

Small Business Enterprise

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Lesson 3: Comparative Measures of
Performance

Key Topics

- Measures of performance
- Importance of performance measures
- Performance measure framework
- Six Sigma

Performance Measurement

- A fundamental building block of TQM and a total quality organisation.
- Historically, organisations measured performance through the financial performance
 - success by profit
 - failure through liquidation.

Performance Measurement

- Traditional performance measures, based on cost accounting information, provide little to support organisations on their quality journey
 - they do not map process performance and improvements seen by the customer
- Performance should be measured by the improvements seen by the customer as well as the results delivered to other stakeholders

Performance Measures

- "We want to change the competitive landscape by being not just better than our competitors, but by taking quality to a whole new level" Jack Welch
- Performance measures should aim at the long-term and should be forward-thinking initiative designed to fundamentally change the way corporations do business. It is not a post-mortem of what happened but a step towards how we do better in the future.

Why measure performance?

- In the cycle of never-ending improvement, performance measurement plays an important role in:
 - Identifying and tracking progress against organisational goals
 - Identifying opportunities for improvement
 - Comparing performance against both internal and external standards
- Reviewing the performance of an organisation is also an important step when formulating the direction of the strategic activities.
 - It is important to know where the strengths and weaknesses of the organisation lie, and as part of the 'Plan –Do – Check – Act' cycle, measurement plays a key role in quality and productivity improvement activities.

Why measure performance?

- The main reasons it is needed are:
 - To ensure customer requirements have been met
 - To be able to set sensible objectives and comply with them
 - To provide standards for establishing comparisons
 - To provide visibility and a “scoreboard” for people to monitor their own performance level
 - To highlight quality problems and determine areas for priority attention
 - To provide feedback for driving the improvement effort
- It is also important to understand the impact of TQM on improvements in business performance, on sustaining current performance and reducing any possible decline in performance.

The value concept - Results control

- The performance measurement concept indicates that employees can increase the value of the firm by
 - Increasing the size of a firm's future cash flows,
 - By accelerating the receipt of those cash flows, or
 - By making them more certain or less risky.

If you are a CEO or CFO, how would you increase the cash flows?

Measure the right things

- An ideal performance management system is one that energizes the people in an organization to focus effort on improving things that really matter –
- One that gives people the information and freedom that they need to realize their potential within their own roles and that aligns their contribution with the success of the enterprise.

Then, why do performance measures fail?

- Root cause: complexity - details, details, details
- Staff who collect data get frustrated.
- Follow: "What has to be done" (WHTBD).

Measure What Matters

- Easy to say but difficult to do.
- Find out what is valued both by customers and stakeholders
 - Examples:
 - process: new product development, measure: time to market.
 - process: customer service, measure: customer retention.
 - process: treasury management, measure: cost of service vs. value created.

Keep it simple

- Performance Measures must be
 - simple to operate
 - simple to understand
 - simple to action
- Example:
 - If a sales person spends too much time on call reporting, they have less time for making calls.

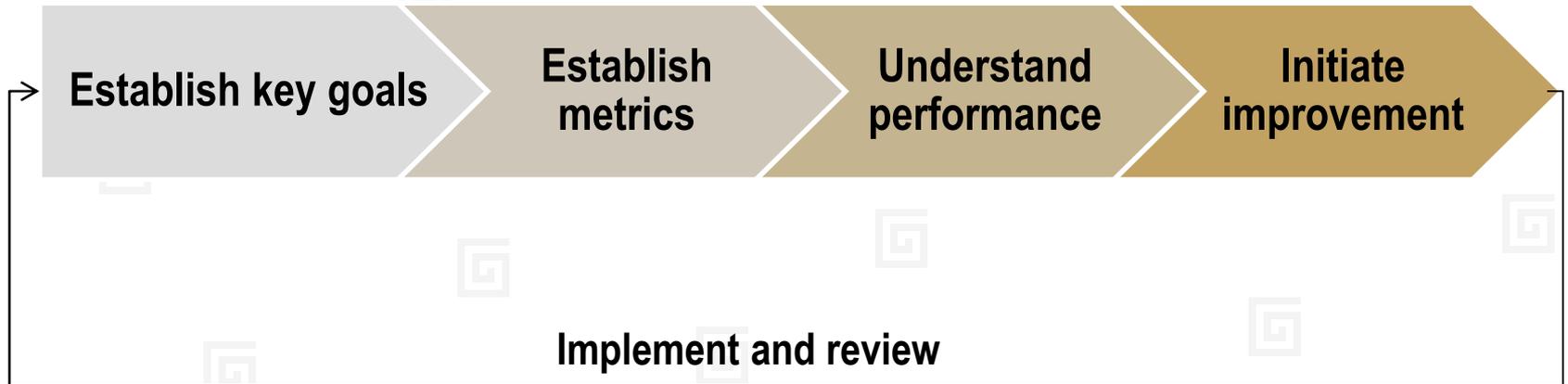
Performance Measurement Framework

- A good performance measurement framework will focus on the customer and measure the right things.
- Performance measures must be:
 - Meaningful, unambiguous and widely understood
 - Owned and managed by the teams within the organisation
 - Based on a high level of data integrity
 - Such that data collection is embedded within the normal procedures
 - Able to drive improvement
 - Linked to critical goals and key drivers of the organisation

Performance Measurement Framework

- There are four key steps in a performance measurement framework
 - the strategic objectives of the organisation are converted into desired standards of performance,
 - metrics are developed to compare the desired performance with the actual achieved standards,
 - gaps are identified, and
 - improvement actions initiated.
- These steps are continuously implemented and reviewed:

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Performance Measurement Framework

- Step 1: Focus on a few key goals that are critical to the success of the organisation or business, and ensure they are SMART:
 - **Specific**
 - **Measurable**
 - **Achievable**
 - **Relevant**
 - **Timely**

Performance Measurement Framework

- Step 2: Define the **outcome metrics** - what has to be measured to determine if these goals are being achieved.
 - If it is difficult to define outcome metrics for a particular goal, it is possible that the goal is either not “SMART” or critical to the success of the business.
 - For each outcome metric, brainstorm candidate **drivers** by answering the question, “*What measurable factors influence this outcome?*” Once the list is complete, select those with greatest impact, and these, the most important drivers, should have **driver metrics**, and be put in place first.
 - Driver metrics at one level will be outcome metrics at the next level down.

Performance Measurement Framework

- An organisation needs to evolve its own set of metrics, using any existing metrics as a starting point in understanding current performance. To ensure they trigger the improvement cycle, they should be in three main areas:
 - **Effectiveness**
 - **Efficiency**
 - **Productivity**

Performance Measurement Framework

- **Effectiveness = $\frac{\text{Actual output} \times 100\%}{\text{Expected output}}$**

This is about the process output, and doing what you said you would do. The effectiveness metrics should reflect whether the desired results are being achieved, the right things being accomplished. Metrics could include quality, e.g., grade of product or level of service, quantity, e.g., tonnes, timeliness, e.g., speed of response, and cost/price, e.g., unit cost.

- **Efficiency = $\frac{\text{Resource actually used} \times 100\%}{\text{Resources planned to be used}}$**

This is about the process input, e.g., labour, staff, equipment, materials, and measures the performance of the process system management. It is possible to use resources efficiently, but ineffectively.

Performance Measurement Framework

- **Productivity = $\frac{\text{Outputs}}{\text{Inputs}}$**

which can be quoted as:

Expected productivity =

$$\frac{\text{Expected output}}{\text{Resources expected to be consumed}}$$

or

Actual productivity =

$$\frac{\text{Actual output}}{\text{Resources actually consumed}}$$

Simple ratios, e.g., *tonnes per person-hour, computer output per operator day*, are used.

Performance Measurement Framework

- Step 3: design a data collection/reporting process using the following steps:
 - Set up a system for collecting and reporting data
 - Write clear definitions
 - Agree method for establishing current performance (if not already determined)
 - List resources required to support the design
 - Agree data formats and classifications for aggregation and consolidation
 - Identify possible sources of benchmark data
 - Set reporting calendar
 - Establish roles and responsibilities
 - Detail training requirements
 - Validate with process stakeholders

Performance Measurement Framework

- Measure the gap between current and desired performance.
- Collect data for existing metrics and new metrics.
- Identify the current performance
 - The target level of performance for the medium- and long-term must be decided.
 - These performance levels must be achievable, and should be broken down into targets for discrete short-term intervals, e.g, the next three quarters.
- Once the plan with timescales and designated responsibilities has been implemented and data collected, set new baselines, make comparisons and set new standards/targets.
- The metrics, targets and improvement activities must be cascaded down through the organisation, involving people and teamwork in the development of new metrics, data collection and improvement activities.

Performance Measurement Framework

- Initiate improvement by examining the gaps between current and target performance of the driver metrics at each level.
 - A minimum, achievable set of actions is determined, with plans, assigned responsibilities and owners.
- The critical elements of a good performance measurement activity are very similar to those required for a total quality improvement activity:
 - Leadership and commitment
 - Good planning and a sound implementation strategy
 - Appropriate employee involvement
 - Simple measurement and evaluation
 - Control and improvement

The Changing Business Environment

- Are historical accounting measures adequate for today's business environment that transcend global boundaries?

Performance Measurements for the new era

- In the global, technology-driven, decentralized environment, measuring financial performance, while important, is not adequate.
- Even if less than precise, other measures of performance are required.
- These measures should be capable of measuring multiple attributes of an organization.

Comprehensive Performance Measures must address

1. Financial performance
2. Customer satisfaction
3. Internal business process developments and
4. Allow an organization to learn and grow.

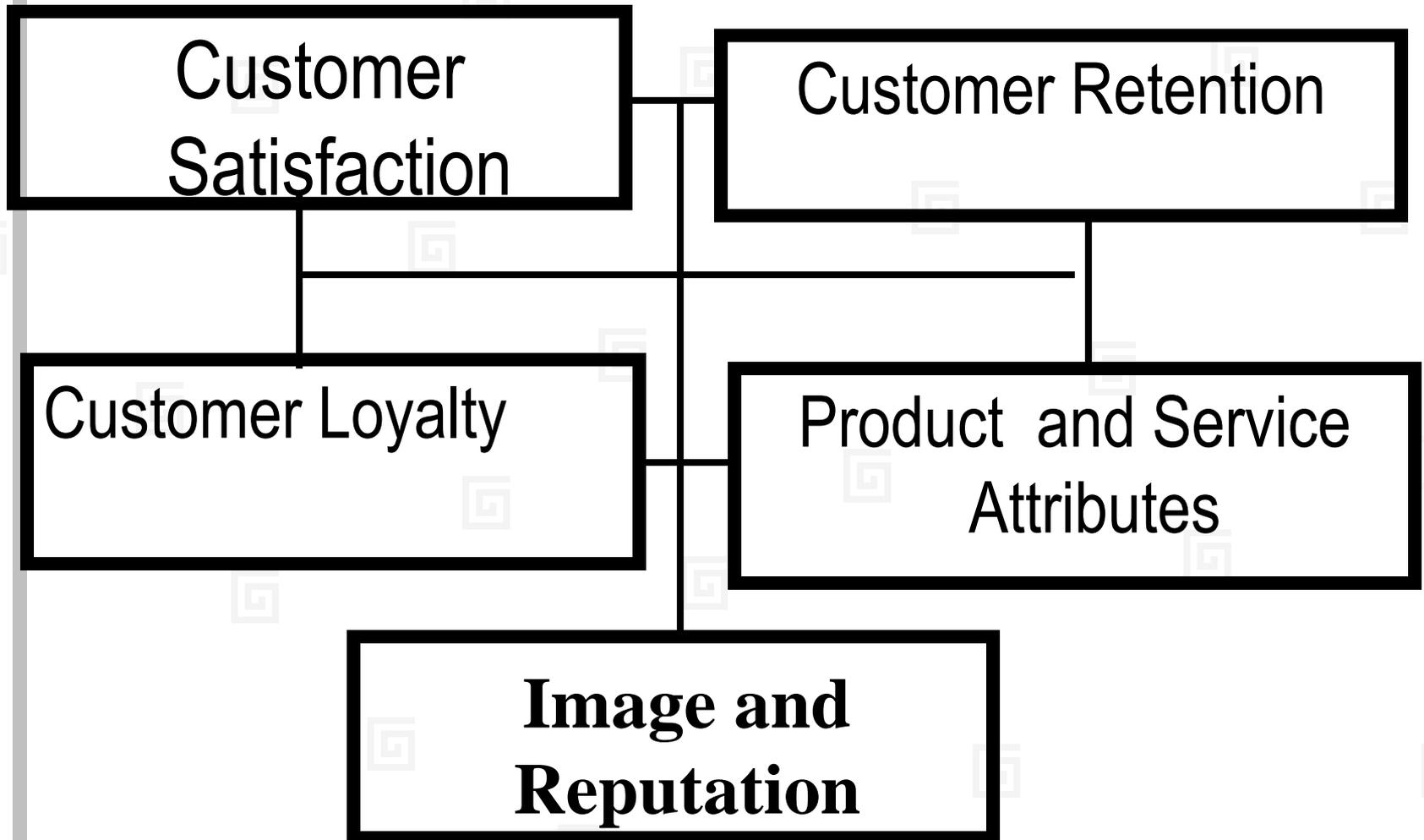
Financial Performance can be measured by

- ROA ROE, EPS etc. These measure are essential to summarize the economic consequences of strategy.

Customer-related measures

- Managers must identify the customer and market segments in which the business desires to compete.
- Develop measures to track the business unit's ability to create satisfied and loyal customers.

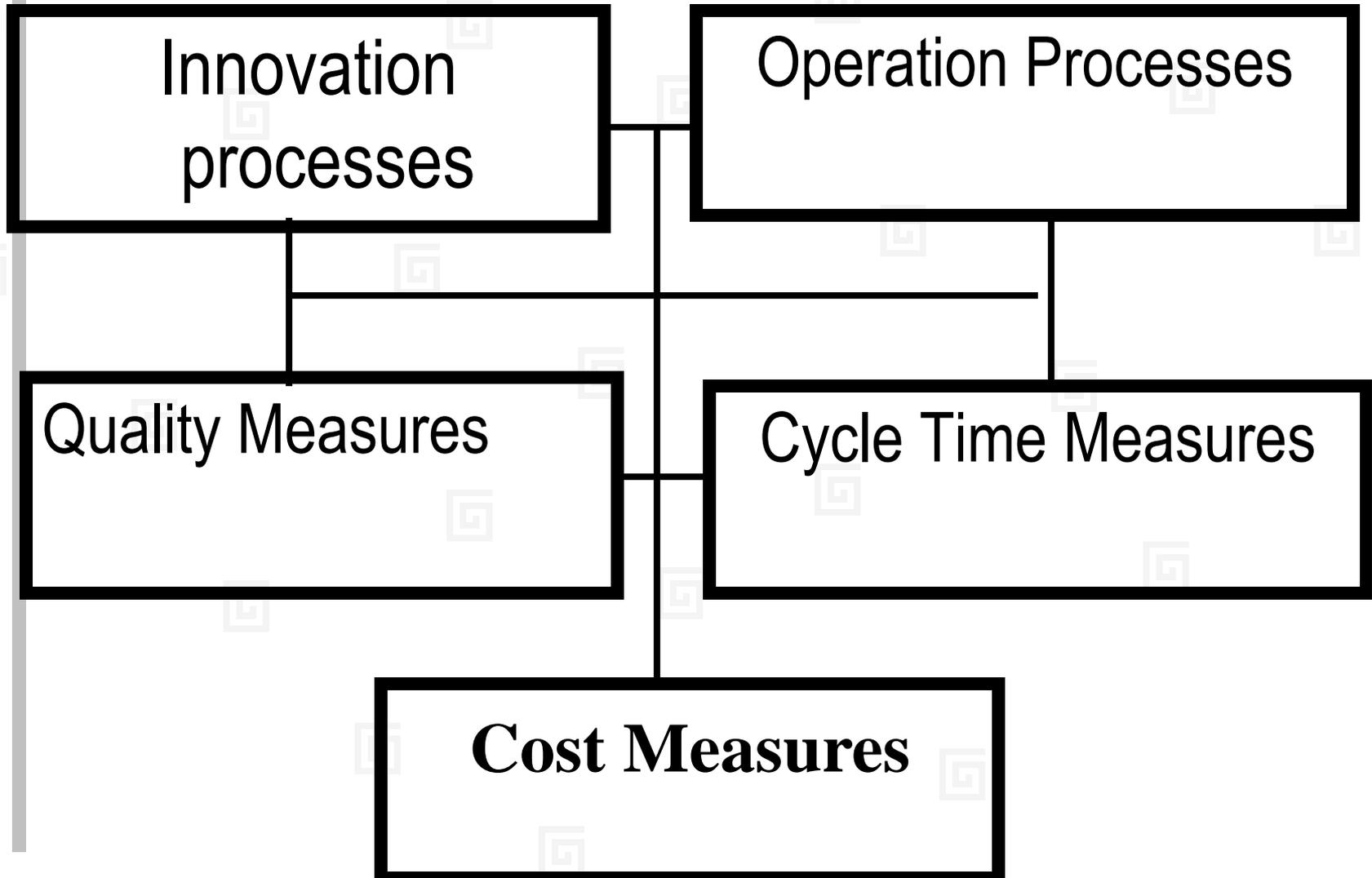
Customer-based measures



Internal Business Process Measures

- Identify the critical internal processes for which the organization must excel in implementing its strategy.
- IBP dimension enable the business unit to
 - deliver the value propositions that will attract and retain customers in targeted market segments, and
 - satisfy shareholder expectations regarding financial returns.

Internal Business Process Measures



Learning and Growth measures

- Learning and growth identifies the infrastructure an organization must build to create long-term growth and improvement.
- Growth comes from: people, systems and organizational procedures.

The Six Sigma

- A business process that empowers companies to increase profits dramatically by streamlining operations, improving quality, and eliminating defects or mistakes in everything a company does.
- The objective is to change the process so that defects are never produced in the first place.

The objectives of Six Sigma

- To satisfy the customer by changing internal performance and processes.
- To enable better performance by better design
- To improve the quality of supplies and other operational processes
- Manage the costs

Six Sigma



Difference between TQM and Six Sigma

TQM

- Focuses on improvement in individual operations with unrelated processes
- Takes many years before all operations within a given process are improved

Six Sigma

- Focuses on making improvements in all operations within a process
- Produces results more rapidly and effectively.

Review Questions

- What measures can be used to assess effectiveness, efficiency, and productivity?
- What is Six Sigma and how does it differ from TQM?
- What are the objectives of Six Sigma?
- What are the purpose and objective of learning and growth measures?
- What are some customer-based measures that organisations use?
- What measures can be used to assess internal business processes?
- How can financial performance be measured?



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