

Performance Management (A2)

September 6, 2006

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Outline

- Outline some pre-qualifications
- Elements of an overall performance measurement program
 - Strategic
 - Boundaries
 - External Measurement
 - Internal Measurement

Pre-Qualifications

- Perspective – Senior Accounting/Financial Officer of organization.
- Supporting all levels of organization from board/external stakeholders to middle Mgt.
- Can only do and be credible if basics within the financial and accounting are all working.
- Need this credibility as others can avoid negative feedback regarding performance if basic accounting can be questioned

Ensuring Credibility/Reputation of CFO

- Compare to building a condo
- The final decorated unit is what we see and admire
- The real strength and cost of the unit is largely in the foundation and the building.
- Without these the condo cannot last
- CFO needs the strongest of foundations

Desired Outcomes from CFO Perspective

- Provides rock solid, reliable information, including financial all believe
- Meet all external requirements (many)
- Fundamental Controls that work, and aid organization
- Favourable measurement of Organization by stakeholders including shareholders
- Organization and CFO benefit
- CEO, shareholders and financial community are delighted with CFO

Much like this living room of a large penthouse condo, result is great.



Basis of credibility and influence is the basics, the Foundation

- All the non-glamorous parts of the job.
- So is building a foundation of a condo!
- Not even seen when done in construction, normally not noticed as well in CFO's and his/her department doing their job.



Pre-qualification, summary

- Senior Financial person and this person's group need to be key to performance management and measurement
- They can only do so if all the basic financial and control systems are working and are seen as reliable by others.
- Like the Condo, they are the foundation and basic building structure that no one ever wants to have to consider.

Role of Performance Measurement

Management is the process of balancing tensions between:

- **Profits**
- **Growth, and**
- **Performance measurement which is in part control**

This notion is fundamental to any organization, and management, and is a healthy source of conflict when well managed and understood.

Performance measurement is how we exercise control in a mostly positive manner

Performance Measurement, 1st tool, Strategic.

- We all would agree need a strategy
- Often would refer to as good means of communications between board, senior management and employees
- But also should be part of performance measurement
- The start is what are longer term goals and to put them in an agreed upon Strategic plan
- What set out to do in current year, goal
- How much was achieved? Measurement

Performance Measurement, 1st tool, Strategic.

- Thus start of a strategic planning session should not be where are we going but past plan measurable outcomes compared with actual outcomes
- This should lead to in-depth discussion of what was achieved, what was not and why.
- This forms basis of development of next round of strategic plan
- Annual reviews with Boards becoming much more common, a major advance in goal setting and performance measurement

Performance Measurement, 1st tool, Strategic.

- Key is connecting development of strategy to implementation.

“Most often today, the difference between a company and its competitor is the ability to execute. Execution is the great unaddressed issue in the business world today. Its absence is the single biggest obstacle to success and the cause of most of the disappointments that are mistakenly attributed to other causes”.

Larry Bossidy, Chairman and CEO Honeywell International

Performance Measurement, 1st tool, Strategic.

- Recent addition to knowledge on strategy implementation has come from authors of BSC, Kaplan and Norton.
- It is an overall map, called the strategy map, with growing levels of detail moving down, that outlines how to implement the approved strategy.
- Like BSC, has many levels so can be understood and used from Board to middle Mgt.
- Most importantly allows measurement of outcomes to plan, real performance measurement!

Performance Measurement, 1st tool, Strategic.

- Strategy and its implementation is likely most powerful measurement tool a board has
- Many ways to do, Balanced Scorecard and Strategy Maps are very good given they allow measurement at board and several levels of company
- Is a much more positive control, because are focusing on reaching agreement on broad overall direction and how to measure, which is tough!
- Seek examples of how participants develop strategy and more importantly used processes to measure performance against the strategy.

Performance measurement, 2nd tool, Boundaries

- Very common to ignore, but of great help to board and senior management
- This is where do we want to participate, where not
- Ethics a good example, Want to grow internationally, how, what are the rules.
- Think of an oil company looking to grow in Russia or Nigeria.
- Example Cargill used ethics to penetrate China, Was very different boundary than two major competitors

Performance measurement, 2nd tool, Boundaries

- Good complete answer for any organization takes lots of exploration
- Should create clear boundary lines that would eliminate most acquisition opportunities in 10 minutes.
- ADM wants to process food, sell to manufacturers, but not be in branded consumer products, why do they sponsor talk shows on Sunday morning?
Understand boundary and how to succeed within

Performance measurement, 2nd tool, Boundaries

- This is a very good area for Board and management to spend considerable time.
- Enron, went from a simple transmission/generation company to a complex energy trading company, did the board understand the fundamental change?
- This was a huge leap, a fundamental change of the nature of the company, which the board was not prepared for in terms of membership.
- How many boundary lines can we think of that should only be crossed with lots of consideration?

Performance measurement, 2nd tool, Boundaries

- Some lines which may have been suggested
 - Ethical
 - Geographical
 - Level of risk/reward
 - Lines of business
 - Types of markets
 - Need for employee skills

Performance Measurement, 3rd Tool, External Measurement

- We are all more comfortable to internal
- Example, profits are up 50 % from last year and are 30% ahead of budget, is this good?
- Traditionally the answer would be yes, and indeed big bonuses paid
- Assume it is 2006 and this is an oil, copper or gold based company. Was this good performance?
- What is a better comparison?

Performance Measurement, 3rd Tool, External Measurement

- If external comparisons are better, what would be some?
- The results of a pre-agreed basket of companies in same industry?
- A sub index on a relevant stock exchange or a basket of pre-agreed companies stock price?
- How does this measure longer term focus versus shorter term?
- How does this measure capital expenditure management, for example in oil sands right now?

Performance Measurement, 3rd Tool, External Measurement

- There are narrower measurements for various levels of management, for example
 - Market share
 - Geographical penetration
 - Average costs when the industry allows, such as can be done in oil and gas industry.
 - Sales from newer products
- Note how much broader this can be than internal budgets.

Performance Measurement, 4rd Tool, Internal Measurement

- Easiest to do, with enterprise systems today, can turn out far too many measurements, key is what are the key indicators, the half dozen factors that if someone at that level manages well will be game breakers.
- Largest challenge is what to measure?
- Airline service example, two measures, overtime and average hours/aircraft wrong

Performance Measurement, 4rd Tool, Internal Measurement

- Clearly Boards need comparison to last year and budget
- Management needs to do similar measurements of performance, but this is hardly enough.
- Such things deal with the fundamentals, but will not take you from good to great, they are constraining mostly

Summary of Performance Measurement

1. Strategic

2. Boundaries

3. External measurements

4. Internal measurements

Size is relevant relationship of probable impact