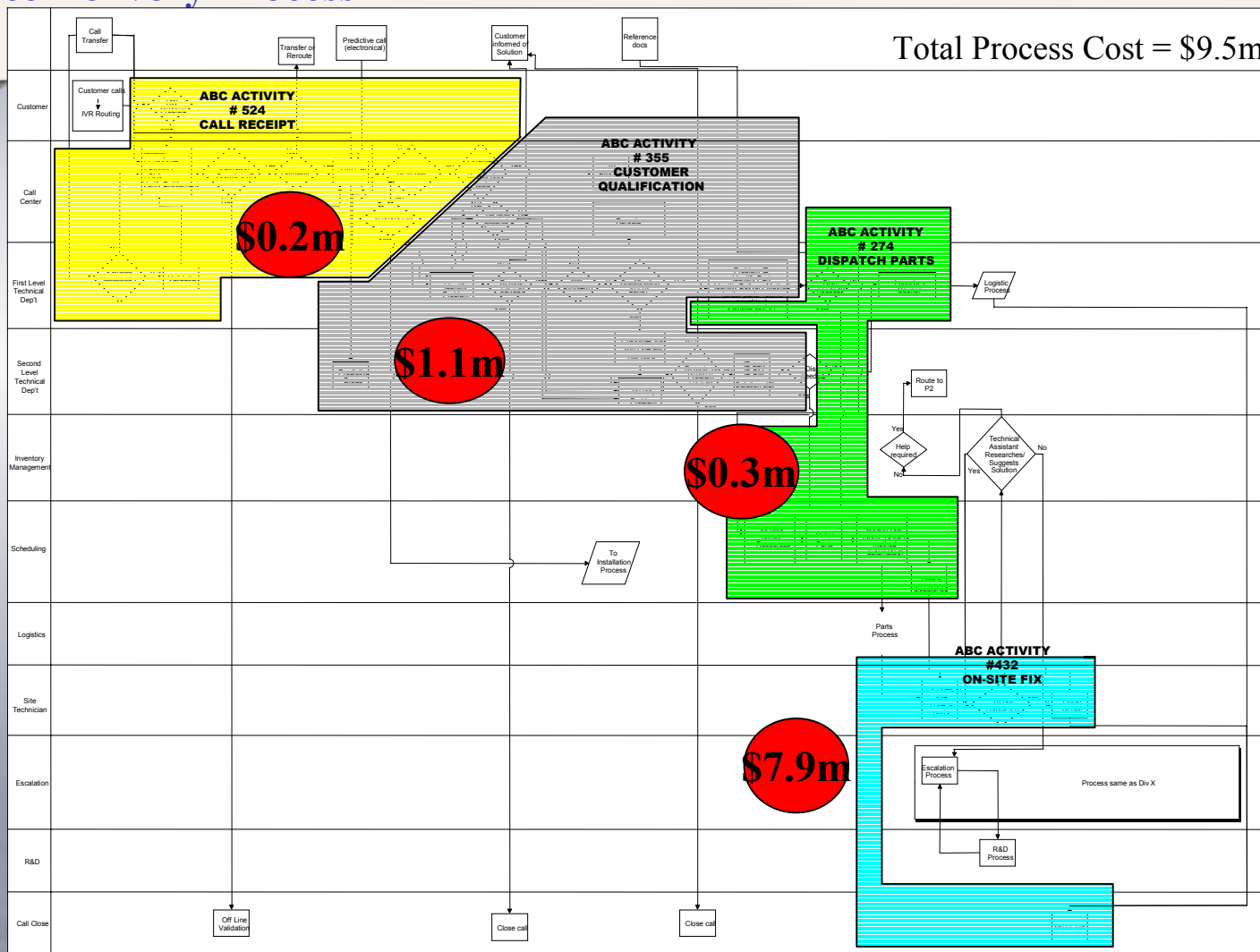


Alignment of jobs, activities and processes with total organization goals is critical to the success of the organization. Shared service organizations are an integral component.



ABC & Process Analysis: Thoughtful Interaction

Service Delivery Process





Costed Process

Process:

Order Fulfillment Process:

TOTAL COST

\$4,437,716

Activities In Process:

Approve credits

Driver

Credits

Cost

170,123

Collecting accounts

Orders

499,689

Freight delivery cost

Orders

167,546

Enter credit notes

Credits

154,539

Enter customer orders

Orders

661,389

Freight pallet miles cost

Pallet X Miles

1,035,546

Pick loose cases

Loose Cases

843,869

Picking pallets

Pallets

305,769

Pay promotional claims

Claims

395,342

Shipping paperwork

Orders

203,903



Best Practice Analysis Unit Cost Comparison

Activity	Pharmacy				
	Iowa	Los Angeles	New York	Tempe	Michigan
Receive orders	0.09	0.15	0.16	0.06	0.06
Order set-up	0.83	0.59	1.22	0.84	0.71
Checking RXs	0.68	0.60	0.59	0.24	0.76
File hard copy RXs & scan	0.07	0.10	0.16	0.12	0.25
Process inventory	0.07	0.04	0.07	0.03	0.21
Bag & ship orders	12.06	7.72	8.45	6.90	7.47





Product / Customer ABC Profit

Product / Market Matrix

Market segments

PharmaCo		Retail		Wholesale	Professional		Commercial		\$ thousands	
		BuYers Retail	All Other Retail	Wholesale	Hospital	Clinics	Export	Other		Totals
P r o d u c t s	Adult Analgesia	4,814 1,464 30%	32,901 16,335 50%	18,363 8,572 47%					56,077 26,371 47%	
	Children's Analgesia	1,510 258 17%	10,121 3,678 36%	5,594 1,867 33%					17,226 5,804 34%	
	Cough Relief	303 (166) -55%	1,614 (566) -35%	997 (382) -38%					2,914 (1,114) -38%	
	Cold Medicine	696 29 4%	4,524 1,091 24%	2,581 539 21%					7,801 1,658 21%	
	Allergy Relief	728 107 15%	4,941 1,666 34%	2,907 893 31%					8,577 2,666 31%	
	Total									
	Revenue	8,051	54,102	30,441	-	-	-	-	92,594	
	Margin	1,692	22,204	11,490	-	-	-	-	35,385	
	% Margin	21%	41%	38%					38%	

How to read this chart. Each cell contains...

* Note: Costs do not include \$6.6 M in Business Sustaining Costs

1. ABC results

Sales Revenue	←→	\$k
Contribution Margin	←→	\$k
Margin % sales	←→	...%

2. Sales & Marketing strategy / expectations

declining sales	stable volume	growth opportunity
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VBM Product / Customer Economic Profit

Economic Profit

EP = Margin - Capital Employed x WACC**

** Weighted Average Cost of Capital **12.2%**

Market segments

PharmaCo

	Retail		Wholesale	Professional		Totals	
	BuYers Retail	All Other Retail	Wholesale	Hospital	Clinics		
P	Adult	3,536	25,986	12,922		42,444	
	Analgesia	431	3,170	1,577		5,178	
		\$ 447	\$ 6,631	\$ 3,567		\$ 10,644	
r	Children's	1,136	9,160	4,497		14,793	
	Analgesia	139	1,118	549		1,805	
		\$ 16	\$ 1,089	\$ 572		\$ 1,677	
o	Cough	331	1,344	795		2,470	
	Relief	40	164	97		301	
		\$ (140)	\$ (504)	\$ (326)		\$ (969)	
d	Cold	676	4,942	2,568		8,186	
	Medicine	83	603	313		999	
		\$ (65)	\$ 52	\$ 10		\$ (4)	
u	Allergy	712	4,580	2,491		7,783	
	Relief	87	559	304		950	
		\$ (23)	\$ 441	\$ 232		\$ 650	
c	TOTAL:						
	Capital Employed	6,391	46,013	23,273	-	-	75,676
	Cost of Capital	780	5,614	2,839			9,232
S	Economic Profit	235	7,709	4,055			11,999

Capital employed is determined by careful analysis of key capital items & drivers including Accounts Receivable (revenues & DSO); Inventories (Cost of Sales & Inventory turns); and Fixed Assets (Dedicated Assets and/or Machine hours).

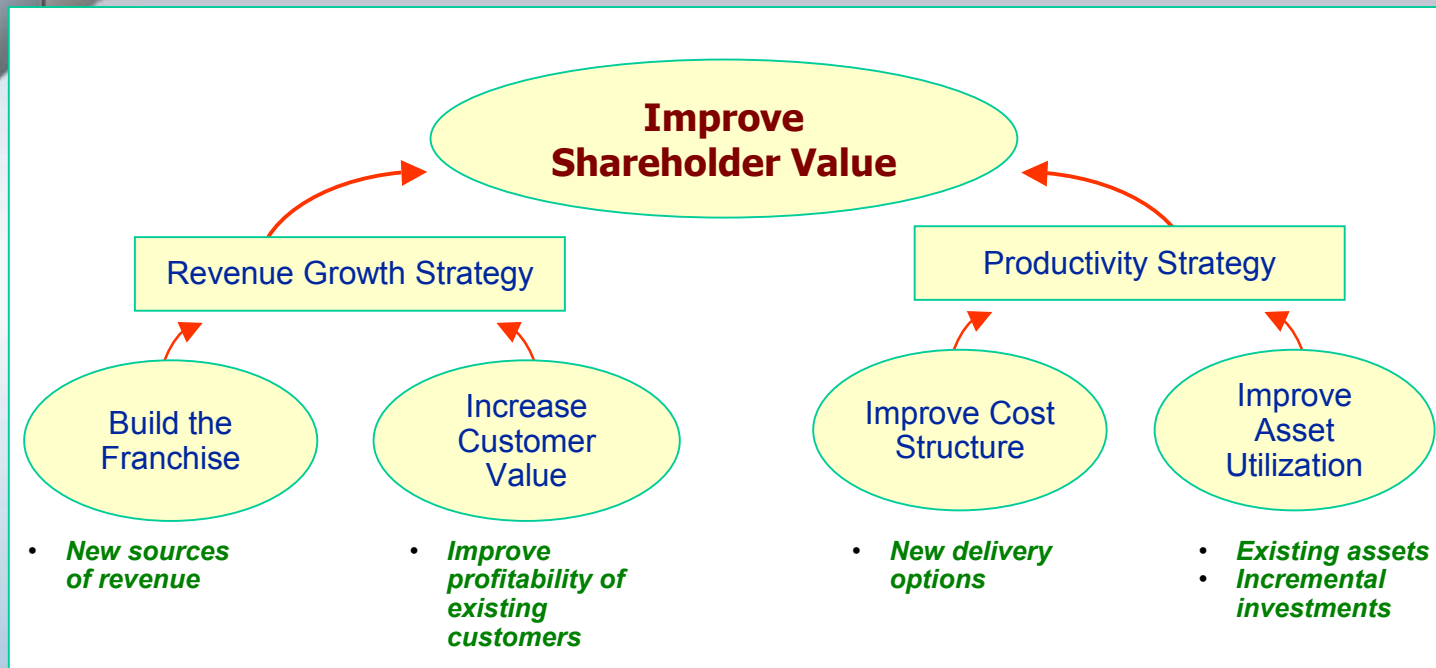
Cost of Capital = Capital Employed x WACC (12.2% in this firm)

Economic Profit = NOPAT (segmented - see chart xx) - Cost of Capital





Strategy Is Balancing Contradictory Forces



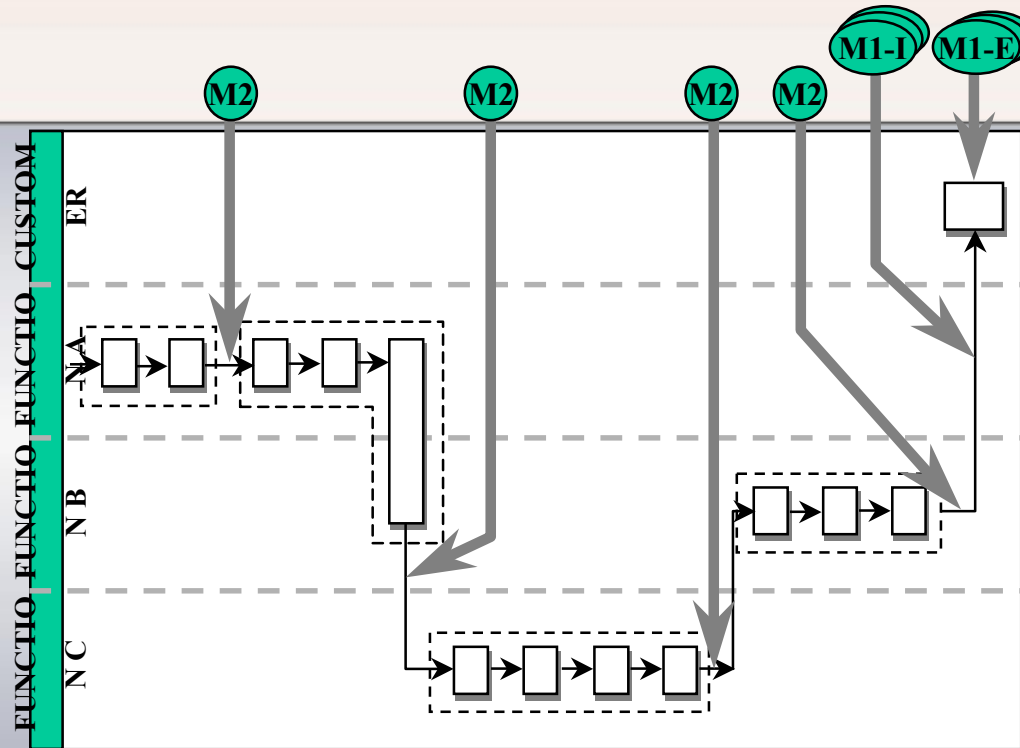
Long Term vs Short Term

Growth vs Profitability





Key Process Measures



- M1-E** External/Customer
- M1-I** Measures
- M2** Internal/Business Measures
- Subprocess Measures

- Measures can be limited to M1 (end of process) and M2 (sub-process) measures
- M1-E (External) measures should be derived from goals





Process Measures Worksheet

Material Acquisition Process Total Process Measures

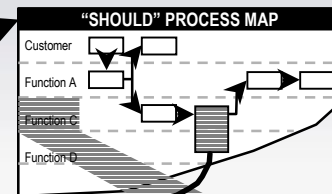
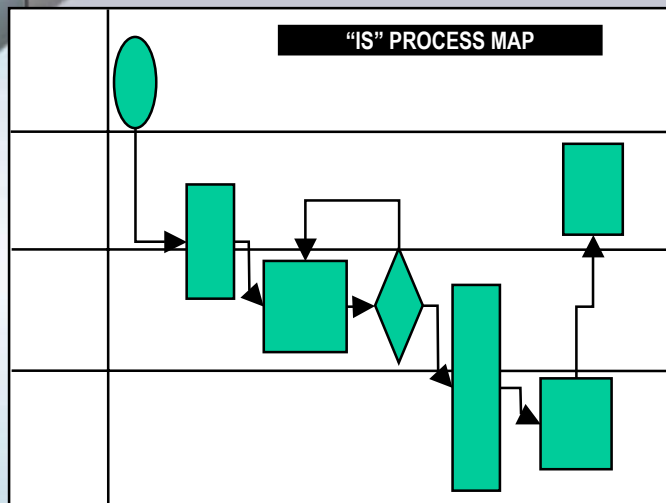
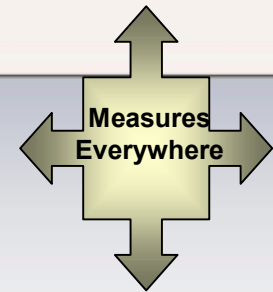
Perspectives of Measurement

Process Output	Dimension	Measure	Current Performance	Bench- marks	Short Term Goal	Long Term Goal	Actions to be taken
<u>Distribute to Production</u>	Time	1. # of Hrs. from order to production	5 days	6 hours	3 days	2 hrs.	Appoint a process owner
		2. # of days of backlog	14 days	1 day	10 days	0 days	Move to a "pull system"
	Quality	1. Material available when needed	80%	90%	85%	100%	Develop long term relationship suppliers
		2. # of material shortages	90%	100%	90%	100%	see above
		3. % of material issues which meet job specs	85%	100%	87%	100%	Better communication
	Cost	1. Total process cost	\$150,000	\$60,000	\$140,000	\$200,000	Appoint a process owner
		2. Cost per transaction	\$85	\$75	\$63	\$40	Improve work flow
		3. Inventory cost /month	\$4.0 m	\$3.8m	\$3.5 m	\$1.0 m	Install point of use inventory
	Quantity	1. # of items moved/ employee	400	900	600	1,000	Automation
		2. # of stock outs	50	0	50	0	Better supplier relations
		3. % of time machines are idle due to material shortages	15%	0%	10%	0%	Improve EDI, batch processing





Linking Process to Job

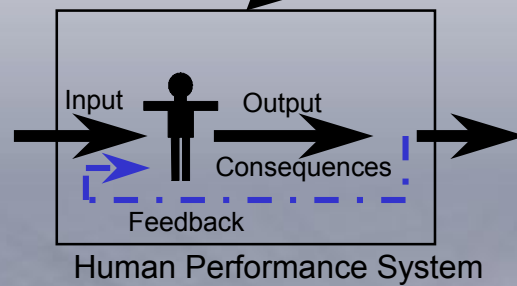


CROSS-FUNCTIONAL ROLE/RESPONSIBILITY MATRIX

"Should" Macro Steps	Functions and Outputs			
	Function A	Function B	Function C	Function D

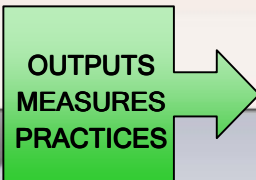
FUNCTIONAL ROLE/RESPONSIBILITY MATRIX

"Should" Process Steps	Function B Outputs	Jobs and Outputs			
		Job 1	Job 2	Job 3	Job 4

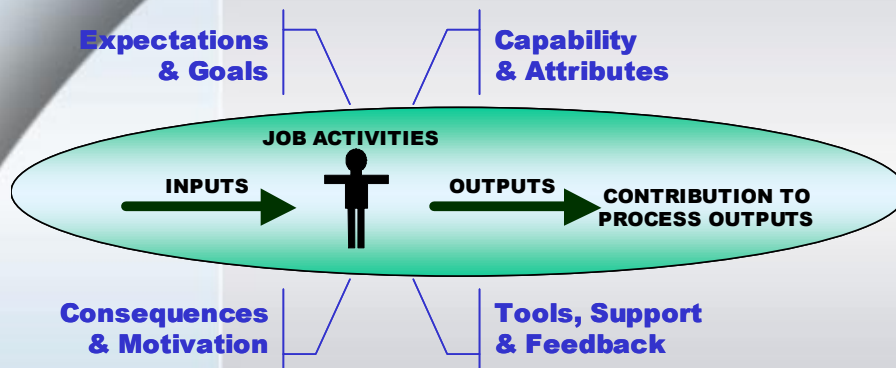




How do people improve performance?



Focuses people on those **critical ingredients** they need to know in order to excel.



It is not necessary to describe everything people need. Focus on the conditions necessary for them to **EXCEL** at producing job outputs.

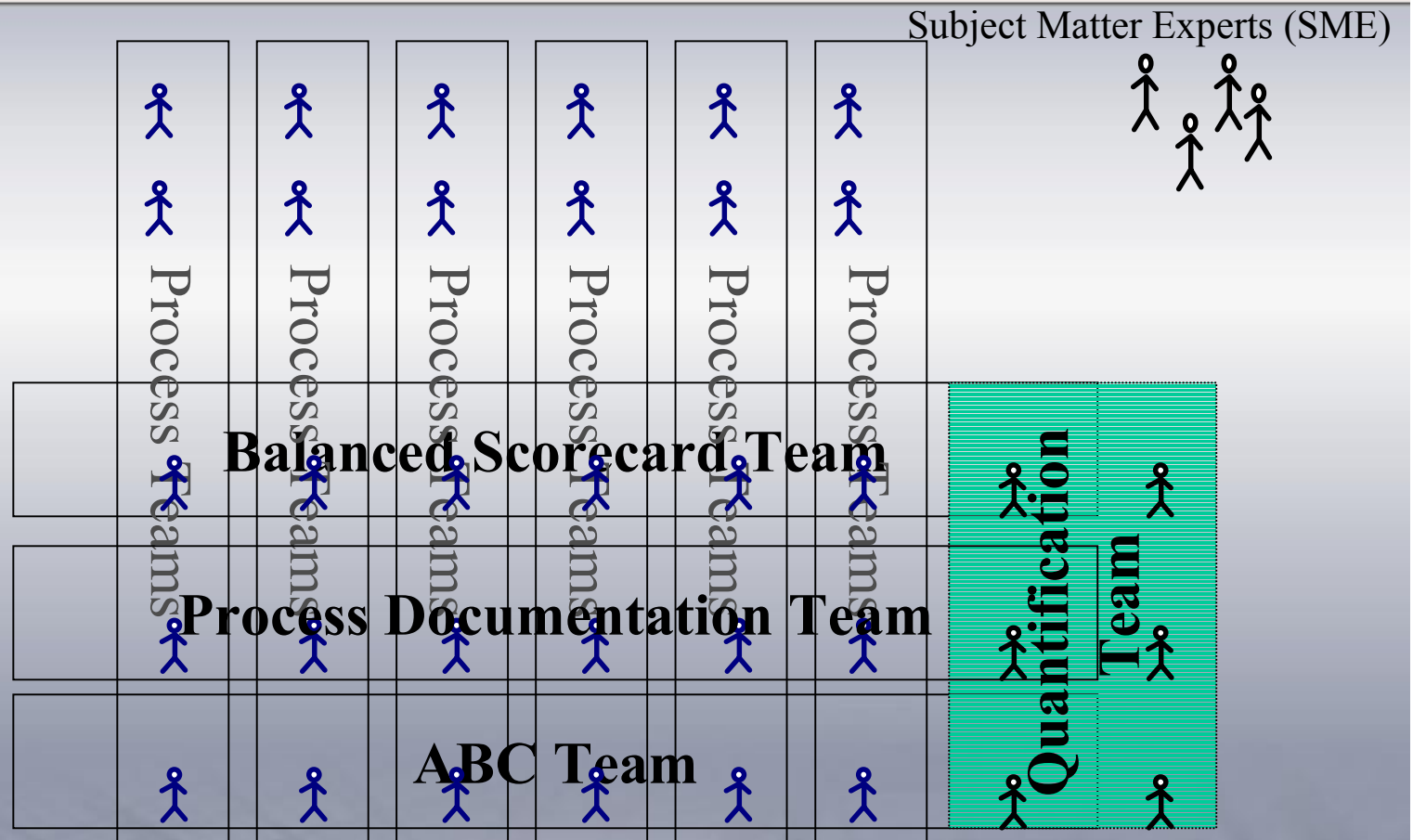
A Performance Contract is a **TOOL** people can use to:

- measure & improve their performance,
- manage their information needs and interfaces
- contract with their leader, and
- seek feedback from others.





Logical Relationship Between Teams

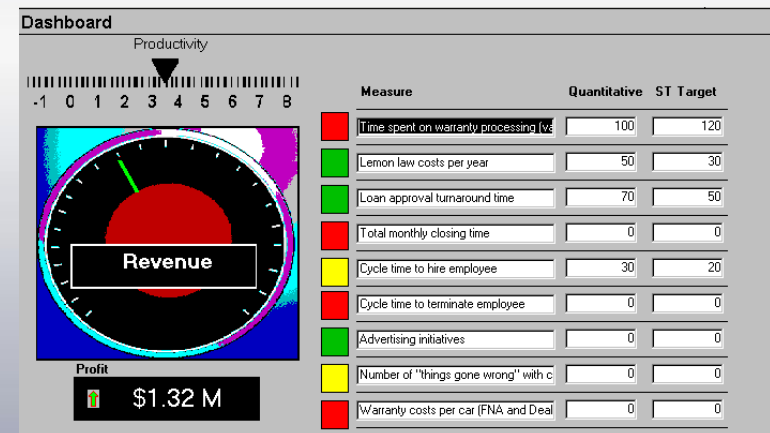




Measures Software to Influence Human Behavior

- Distribution of consistent and appropriate measurement information to everyone in the organization is fundamental to execution of A/VBM
- Use of computer technologies - data warehouse, OLAP and presentation layer software provide the “media” of distribution
- It is the media that facilitates organization change. The marriage of management philosophy with technology and the imperative to create value
- The media is represented by the presentation of current measures and performance information on computer screens to all accountable parties
- The suite of tools includes software to perform simulation modeling of processes and economic performance

Sample Measurement Scorecard / Dashboard





Driving Performance in Organization

- Determine stakeholder needs
- Develop organization strategy
- Analyze activities, processes and measures
- Determine costs, current performance and benchmark
- Establish performance standards
- Establish goals / budgets & action plans
- Deploy measures and knowledge repository systems

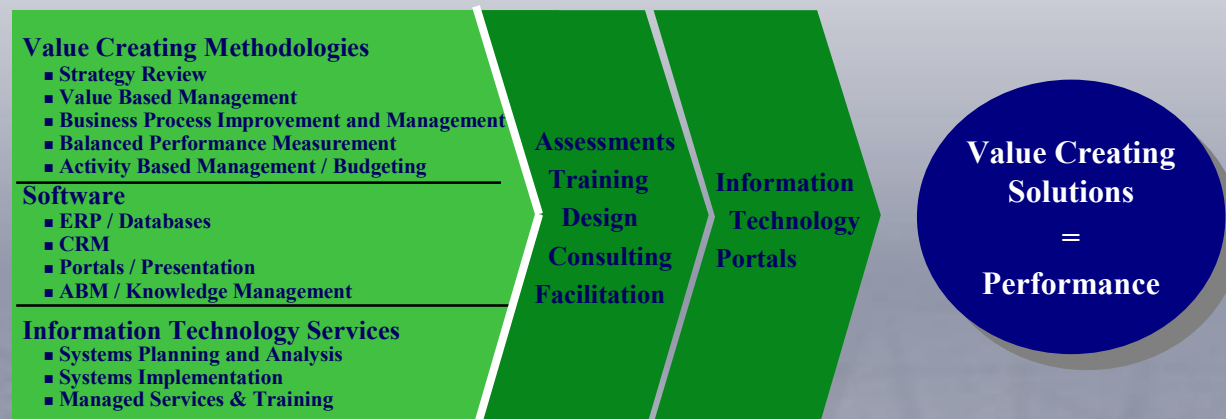




Focused Management Inc.

- At Focused Management Inc. we are devoted to creating value for our clients by working with their staff to transfer skills and knowledge through the implementation of highly respected and proven performance management methodologies and software solutions.
- Our market led, technology focus enables us to provide responsive, comprehensive solutions that link strategy with practical results.
- Our seasoned team of professionals will address strategy, operations, risk, and technology issues in designing and facilitating end-to-end solutions that are specific to a client's situation and business needs.
- We have professional staff and affiliates around the world who provide strategic, operations improvement and systems integration consulting to organizations in all segments.

Seasoned professionals, powerful software working with your people to achieve business objectives





...Partial List of Clients

• **Financial Services**

- Citibank - NY & Brazil
- Banco Wiese Sudameris
- Toyota Motor Credit Corp.
- Canada Trust
- Zurich Insurance
- Sun Life Insurance
- TD Bank
- Fidelity Investments

Government Services

- Canadian Navy
- City of Burlington
- City of San Diego
- Region of Halton
- Canadian Coast Guard
- City of Kitchener
- Alberta Environmental Protection

Consumer Products / Distribution

- ESI/Value Rx
- Kellogg's
- Hewlett Packard
- McNeil Consumer Products

Manufacturing

- LOF Pilkington
- Volkswagen Canada
- DuPont
- Procor

Network Services

- CP Rail
- Telus
- AT&T
- MCI WorldCom
- Ontario Hydro
- Rogers Cable



Paul A. Sharman, ACMA

- Paul Sharman is President of *Focused Management Inc.*, a company established in 1988 to help manufacturing and service organizations to implement new cost management techniques. Paul has extensive experience in industrial financial management, most recently as controller in Northern Telecom. He is a specialist in the field of Activity Based Management, Activity Based Costing and aligned Performance Measurement. Integrating these tools into forecasting tools and the management decision-making and control process is an important aspect of Paul's work. As a consultant, his primary goal is to transfer technology and capability to his clients as rapidly as possible using training and facilitation techniques. Implementation may involve the use of software tools, when appropriate.
- Paul is well known as Performance Measurement and Management consultant, Paul has facilitated the implementation of ABC, Performance Measurement Systems Process and Organization design on behalf of many organizations including, Dupont, Hewlett Packard, L.A. Gear, AT&T, US Army, Canadian Department of Defense, Sun Life Insurance, ESI, Toyota Motor Credit Corporation, MCI Worldcom. Ect. In Peru has worked with Banco Wiese, ETECEN and E. Wong. Paul has trained thousands of people around the world in many seminars, in association with the Institute for International Research, York University and the Institute of Management Accountants, Canadian Productivity Network as well as numerous in-house sessions for his clients.
- He is involved with benchmarked performance measurement with the American Productivity and Quality Center. He is well known as a conference speaker on Strategic Cost Management and Activity Based Management/Costing in the U.S. and Canada. He has written many articles and is author of significant sections of the Hand Book of Cost Management and the Handbook of Cost Management for Service Industries.



For Additional Information :
www.focusedmanagement.com

Emi@focusedmanagement.com