



Making performance measurement digestible

There have been vast tomes written on performance measurement frameworks, the characteristics of a good performance measure, sales & operations planning and the like.

So rather than attempting a comprehensive dissertation on performance measurement that fits neatly on a single page, following are some readily digestible, low kilojoule tips for the day. Happy snacking!

It's still quite common to see performance measures and remuneration schemes that aren't aligned with a business' strategy or goals. One recent example took place in an organisation that had "annual double digit profit growth" as its stated goal.

Rewarded for revenue growth alone, the sales team held a congratulatory party when they exceeded their sales targets in Western Australia. Was this new business profitable? Who knew? That metric wasn't part of the reward scheme, so it wasn't the sales department's concern. The sales people were behaving in an entirely reasonable manner considering their performance measures.

Any guesses as to what happened in the logistics department? Yep, they got a slap on the wrist for exceeding their linehaul budget to Western



Australia. Many of you are likely nodding (or shaking) your heads because this sounds all too familiar.

Performance measures and their associated rewards drive behaviour, and if these are out of kilter with the business' goals, the ship may well stray off course. As a pleasing aside, there are examples of companies that reward sales teams on profitable sales growth or Return on Net Tangible Assets (RONTA).

Organisations that have adopted this approach speak glowingly of the results – and how it helps to create a "one team" culture, but they are still very much in the minority.

It's useful to have a mixture of measures to provide a balanced



view. Following are some types of measures you might consider using and/or testing your existing measures against:

Lagging – These measures tell us what happened. They record history. What was our customer service level or DIFOT performance? How much inventory did we write-off? What was our production asset utilisation?

It is essential to know what happened (and equally important to know why, but we'll get to that in a minute), but many performance measurement processes focus exclusively on the past. A review of history is useful only if we can learn something from it. This brings us to the next type of measure.

Leading – These measures provide insight into what is going to happen. They give us a picture of the future so that we can act today to change outcomes.

What is our future demand forecast compared with our sales target? What is our future stock balance (ie where do we have too much and too little inventory)? Where do we have expected DIFOT misses?

Process – These are measurements of process efficiency, effectiveness and/or compliance.

Examples include planning cycle time, forecast accuracy, orders actioned versus orders recommended, cash-to-cash cycle, S&OP meet-

ing attendance, etc.

Outcome – These are measurements of results. Examples include DIFOT, inventory levels, sales, profit, Return on Assets (ROA), etc.

Performance measures and their associated rewards drive behaviour, and if these are out of kilter with the business' goals, the ship may well stray off course. There are companies that reward sales teams on profitable sales growth.

Internal – These are "internally facing" measures of your organisation. Examples might include staff retention, manufacturing yield, supply chain costs, etc.

External – These are "externally facing" measures. They measure how you look to the outside world, perhaps to your customers and suppliers. Examples might include DIFOT, adherence to supplier purchasing schedule, customer lead time performance, market share, etc.

You may have noticed some overlap between these measures. In reality, performance measures are a combination of these measurement types. For example, DIFOT is an external lagging outcome measure.

As a suggestion, take each of

your performance measures and test it to see if it is Lagging or Leading, Process or Outcome and Internal or External.

Once you've done this for all your measures, tally the results. This may highlight underrepresented measures or reveal a skewing in your reporting framework.

Having said all that, the key is to focus on a few meaningful and relevant measures that are consistent with your business strategy. Focus on the areas of greatest pain or opportunity. Less is more, so don't try to "boil the ocean"!

There's no point having a DIFOT measure that your customers don't agree with. There are examples of DIFOT measures based on "total value of customer orders placed versus filled in a month".

So a customer orders 1,000 units in September, and we supply 1,000 units in September. Fantastic, we get our bonuses! The only problem

is that the customer needed the 1,000 units in the first week of the month, and we supplied them in the last week in the month.

We congratulate ourselves for perfect service while leaving the customer in the cold. Our performance measure masks reality and gives us no indication that we need to improve.

The ability to "drill down" and diagnose is essential for effective performance management. If forecast error is 78 per cent in aggregate, is that because it's 20 per cent for some lines and 99 per cent for others? For the lines at 20 per cent accuracy, are there key customers, products and/or channels at risk?

Likewise, detailed performance measures should aggregate up to provide a "Top Down" view. The key point is that the "top down" and "bottom up" measures should be integrated, directly linked and based on the same set of numbers.

In absence of these characteristics, action plans are based on assumptions, recent history and the view that creates the greatest perception of risk – instead of the facts.

Finally, make sure there are checks and balances in your performance measures. Let's use an example to illustrate this point. Generally speaking, most organisations like to see inventory turn rates go up.

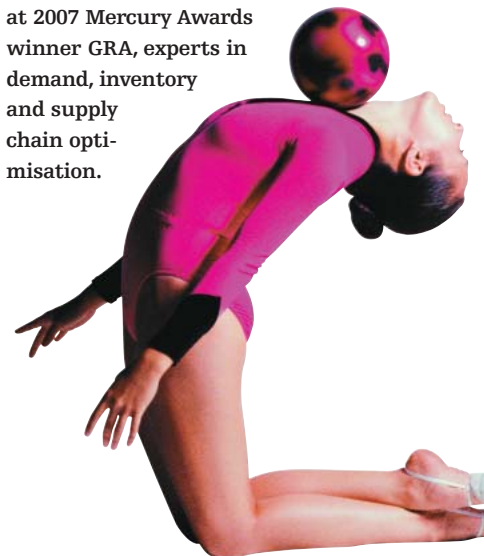
There is one very quick and effective way of achieving this. Just stop ordering. As you run out of stock, your turn rates will rise - for a little while.

Then, as your customers start leaving in droves because of abysmal service levels, your turn rates will fall back to earth as sales plummet. Clearly, not a great result. Make sure that for every measure, there is an equal and opposite measure.

So in conclusion, your performance measures should be consis-

tent with company strategy, you should have a good balance of meaningful and relevant measures, "top down" and "bottom up" measures should be integrated, and checks and balances should be in place to ensure positive outcomes.

Carter McNabb is Partner at 2007 Mercury Awards winner GRA, experts in demand, inventory and supply chain optimisation.



EXPERTS IN DEMAND, INVENTORY & SUPPLY CHAIN OPTIMISATION

We deliver:

- a minimum 3:1 ROI
- increased service levels up to 99.9%
- 20-40% inventory reduction
- reduced supply chain costs

To find out what we can do for you, call us on (03) 9421 4611.

www.gra.net.au