Performance Management: Making it Work

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CMA – CAM-I
September 6, 2006
Toronto, Canada
About Gary Cokins

B.S. Industrial Engineering & Operations Research; Cornell University, 1971

M.B.A. Finance & Accounting; Northwestern University, Kellogg Graduate School of Management, 1974

Previous Associations:
- FMC Corporation
- Consultant with: Deloitte & Touche, KPMG Peat Marwick, & Electronic Data Systems (EDS)
About Gary Cokins

Gary Cokins is a Strategist with SAS, the world’s leading provider of business intelligence and analytics software. He is an internationally recognized expert, speaker, and author in advanced cost management and performance improvement systems.

Gary has authored:


Performance Management: Finding the Missing Pieces (to Close the Intelligence Gap)

by Gary Cokins (Author)

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SAS is the World’s Largest Privately-Owned Software Vendor

- 238 offices in 53 countries
- 10,000 employees; $1.6 billion
- 3.5 million users worldwide
  - 40,200 sites
  - 113 countries
  - 90% of Fortune 500
  - 97 of Forbes Super 100
- Hundreds of local user groups globally
What Do These Companies Have in Common?

• Amdahl
• Cheesebrough-Ponds
• Data General
• Delta Airlines
• Digital Equipment
• K-Mart
• Kodak
• Levi Strauss
• Raychem
• Revlon
• Wang Labs

They passed all the “hurdles” for 1961-80 in Tom Peter’s book “In Search of Excellence”; p. 20-21

Source: The Sonax Group; David Axson
AGENDA

What is Performance Management ... and Why?
- Executive’s Frustration - Measuring Performance
- Untrustworthy Managerial Accounting
- Poor Customer Value Management
- Missed ROI Promises from CRM and ERP
Value Multiplier through Integration
What Does Performance Management Look Like?

There are a few information technology views.
An IT Performance Management Framework

Key: Operational Feedback Loop: → Strategic Feedback Loop: ← Links between Loops: ——

Source: Gartner Research
How Do They All Fit Together?

Strategy, Mission

customer satisfaction

ERP, etc.

CRM

Scorecards

Your Organization

Supplier Inputs

ROI

Shareholders
What’s the Problem?

Direction, traction, and speed.

What’s the Answer?
Performance Management

PM embraces methodologies, metrics, processes, software tools, and systems that manage an organization’s performance.
AGENDA

What is Performance Management … and Why?

Executive’s Frustration - Measuring Performance

Untrustworthy Managerial Accounting

Poor Customer Value Management

Missed ROI Promises from CRM and ERP

Value Multiplier through Integration
(1) What’s the Problem?

Executives are failing to successfully implement their strategy.

... And, as a result, they are getting fired faster. Why?
When Dilbert Jokes About It, It is Mainstream
Goal Non-congruency, Conflict, and Mis-alignment

Mission Strategy

Maximize Shareholder Value

High quality  Speedy  Low cost  Great service  Flexible

Sub-optimization of work

“Wall of Disconnects”

Purchasing department

Strategies

Measures  Accountability
Vision and Mission Statements

A Vision statement answers “where do we want to go?”

Examples:
USA President Kennedy, “We will put a man on the moon.”
Microsoft, “A computer on every desktop.”

Strategy maps and scorecards answer, “How will we get there?”

The strategy map and scorecard are mechanical. They help realize the vision and mission.
vision & mission

Financial
- Diversify income stream
- Increase sales volume
- Improve profit margins

Customer
- Diversify customer base
- Increase sales to existing customers
- Attract new customers

Internal Process
- Target profitable market segments
- Develop new products
- Optimize internal processes
- Attract new customers

Learning & Growth
- Develop employee skills
- Integrate systems
Financial value

Financial

Customer

Internal Process

Learning & Growth

vision & mission

Exceed shareholder expectations

Improve profit margins

Increase sales volume

Diversify income stream

Increase sales to existing customers

Diversify customer base

Attract new customers

Target profitable market segments

develop new products

Optimize internal processes

Attract new customers

Develop employee skills

Integrate systems

Financial

Customer intimacy

leads to

Process excellence

stimulates

A learning environment

A learning environment stimulates process excellence, which leads to customer intimacy. Customer intimacy leads to financial value created by diversifying income streams and optimizing internal processes. Financial value exceeds shareholder expectations, increasing profit margins and sales volume, and diversifying income streams and customer bases.
Who Does What?

A scorecard is more of a **social** tool than a technical tool.

<table>
<thead>
<tr>
<th>1st Quarter</th>
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<td>X</td>
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<td></td>
</tr>
<tr>
<td>Managers and Employees</td>
<td>X</td>
<td>X</td>
<td>their score</td>
<td>X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<---- period results -------->
The Key to Scorecards

How does everyone answer this single question:

“How am I doing on what is important?”

Strategy Maps and Scorecards provide this answer.

The overriding purpose of a scorecard system is to make mission and strategy everyone’s job.
Scorecard Lessons Being Painfully Learned

Scorecard or Report Card?
KPIs, not PIs
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What is Performance Management … and Why?
Executive’s Frustration - Measuring Performance
Untrustworthy Managerial Accounting
Poor Customer Value Management
Missed ROI Promises from CRM and ERP
Value Multiplier through Integration
(2) What’s the Problem?

Managers and employees do not trust the accounting system.
The Need for ABM

Changes in Cost Structure

Overhead (indirect expenses)

Direct (recurring) Labor

Cost Components

Old-fashioned
1950s

Hierarchical

Integrated
1990s

Direct
Material

Stages in the Evolution of Businesses

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The General Ledger View is Structurally Deficient for Decision Analysis.

<table>
<thead>
<tr>
<th>Chart-of-Accounts View</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance Claims Processing Department</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Salaries</td>
</tr>
<tr>
<td>Equipment</td>
</tr>
<tr>
<td>Travel expense</td>
</tr>
<tr>
<td>Supplies</td>
</tr>
<tr>
<td>Use and occupancy</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

When managers get this kind of report, they are either happy or sad, but they are rarely any smarter!
Multi-Stage Cost Flowing

Simple ABM

Expanded ABM
ABC/M Cost Assignment Network

Resources
(general ledger view)

Work Activities
(verb-noun)

Final Cost Objects

People Activities

“cost-to-serve” paths
$30 \text{ sales} - 28 \text{ expenses} = $2 \text{ profit}
ABM provides insight for the product’s or service’s cost drivers and driver quantities.

Price/Fee (Revenue)

Activity Costs

Work Activities

each activity’s driver quantity

X

unit activity driver cost

(eg. # of registrations)
The evolution of...
Darwin’s Evolution of Cost Accounting Methods

Traditional Costing

- Resources
  - Allocated to

  - Activities
    - Consumed by

  - Cost Objects

ABC (simple & minimal)

- Resources
  - Consumed by

  - Activities
    - Consumed by

  - Cost Objects

ABC (multidimensional & arterial)

- Resources
  - Consumed by

  - Activities
    - Consumed by

  - Outputs
    - Consumed by

  - Channels
    - Consumed by

  - Users
    - Consumed by

Cost Objects
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What is Performance Management … and Why?
Executive’s Frustration - Measuring Performance
Untrustworthy Managerial Accounting
Poor Customer Value Management (Part 1)
Missed ROI Promises from CRM and ERP
Value Multiplier through Integration
(3) What’s the Problem?

Customers and channels cause costs too, often in disproportionate ways, and their impact on profits should be measured.
But what about the Other Below-the-line “Calculated” Costs?

Products and standard service-lines are not the only thing for which accountants should compute costs.

What about costs that have nothing to do with products and standard service-lines?

The problem with traditional accounting’s gross margin reporting is you don’t see the bottom half of the picture.
CEO Concerns

Most important

Attracting and retaining loyal customers: 8.95
Increasing market share: 8.39
Balancing short-term goals w/ long-term strategy: 8.02
Improving productivity: 7.93
Responding to regulatory changes: 7.86
Attracting and retaining skilled workers: 7.82
Building a responsive, flexible organization: 7.8
Using technology for competitive advantage: 7.67
Managing risk on an enterprise basis: 7.66

Moderately important

Focusing on core competencies: 7.62

Source:
Gartner, 2004: "Bank CEOs Rate Business & Technology Concerns"
Adding S,G, & A Cost Objects

**Scope:** The more expenses that are included for tracing, the more expense traced to *different* cost objects, particularly to other than just products.

![Diagram of cost objects](Image)
The Perfect Storm

# 1- Customer Retention – It is relatively much more expensive to acquire a new customer than to retain an existing one.

# 2 – Sources of Competitive Advantage – As products and standard service-lines become commodity-like, the shift is towards service-differentiation.

# 3 - Power Shift – The Internet is shifting power … irreversibly … from sellers to buyers.
Profitable and unprofitable customers are distinguished by how they place demands on work activities.

**Less** profitable customers

They make you jump through flaming hoops!

**More** profitable customers

You hardly know they are there … but they keep on buying from you.

This behavior can be measured by activity costs and activity cost drivers.
# ABM Customer Profit & Loss Statement

CUSTOMER: XYZ CORPORATION (CUSTOMER #1270)

<table>
<thead>
<tr>
<th>Sales</th>
<th>Margin ($)</th>
<th>Margin % of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales $$$</td>
<td>(Sales - ∑ Costs)</td>
<td></td>
</tr>
<tr>
<td>Product-Related</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplier-Related costs (TCO)</td>
<td>$ xxx</td>
<td>$ xxx</td>
</tr>
<tr>
<td>Direct Material</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Brand Sustaining</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Product Sustaining</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Unit, Batch*</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Distribution-Related</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outbound Freight Type*</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Order Type*</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Channel Type*</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Customer-Related</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer-Sustaining</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Unit-Batch*</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Business Sustaining</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td><strong>Operating Profit</strong></td>
<td><strong>xxx</strong></td>
<td><strong>8%</strong></td>
</tr>
</tbody>
</table>

* Activity Cost Driver Assignments use measurable quantity volume of Activity Output (Other Activity Assignments traced based on informed (subjective) %s)
Migrating Customers to Higher Profitability

Types of Customers

- High (Creamy)
- Low (Low Fat)

Product Mix Margin

Profitable

Unprofitable

Cost-to-Serve

Very Profitable

Very Unprofitable
AGENDA

What is Performance Management … and Why?
Executive’s Frustration - Measuring Performance
Untrustworthy Managerial Accounting
Poor Customer Value Management (Part 2)
Missed ROI Promises from CRM and ERP
Value Multiplier through Integration
Customer Equity (CE) and CLV Management

Who is more important to pursue with the scarce resources of our marketing spend budget?

Our most profitable customers?
Or our most valuable customers?

What is the difference?

The “customer lifetime value” measure is intended to answer this question.
You are pharmaceutical supplier. Which Customer is more Important?

Dentist A
Sales = $750,000
profits = $100,000
Age 61

Dentist B
Sales = $375,000
profits = $40,000
Age 21

Which is more profitable?
Which is more valuable?
Current vs. Long-Term Potential Value

If you could measure past-period customer profitability but also future potential customer economic value, then …

<table>
<thead>
<tr>
<th>high current profit contribution (static)</th>
<th>… you’d view existing customers in different categories.</th>
</tr>
</thead>
<tbody>
<tr>
<td>low substantial</td>
<td>limited limited</td>
</tr>
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</table>

future potential (long-term)
Current vs. Long-Term Potential Value

There appear to be obvious customer strategies for each category.

<table>
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<th>Future Potential (Long-term)</th>
<th>Substantial</th>
<th>Limited</th>
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<tr>
<td>Current Profit</td>
<td>Maximize</td>
<td>Manage up or out</td>
</tr>
<tr>
<td>Current Profit Contribution (static)</td>
<td>Most favored status</td>
<td>Defend &amp; retain</td>
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High

Low
After CLV (or CP) is calculated and rank-ordered, then ...

Customer Equity $

Get more value from these

Protect these

Existing Customers

retain  develop, streamline

Source: Customer Equity Marketing; European Mgmt. Journal; Vol 20, No. 3; June, 2002
Also, be prudent attracting new customers.

Customer Equity $

- Be selective pursing these
- Get more value from these
- Protect these

Existing Customers
- retain
- develop, streamline

Possible New Customers
- acquire, retain
- do not acquire

Source: Customer Equity Marketing; European Mgmt. Journal; Vol 20, No. 3; June, 2002
“Which-type and How Much?”
Sales and Marketing ROI

The spending budget for sales and marketing is critical … but it should be treated as a precious scarce resource to be aimed at generating the highest long-term profits.

This means answering questions like:

**Which type** of customer is attractive to newly acquire, retain, grow, or win back? And which types are not?

**How much** should we spend attracting, retaining, growing, or recovering each customer segment?
A Shift in the CFO’s Emphasis

The CFO is now aiding Sales and Marketing.

Segmentation, predictability, churn, and uncertainty must be understood in the language of money. That is what Wall Street and investors understand.
Rapid Prototyping with Iterative Remodeling

Models

A System (repeatable, reliable, relevant)
Balancing Levels of Accuracy with Effort

Level of Data Collection Effort

Accuracy of Final Cost Objects

World Class ABC System Design

Little       Modest      Great
What’s the Problem?

Annual Budgeting !! –

The budget is typically a fiscal exercise by the accountants that is disconnected from the executive team’s strategy.
The Annual Budgeting Process isDisconnected From Strategy

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But this problem is solved if management funds the managers’ projects.
Historic Reporting vs. Predictive Costing

- **Past**
  - Activity-Based Costing
    - Historical & Descriptive
    - Starts with known:
      - spending
      - driver measures
      - output quantities
    - Calculates “costs”

- **Now**
  - Activity-Based Planning
    - Predictive
    - Requires capacity analysis
    - Starts with estimated outputs
    - Solves for Resource “expenses”

- **Future**
  - Activity-Based Planning
  - Predictive
  - Requires capacity analysis
  - Starts with estimated outputs
  - Solves for Resource “expenses”
The Challenge of projecting “what-ifs”

Resources

Work Activities

Final Cost Objects

Salary, Fringe Benefits
IT
Depreciation
Rent, Interest, Tax

Customers
Business
Sustaining

Suppliers

Resource expenses can be calculated with “backwards ABC”

People Activities

“cost-to-serve” paths
Match the Budget Method to its Category

- **Demand-driven**
  - Recurring
  - Volume & mix of drivers

- **Decision-driven**
  - Discretionary
  - Costed work plans

- **Project-driven**
  - Non-recurring
  - Strategy map & BSC

Integrated Budget

Source: Mike Tinkler; www.synerma.com
ABC/M Lessons Being Painfully Learned

ABC/M system Over-Design … the quest for precision.

Fear of knowing the truth.

“I feel like a dog watching television … “
AGENDA

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(4) What’s the Problem?

ERP and CRM systems are falling short of producing the planned return on investment (ROI).

Business intelligence is the value multiplier.
The Database Core

What matters more is what decisions are made with the data.
The Gap Between Strategy and Transaction Systems

Strategy

Enterprise

Suppliers
Organization
Customers

Intelligence Architecture

Operational and transaction-based data
AGENDA

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How do They all Fit Together?

Strategy, Mission

customer satisfaction

ERP, etc.

CRM

Your Organization

Scorecards

Supplier Inputs

Shareholders

ROI

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How Do They All Fit Together?

- Strategy, Mission
- Adjusted Strategy
- Senior Management
- Products, Services, Missions
- ERP, etc.
- Process planning & execution (back office)
- CRM
- Order Management (front office)
- Assets
- Scorecards
- KPIs
- Employee behavior
- Your Organization
- Inputs
- $ (ROI)
- Shareholders

Employees

“How am I doing on what is important?”

Customer satisfaction

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The Performance Management Umbrella

- Strategy, Mission
- CRM
- ERP, etc.
- Supply Chain management
- Process and operational management & Six Sigma

Your Organization

Scorecards

- Strategy formulation
- Customer Value management
- Financial management

Inputs

ROI

Shareholders

Strategy execution
The Intelligence Hierarchy

Power of Information

Data → Information → Knowledge → Intelligence

Raw Data → Standard Reports → Ad hoc Reports & OLAP → Descriptive Modeling → Predictive Modeling & Optimization → Predictive Modeling & Optimization Put into Action

$ROI
The Buy-in to Performance Management

Why has the adoption rate for PM’s methodologies been so slow?
The “Law of the Lid”*

“If your senior leadership cannot articulate the basic principles of an improvement initiative, then employees will never achieve or sustain the initiative.”

“If leadership is weak, the lid is low.”

* *The 21 Irrefutable Laws of Leadership* by John C. Maxwell
Most Organizations are Over-managed and Under-led.

Leadership is different that management, but not for reasons most people think.

Managers follow rules and are risk-averse. Leaders take calculated risks and are risk managers.

Management is about coping with complexity. Leadership, in contrast, is about coping with change which is accelerating.

Management copes by planning, budgeting and control with organization charts and staffing battles. Leadership creates vision, sets a direction, and inspires people.
Creating Vision is Not Mystical.

Creating vision is not so mysterious that mere mortals can not do it. It simply requires strategic thinking with risk-taking.

Sadly, managers are promoted to where they should be leading, but they revert to managing more intensely.

Leaders look past organization charts as the source of power. They know that loose social networks rather than hierarchy governs results and performance.
Your success depends on how well and how fast the right information gets to the right people.
Thank You

Visit our educational Web Portal:
www.BetterManagement.com

Visit our corporate Web Site:
www.sas.com

Or feel free to contact:

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