Are You Throwing Away Profit Due to Inadequate Reporting

How Inappropriate Performance Reporting Can Drive Poor Process Outcomes and Dysfunction

A Guide to Developing Effective Process Performance Measurement

By: Peter Humphries
& Bruce Campbell
Directors Bypass Solutions
Level 1, 90 William Street
Melbourne
Victoria 3000

Phone 61 3 86400910
www.bypasssolutions.com.au

BYPASS SOLUTIONS

As business manages we rely heavily on information in the form of reports to guide our course of action. What areas of the business are running well? What area's need attention? Are we meeting our goals and if not why not? Are all my people working together in pursuit of our common business goals?

But how good is this information that you rely on so heavily. Does it encourage the right behaviours in your people and outcomes from your processes and does it really serve you well in the pursuit of your goals or is your business reporting causing more problems that you know?

In recent months you have probably received a big shock when you found out something you should have known about before it got that bad. A vital piece of has equipment failed, a major customer cancelled the contract because you have not delivered their order again, your competitors keep taking business from you at negative margins, your stock shrinkage is higher than it has ever been. These indicate you have a performance measurement problem.

Bypass Solutions is a group of experienced senior managers who have studied and applied business performance measurement across many sectors and business activities. We have helped many firms get it right and make significant and sustainable business improvements.

In this report we will first look at 9 critical errors to be avoided, then look at some real life examples before discussing 10 core attributes of good performance reporting.

9 Critical Errors to Avoid in Measurement Indicators

1. Processes that are critical to the business objective have no measures in place to enable their control.

- Waste and material utilisation were not part of the production department's performance criteria leading to large inventory stock adjustments and value right offs..

2. Sometimes part of an organisation focuses on a particular performance measure to the detriment of the organisation as a whole. E.g.

- Sales focus on volume over margin resulting in sales with negative margin.
- Tight departmental budget controls causing large expenditures elsewhere.

3. There is a blow out in performance in an area that is caused by the actions of people working in other areas.
The group causing the problem may be totally unaware they are causing an issue elsewhere and have no measures to manage the problem. For example

- Production orders for internal orders are produced months ahead of time to meet early delivery performance measures, causing massive stock build at the receiving warehouse.
- Purchasing reducing stock order quantities in order to reduce working capital which then causes delay in manufacturing, and subsequent late customer order delivery.

Critical Errors to Avoid in Measurement Indicators

4. Performance measures tell you what happened but do not help to tell you what to do about it or how you will perform in the future. Performance measure can be negative and de-motivating.

- A classic example of this is the measurement of safety performance. When asked, organisations can often tell you how they performed I.e. how many accidents they had, but often can not advise how well they are doing against a safety improvement plan. It can be de-motivating to only ever be asked about things that went wrong.

5. Performance measures can develop into political footballs. More time can be spent trying to blame someone else or re-classify a problem rather than trying to fix the real problem.

- We have seen examples where despatch staff re-keyed the delivery dates on every order so they met their performance measures. They blamed the order taking department for keying the orders incorrectly. The customer on the other hand was ignored.

6. The wrong measures are being used that don't support the business objectives. For example

- Business measures sales dollars by account manager and uses this to reward the sales team. However the company's objectives are to improve margin not just gross sales. Measures must motivate people to actions that support your company objectives.

7. The measures give inaccurate and misleading information that result in poor decisions. For example

- Incorrect allocation of costs in Customer profitability reports can result in low volume products appearing to have low production costs and high volume products having relatively high production costs? Pricing and Sales decisions based on this information can lead to a loss of profitability.

8. The cost of producing a report out ways its benefit or there is little no or benefit from the data. For example

- Production of weekly P&L can be very expense especial if weekly stock takes are part of the process – Using well designed KPI's that can be produced daily to manage the key process outcomes can ensure your P&L statement at the end of the month is on budget.

9. Performance measures need to be meaningful to the workgroup they are being presented to.

- Measures perceived to be outside the control of a workgroup do not motivate the group to improve performance, and can be de-motivating and cause conflict with other groups.

How do your performance measures stack up?

How much one off analysis and action did your last monthly meeting produce. Was all this action and analysis focused on your core business objectives? How long will it take your business to finally take action to avert the discovered issue from the time that the issue arose? These sorts of reactive processes can be avoided by frequently produced measures that enable good business process control. With these measures properly in place the monthly meeting becomes a review of the issues that occurred and the actions already taken. You get to devote more time to strategic initiatives and business planning as a team.

As we all know and have experienced the consequence of decisions made with little or no supportive information can be disastrous. At worst this can lead to loss of market value of a business or ultimately business failure.

Without accurate, up to date, frequent and strategically aligned performance reports you stand little chance of catching and correcting important issues until they have caused significant damage. However with good business key process outcome performance measurement you will be able to significantly reduce waste and loss and increase your bottom line. Every dollar saved is another dollar profit or put another way every dollar lost is $10 more sales needed to recover it.

Case Studies

1. **Measuring Random Events**
   A large organisation measured and reported their safety performance in terms of lost time injuries. Figures showed an improving performance over a number of years and management was satisfied that they had the issues under control. Then they had 2 very significant incidents and the state workplace safety authorities were involved in an investigation. They found that planned audits, safety meetings and training had not been completed. The company was fined and two employees and their families had their lives unnecessarily disrupted. Under today's workplace safety legislation managers may have been individually fined or even jailed had the consequences been worse. The company was looking at random events that did not identify gaps in their work place safety management system. Members of our team assisted in the design and implementation of measures that monitored performance against a safety plan.

2. **Getting the Wrong things Right**
   An organisation measured full and on time delivery as a key control for service performance and they were clearly the best in their market at 95%. With such a large service differential they expected to gain market share from their customers. But after of six months of no market share increase they began to question their strategy. With assistance from members of our team they were able to identify that their strategy was good, the problem was in its implementation. We found that although they were delivering to their promise, and their competitors were not, their competitors did have much shorter delivery times. The service performance they should have been measuring and improving was the order to delivery lead time. Six months of wasted sales revenue improvement has a significant affect on the bottom line.

Case Studies

3. **I can't fix it anyway**
   A trucking company identified it could significantly improve profit by improving the efficiency of delivery through route and load optimisation. They developed a reporting system so the schedulers could see the profitability of every load before the loads were dispatched. They hoped the schedulers would use this information to increase profit by optimising the load and schedule. We advised the company not to implement these measures. Had they been implemented they would have caused:
   - Internal fights when schedulers blamed the sales staff for selling the service at the wrong rate because reported load profit was low.
   - Schedulers in attempting to optimise profit, would have lowered the priority and therefore would have provided poor service to lower margin customers, who were generally the larger customers of the company.

   The measures put in place measured delivery quantity per hour and distance. Performance measures need to be relevant to the workgroup involved, they need to relate to the actions of the workgroup.

4. **It must be good, look at the measure**
   A large company in an industry, where there is product redundancy caused by change in fashion, uses a product cost write down method to quit slow moving stock. Product costs are changed in the system and the inventory revaluation expense gets lumped into one account. This happens for new and old products alike – if the stock is considered aged it gets written down.
   Sales now sell the product. Reported product margins are based on the written down value so the sale team looks good even if the stock was created by very high forecasts generated by the sales team. The poor performance of individual product is hidden in the write down methods used.
   This system of reporting encourages poor portfolio management and results in significant write down costs. We recommended a small change in the performance measure that will save up to half the write down amount.

10 Core Attributes of Good Key Performance Indicators

The follow principles will help you assess your performance measures and guide you in the creation of new ones that will give you comfort and control of your business performance.

1. **Performance measures need to be aligned with the corporate objectives and organisational culture**.
   Performance measures serve a number of purposes including; to control process outcomes, to encourage behaviour of managers and staff, to satisfy stakeholder requirements. If the measures that are used in your organisation are not well aligned with your corporate objectives and culture then you will be encouraging the wrong behaviours and hence the wrong business result. As corporate objectives and organisational culture change, performance measures also need to change. In fact managing the organisation with aligned performance measures is a great way to constantly re-affirm the achievement of the objectives.

2. **They need to be meaningful to those who review the measure. I.e. they understand what is being measured**.
   Large amounts of detailed information can be used in developing performance reports, from bill of materials to shipping routes to production routes. This can lead to complex interpretation of the results of the measures. If the people using the measure do not understand what influences the outcome of the measure, they will not know what to do to correct low reported performances.

   An opposite example is where the measure is too simple and therefore does not correctly represent the real process performance. For example labour efficiency is determined using only units produced and an averaged target labour amount per unit. On days when high labour component products are made the efficiency may be very good for the day but will be reported as being poor.

3. **Staff in the groups being measured need to believe they can positively influence the outcome**.
   If measures are assigned to a group for which they can have no influence on the result or for which they feel they can have little influence then the measure can become de-motivating. When assigning measures to a group of people, ensure that the people within the group, as a whole, have the ability and authority to influence the outcomes.

4. **Measures should be a reflection of your customers' expectations, not of your current process limitations**.
   It is easy to set incremental targets for performance measures based on your current process limitations. However if these targets do not represent value to the customer then it is pointless to strive for them. To re-use a early example. If your IFOT (in full on time) is at 95% But your product lead times are 8 weeks, and your customer expectation is delivery in 4 weeks, then a planned improvement in IFOT to 97% with the same lead time is going to go unnoticed by the customer who will still be dissatisfied with the long 8 week order to delivery lead time.

5. **Most measures do not work in isolation but must be grouped so that an improvement in one performance measure does not offset the reduction in another**.
   For example service delivery performance could be achievement by increasing stock if there was not also a measure to control stock levels. The attainment of market share could be achieved with proliferation of SKU's which could have signification effect on inventory levels, service and product costs if there was no control on the additions and deletions of products from the range. In practice many measures are grouped together to form the basis for the performance measurements of a functional area. Each functional area's measurement system must include measures that ensure the functional area is motivated to perform in a way that does not hinder other functional areas. For example, sales should not only measure sales turn over and margin but also indicators like, numbers of SKU's and forecasting accuracy that can effect the ability of an organisation to services its customer, return a profit and a reasonable ROC. Simply grouping these other indicators into the measure of profit can be de-motivating and provide little guidance of "how".

6. **The frequency that the measure is produced needs to be related to the risk of the process becoming out of control and magnitude of the consequence when it does**.
   In large manufacturing environments a day of poor performance can be very costly – a whole month of it maybe disastrous. Yet creating a measure of daily plant P&L may seem like an enormously task to complete on a daily basis. However given the risk and likelihood the performance maybe best managed on a daily basis. By picking the key components of what will mostly effect the plant P&L, KPI's can be easily set up to ensure that overall performance is easily manageable.

7. **Measurement needs to be cost effective. It will be necessary to compromise in some areas or look at other measures that can control the process**.
   If the cost of producing a measure even comes close to the loss associated with poor performance the measure is not worth recording. Often there will be other less costly ways to measure the process performance such that the process can be controlled. Measurement can be as simple as a recorded observation.

8. **Performance measurement reports should not be hidden in a directory but put in the face of those that it is intended for.**
   Do not automate the reporting and expect people to open the reports. This is no different to printing reams of reports off printers that no one reads. Do something with them that puts them in peoples' faces; email them, have them open on start up of a computer, have daily/weekly/monthly meetings where process performance is discussed by referring to the measures.

9. **Reports should facilitate "management by exception" - i.e. highlight poor process performance and what needs action clearly and simply**.
   Reports should make there point clearly and simply. If the reader has to work through numerous pages to get to the results and then work out how to interpret them, then the report will not read and actioned as often as you need it to be (if at all).

10. **Use technology to automate the data capture, collation and report generation to reduce errors and cost**.
    Make reporting easy by using technology, from process controllers (automatic data capture) to handheld computers for observational measurement that must be recorded manually. Combine the data with that of your business systems using data warehouse applications. In most cases the investment is a fraction of its worth

It needs to be recognised that everything can not be measured and that there will be conflicts between measures. A good Performance measurement programme should include an individual appraisal system which looks at how the individual has contributed to the performance outcome and how the individual has managed the conflict between the performance measures

So why is it so hard for you to get the measures right?

It is not easy to apply the above core attributes in the real world. You will have found some attributes have to take priority over others. Even working through the core processes that need control is a difficult task. It is easy to leave critical process out and not measure them at all or to provide a group of measures to an area that will drive a negative impact on another area.

You may not have adequately skilled people who can spend the time to setting up fully cohesive reporting and KPI systems.

Someone else may be determining your reporting and KPI. These may not be optimising the performance in your area or may be poorly linked to other areas performance.

You will have found that people often resist measurement of the areas that are in their control and it becomes especially difficult to get these people to implement measures when significant time is required to complete them.

You may have found barriers to investing in technology for the core purpose of supporting improved business measurement. We see this time and again with the implementation of ERP systems where reporting is not in the scope of the main implementation project. Or standard reporting in these systems is seen as being adequate at the time of purchase.

The daily routines of managing your business does not always allow you to step back and critically look at what you are doing and why.

All the quality gurus agree that you cannot improve what you do not measure, or that in any improvement process, measurement must be the first step.

Every control system needs a feedback loop. In most cases in business process management this feedback loop is a process performance measure. Without it you can not control the process.

We constantly see that process outcome improvement is simply achieved by nothing more than getting the right measure in place and then setting performance targets. Of course major step improvements in process performance require a lot more to be done, but measurement is always the place to start.

Where do you start?

Our clients are often surprised at how quickly improved performance measures can be identified and implemented. They are even more surprised at how effective good performance measures can be at improving business performance.

One of the services we offer is to carry out a review, make recommendations and implement improvements to key performance measures. This type of review takes only a few days and usually result in performance improvements in excess of $50k in the first year.

The process we would generally follow would be to;

- Review current process measures
- Work through your business unit objectives
- Work with your team to identify opportunities to improve your performance measures.
- Implement the top 2 or 3 opportunities with anticipated annual savings in excess of $50k.

To do this we will:

- ◊ Develop an action plan with your team for your team to implement the improvements.
- ◊ Agree process improvement targets based on improved measures.
- ◊ Follow the implementation to ensure that it is successful.
- ◊ Review your behaviour modifies to ensure they support improved process outcomes with the new measures.
- ◊ Guide you to change your behaviour modifiers if necessary.
- ◊ Follow your process performance outcomes over three months to ensure that you gain the targeted improvements or at least are well on the way.

We can usually guarantee that you will save our fees in less than 3 months from the completion of the project or you can have your money back.

If you would like to talk to us about your performance measures or receive a free self assessment of what improved performance measures can do for you, please call us on the contact numbers below.

Bypass Solutions can also assist in Project Management and IT Procurement

Call Bruce Campbell or Peter Humphries on 03 86400910 or email Bruce.Campbell@brtech.com.au, to arrange an obligation free appointment.