SAS | The Power to Know.

Performance Management: Making it Work

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CMA – CAM-I
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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:

- the acclaimed An ABC Manager's Primer (ISBN 0-86641-220-4) sponsored by the Institute of Management Accountants (IMA).

- Activity Based Cost Management: Making it Work (ISBN 0-7863-0740-4), which was judged by the Harvard Business School Press as "read this ABC book first."

- Activity Based Cost Management: An Executive's Guide (ISBN 0-471-44328-X) recently ranked #1 'bestselling' of 151 books on the topic.

- Performance Management: Finding the Missing Pieces to Close the Intelligence Gap (ISBN 0-471-57690-5).


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

- 238 offices in 53 countries
- 10,00 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

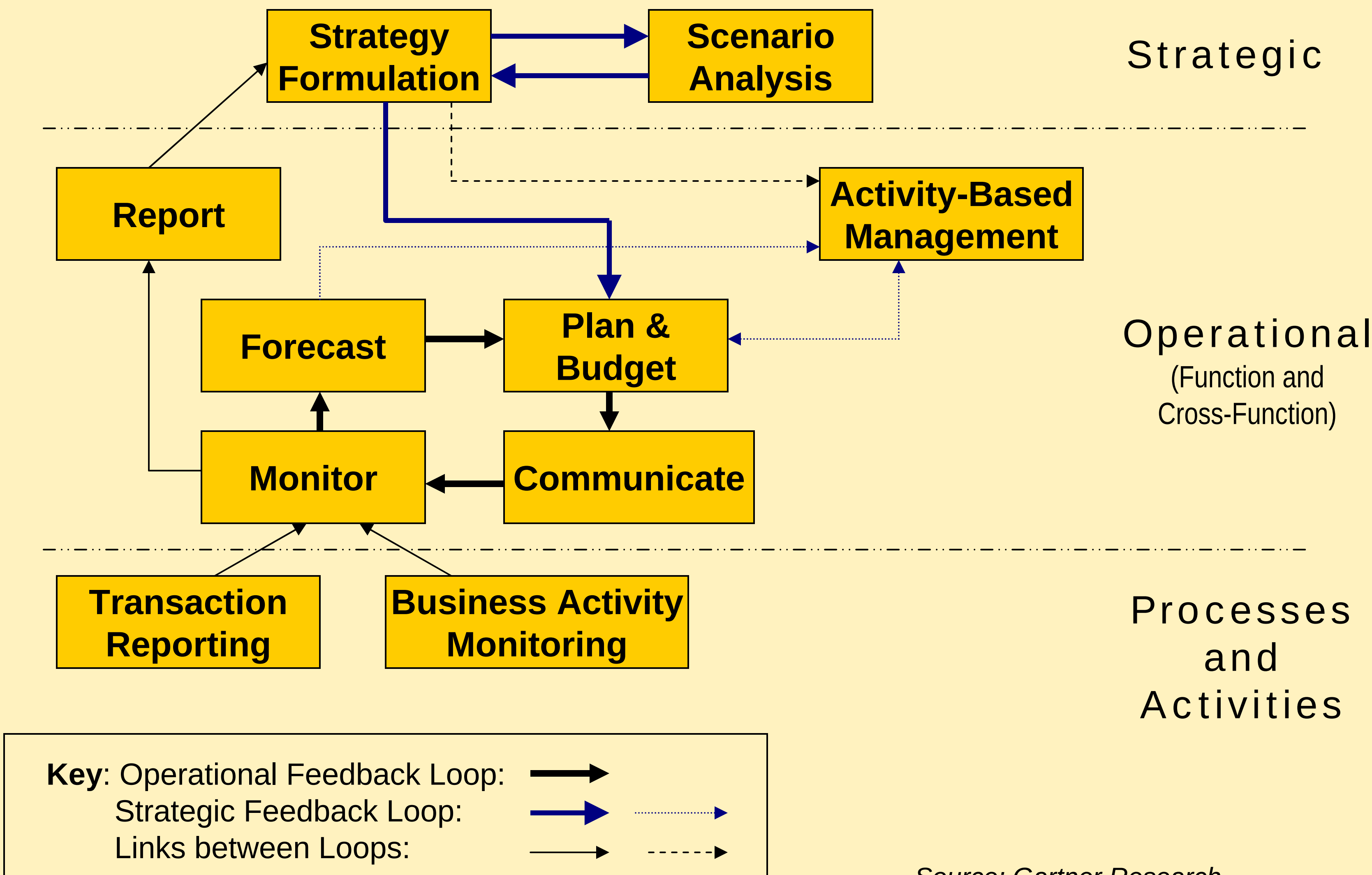
- Missed ROI Promises from CRM and ERP

Value Multiplier through Integration

What Does Performance Management Look Like?

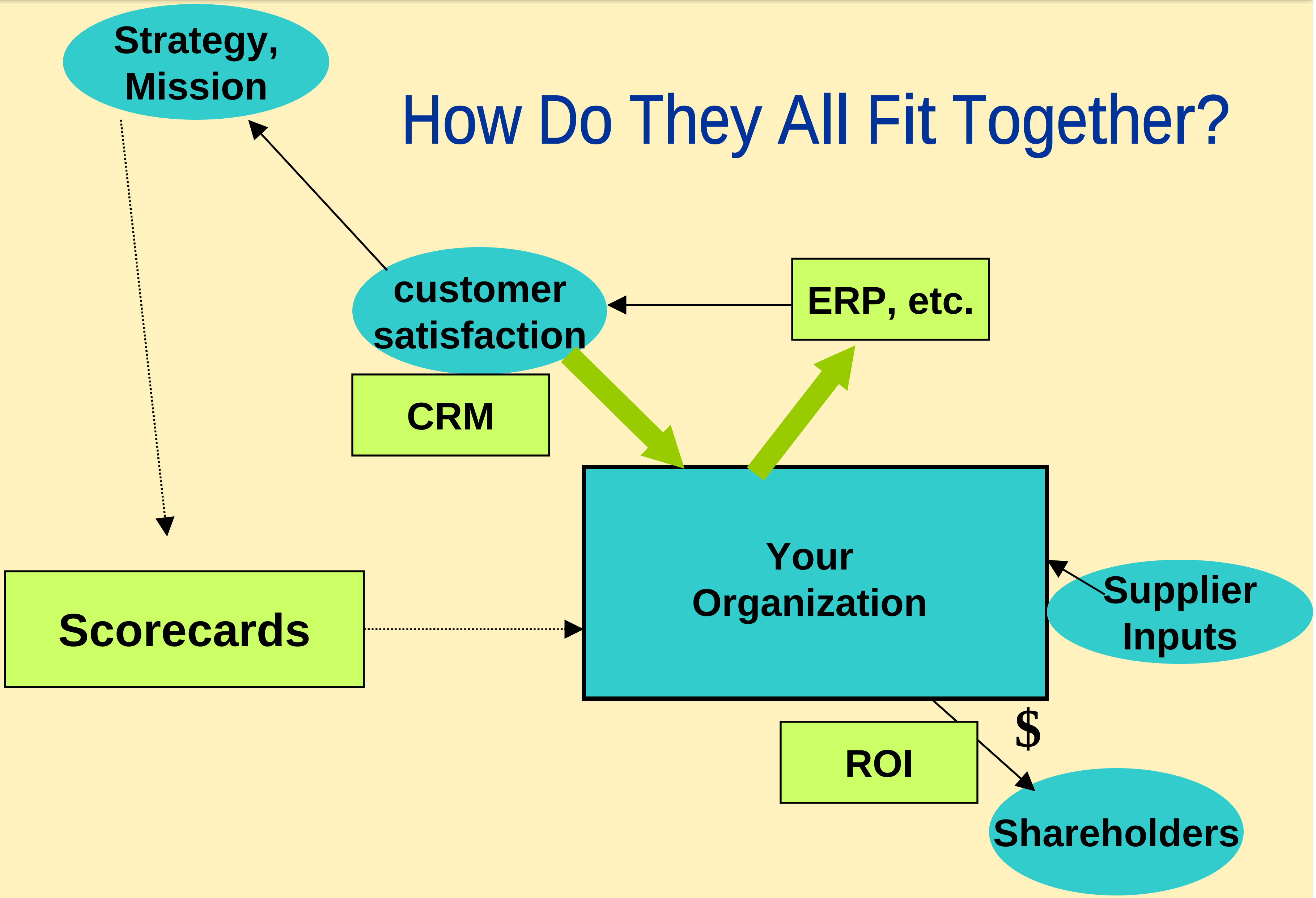
There are a few information technology views.

An IT Performance Management Framework



Source: Gartner Research

How Do They All Fit Together?



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

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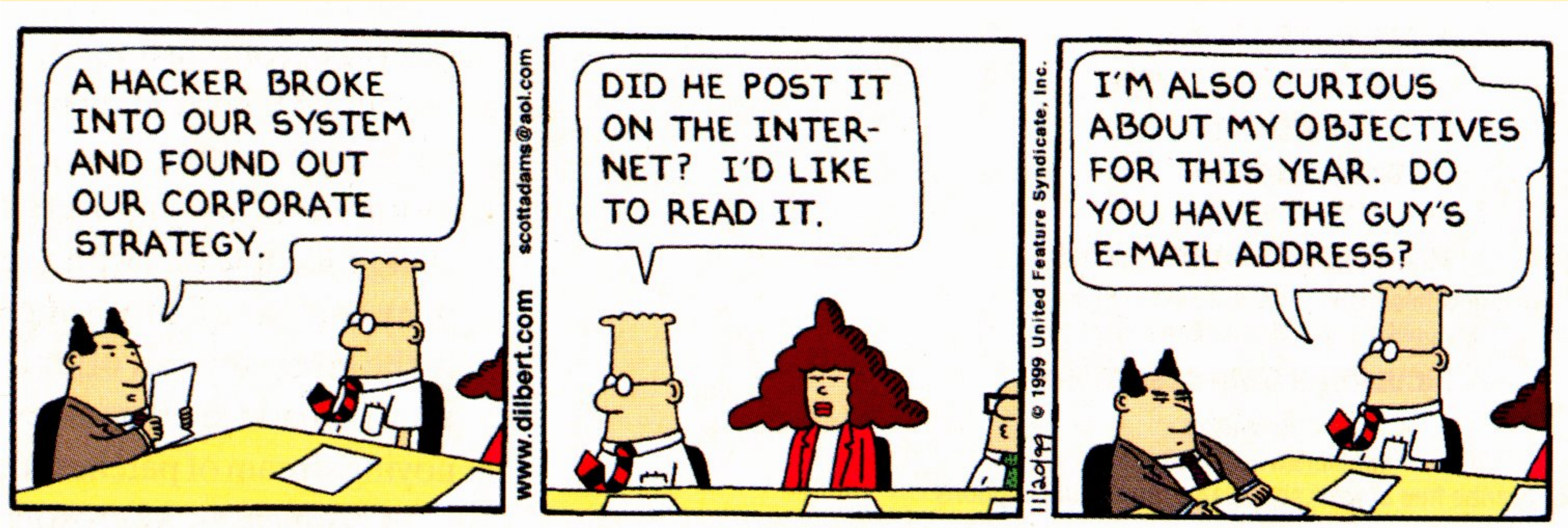
(1) What's the Problem?

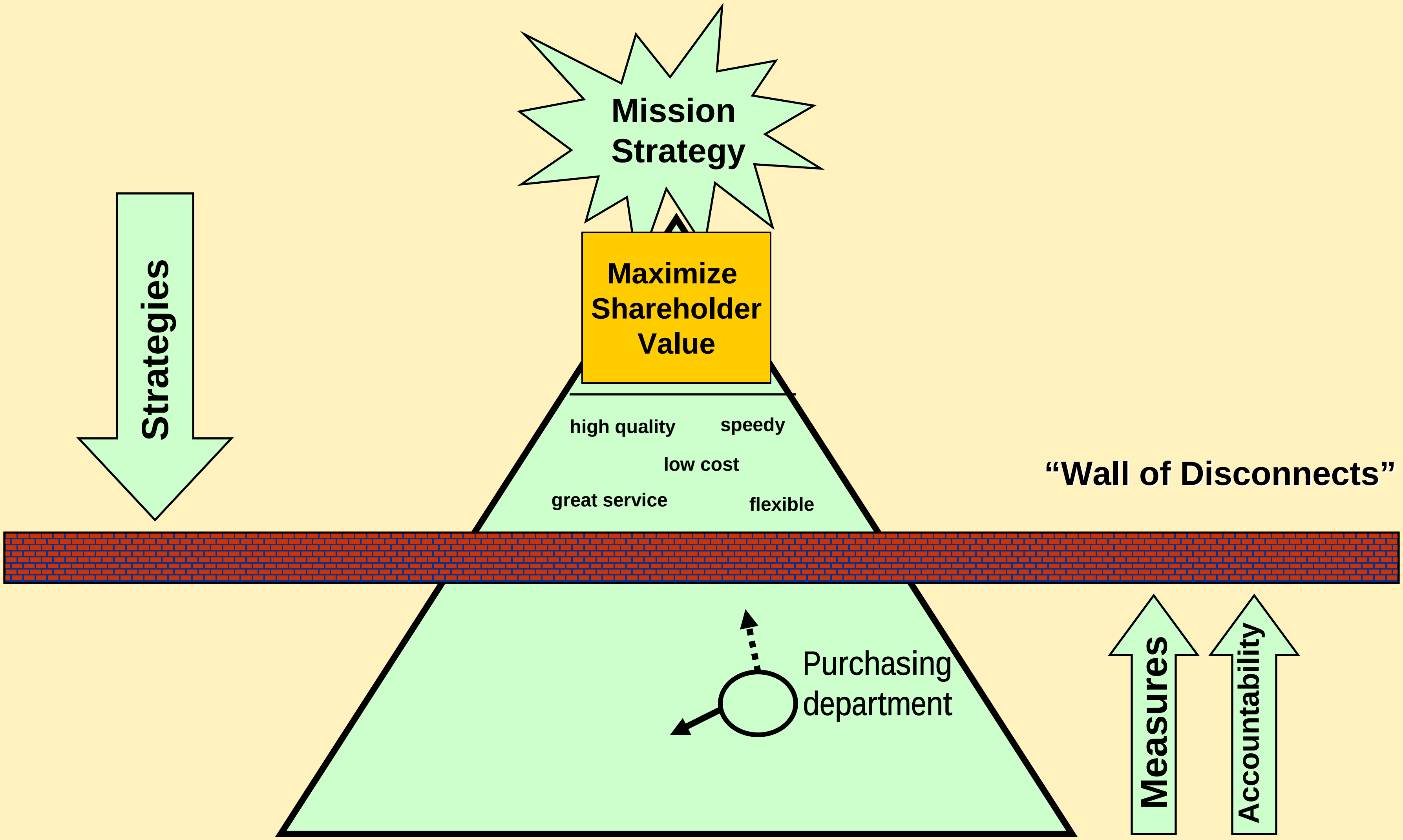
Executives are failing to successfully implement their strategy.

… 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



Sub-optimization of work

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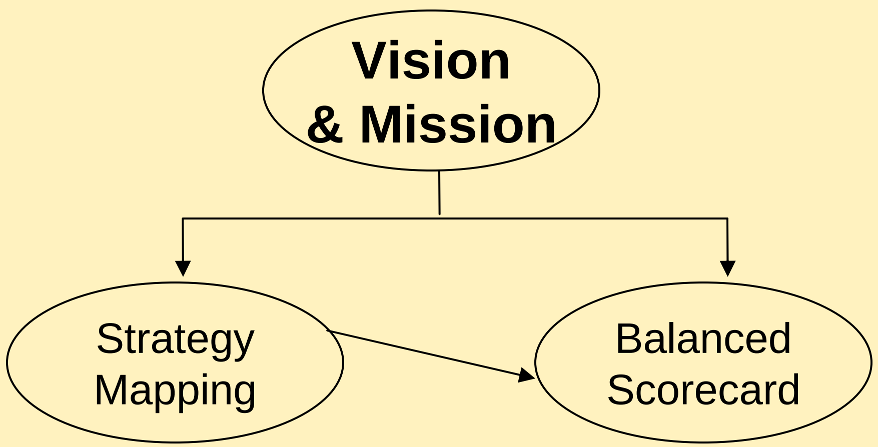
Vision and Mission Statements



A Vision statement answers "where do we want to go?"

<u>Examples:</u>

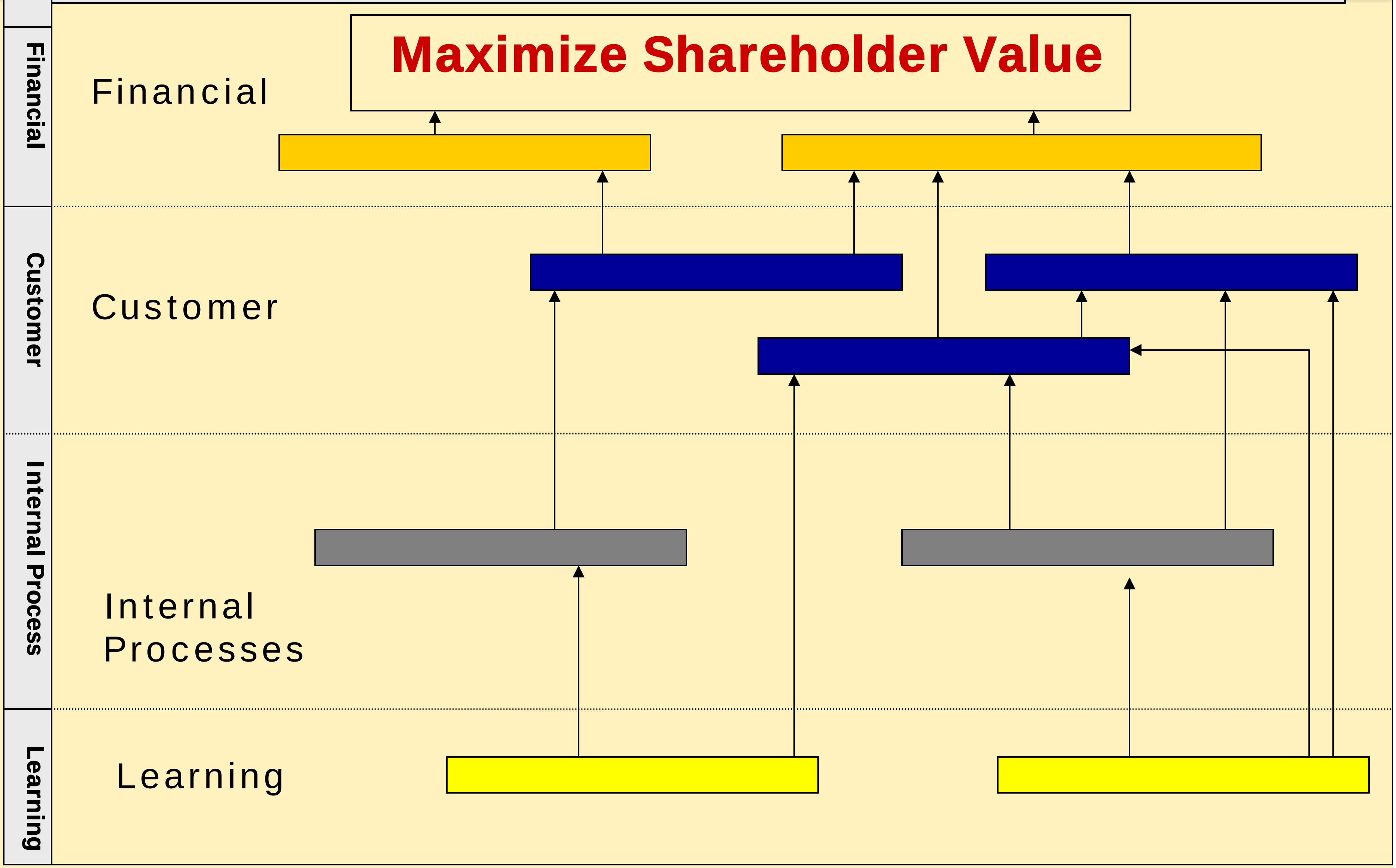
USA President Kennedy, "We will put a man on the moon."

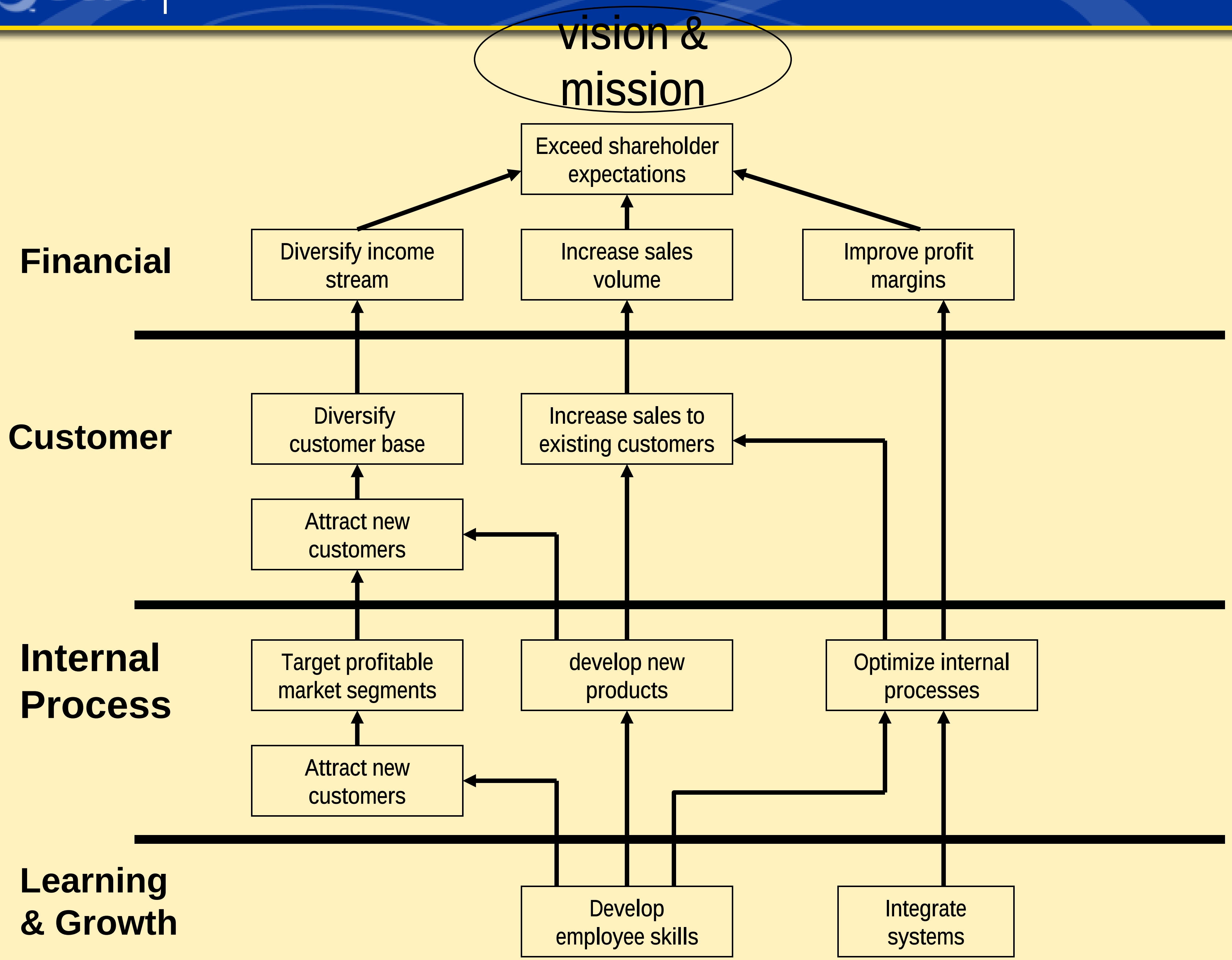
Microsoft, "A computer on every desktop."

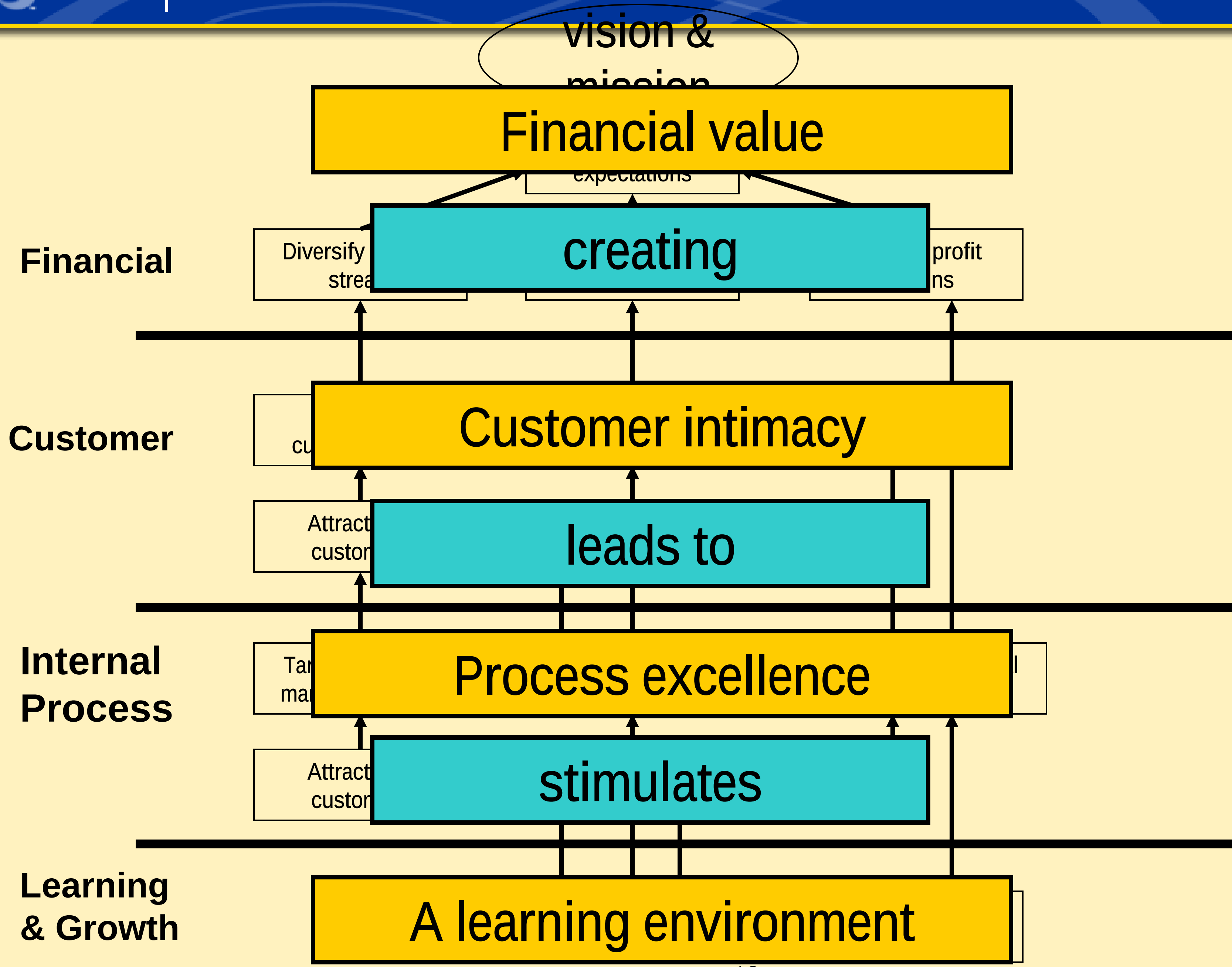
Strategy maps and scorecards answer, "How will we get there?"

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

Generic Strategy Map Architecture



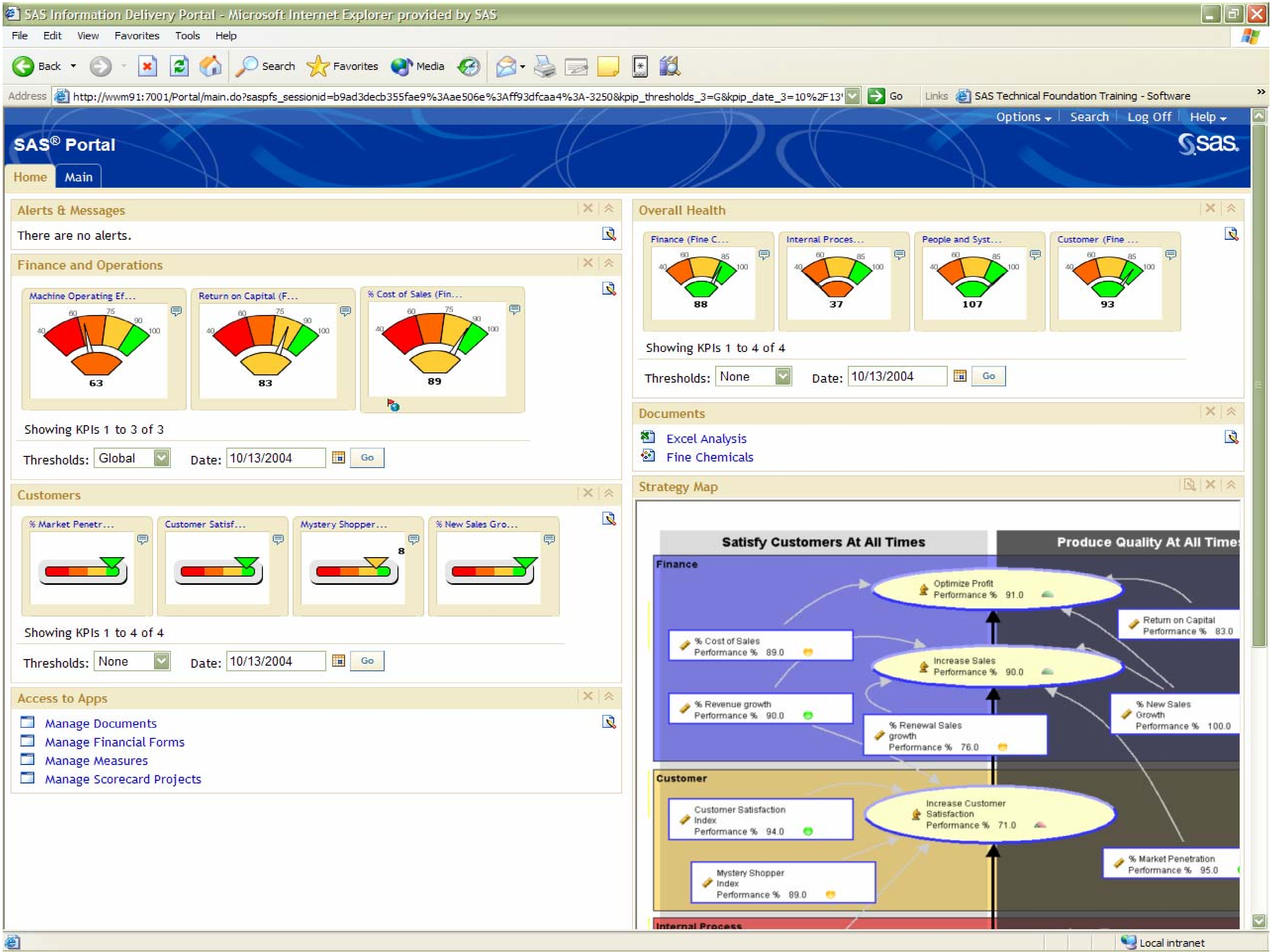

vision & mission
Exceed shareholder expectations
Financial
Diversify income stream
Increase sales volume
Improve profit margins
Customer
Diversify customer base
Increase sales to existing customers
Attract new customers
Internal Process
Target profitable market segments
develop new products
Optimize internal processes
Attract new customers
Learning & Growth
Develop employee skills
Integrate systems


vision & mission
Financial value
expectations
creating
Diversify strea
profit ns
Financial
Customer
Customer intimacy
cu
leads to
Attract custon
Internal Process
Process excellence
Ta ma
stimulates
Attract custon
Learning & Growth
A learning environment

Who Does What?

1st Quarter						
	Strategic Objective	Identify Projects, Initiatives, or Processes	Measure	KPI Target	KPI Actual	comments / explanation
Executive Team	**X**			**X**		
Managers and Employees		**X**	**X**		***their score***	***X***
					<----- period results -------->	

A scorecard is more of a <u>social</u> tool than a technical tool.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Go Links SAS Technical Foundation Training - Software
Options Search Log Off Help
SAS® Portal
Home Main
Alerts & Messages
There are no alerts.
Finance and Operations
Machine Operating Ef...
Return on Capital (F...
% Cost of Sales (Fin...
63
83
89
Showing KPIs 1 to 3 of 3
Thresholds: Global Date: 10/13/2004 Go
Customers
% Market Penetr...
Customer Satisf...
Mystery Shopper...
% New Sales Gro...
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Thresholds: None Date: 10/13/2004 Go
Access to Apps
Manage Documents
Manage Financial Forms
Manage Measures
Manage Scorecard Projects
Overall Health
Finance (Fine C...
Internal Proces...
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Customer (Fine ...
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Documents
Excel Analysis
Fine Chemicals
Strategy Map
Satisfy Customers At All Times
Produce Quality At All Times
Finance
Optimize Profit Performance % 91.0
Return on Capital Performance % 83.0
% Cost of Sales Performance % 89.0
Increase Sales Performance % 90.0
% Revenue growth Performance % 90.0
% Renewal Sales growth Performance % 76.0
% New Sales Growth Performance % 100.0
Customer
Customer Satisfaction Index Performance % 94.0
Increase Customer Satisfaction Performance % 71.0
% Market Penetration Performance % 95.0
Mystery Shopper Index Performance % 89.0
Internal Process
Local intranet

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.

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Scorecard Lessons Being Painfully Learned

Scorecard or Report Card?

KPIs, not PIs

AGENDA

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Value Multiplier through Integration

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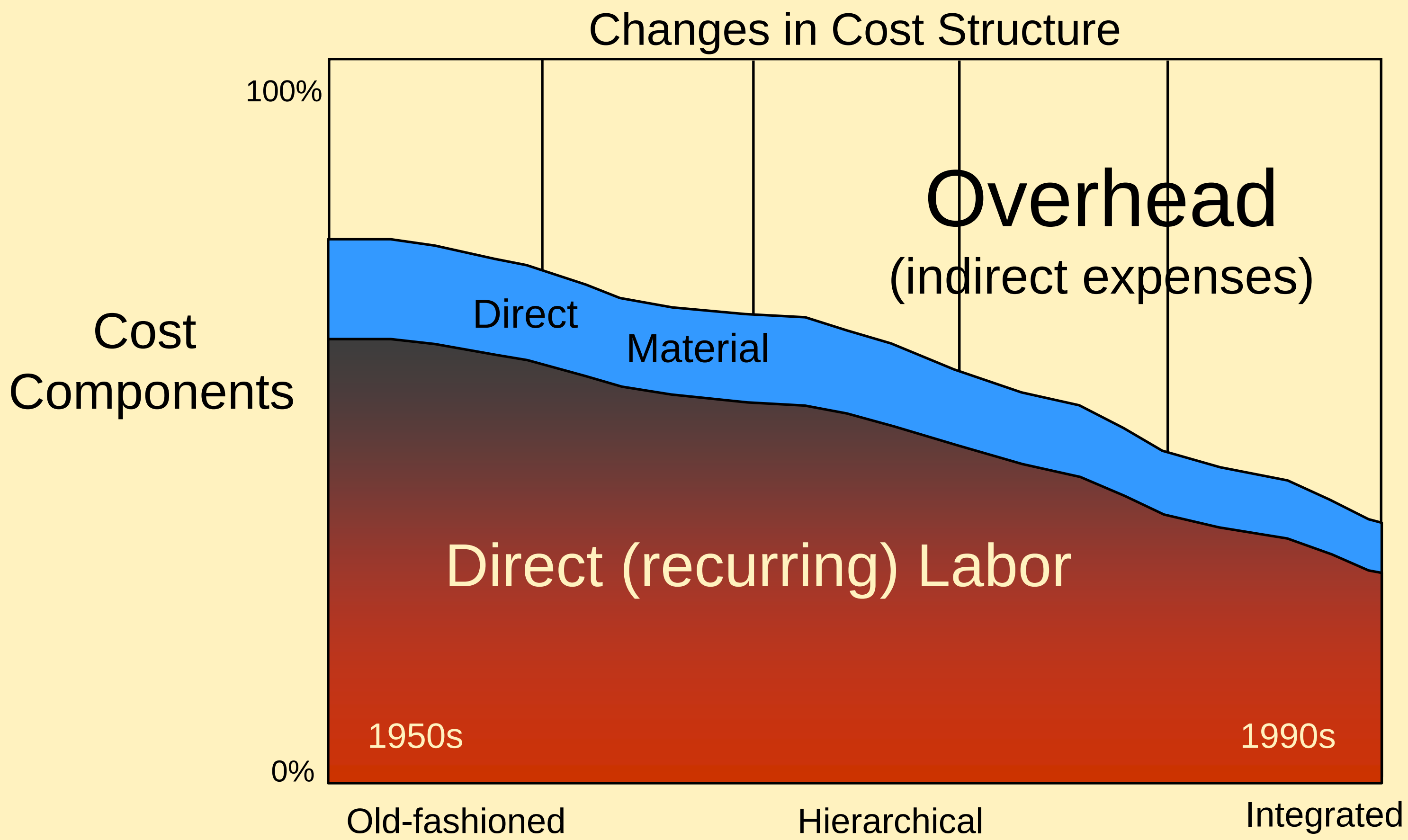
(2) What’s the Problem?

Managers and employees do not trust the accounting system.

The Need for ABM



Stages in the Evolution of Businesses

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The General Ledger View is Structurally Deficient for Decision Analysis.

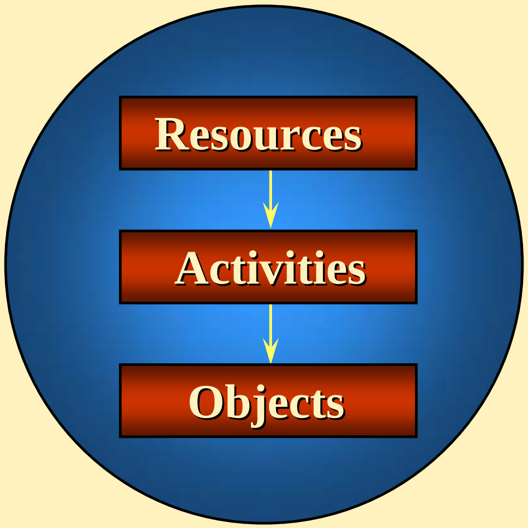
Chart-of-Accounts View

Insurance Claims Processing Department

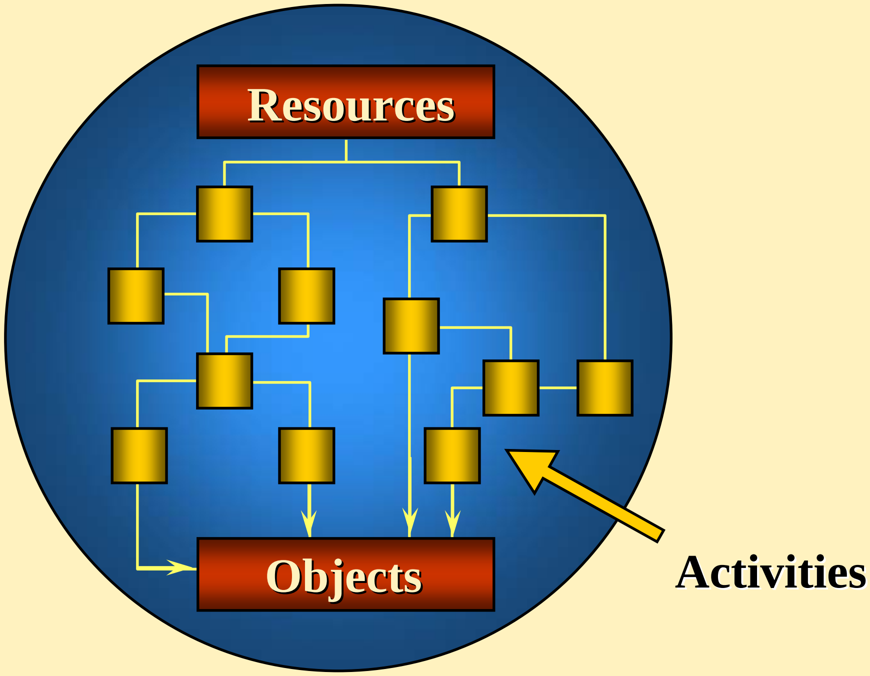
	Actual	Plan	Favorable/ (unfavorable)
Salaries	$621,400	$600,000	$(21,400)
Equipment	161,200	150,000	(11,200)
Travel expense	58,000	60,000	2,000
Supplies	43,900	40,000	(3,900)
Use and occupancy	30,000	30,000	—
Total	$914,500	$880,000	$(34,500)

When managers get this kind of report, they are either happy or sad, but they are rarely any smarter!

Multi-Stage Cost Flowing

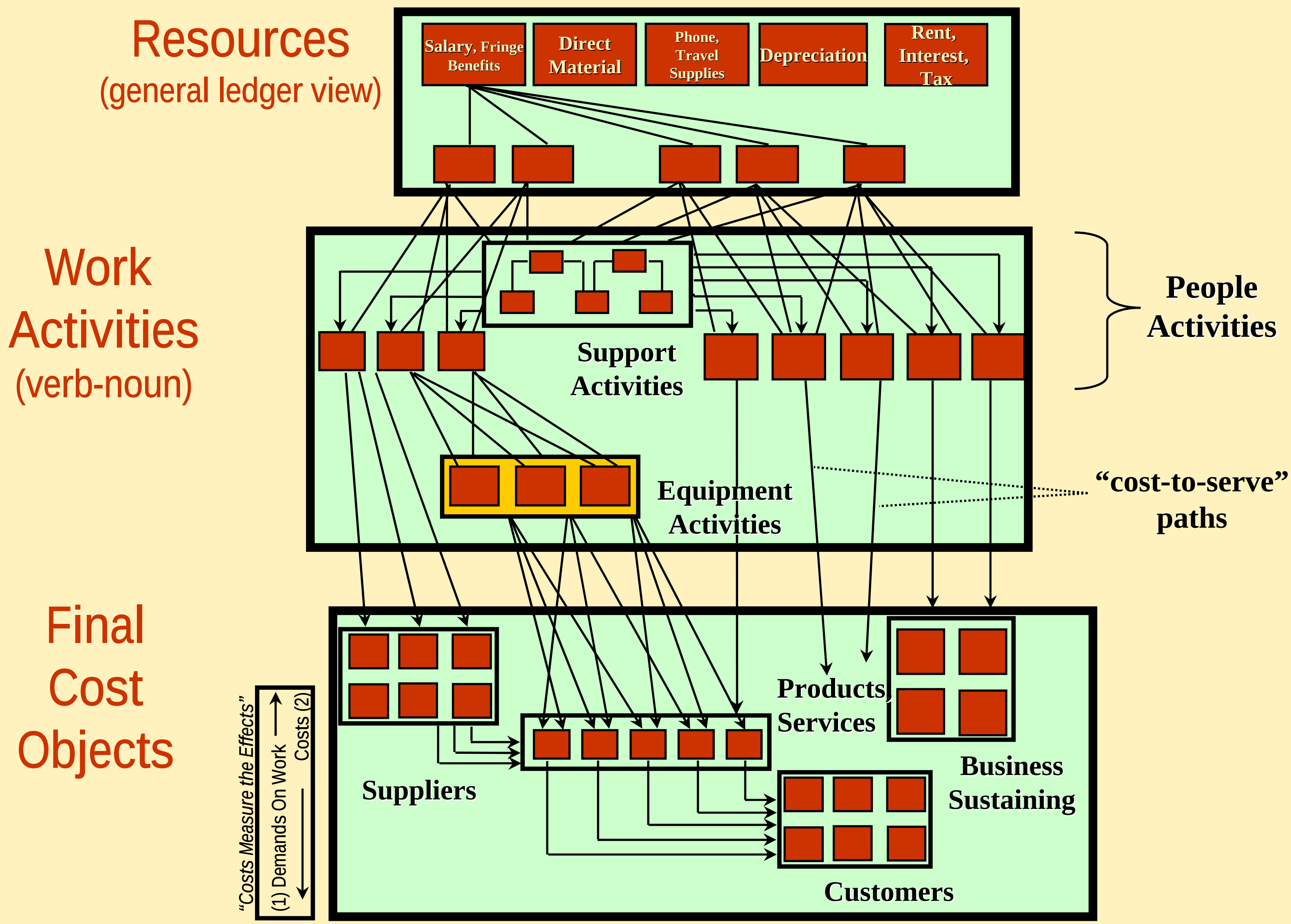


Simple ABM

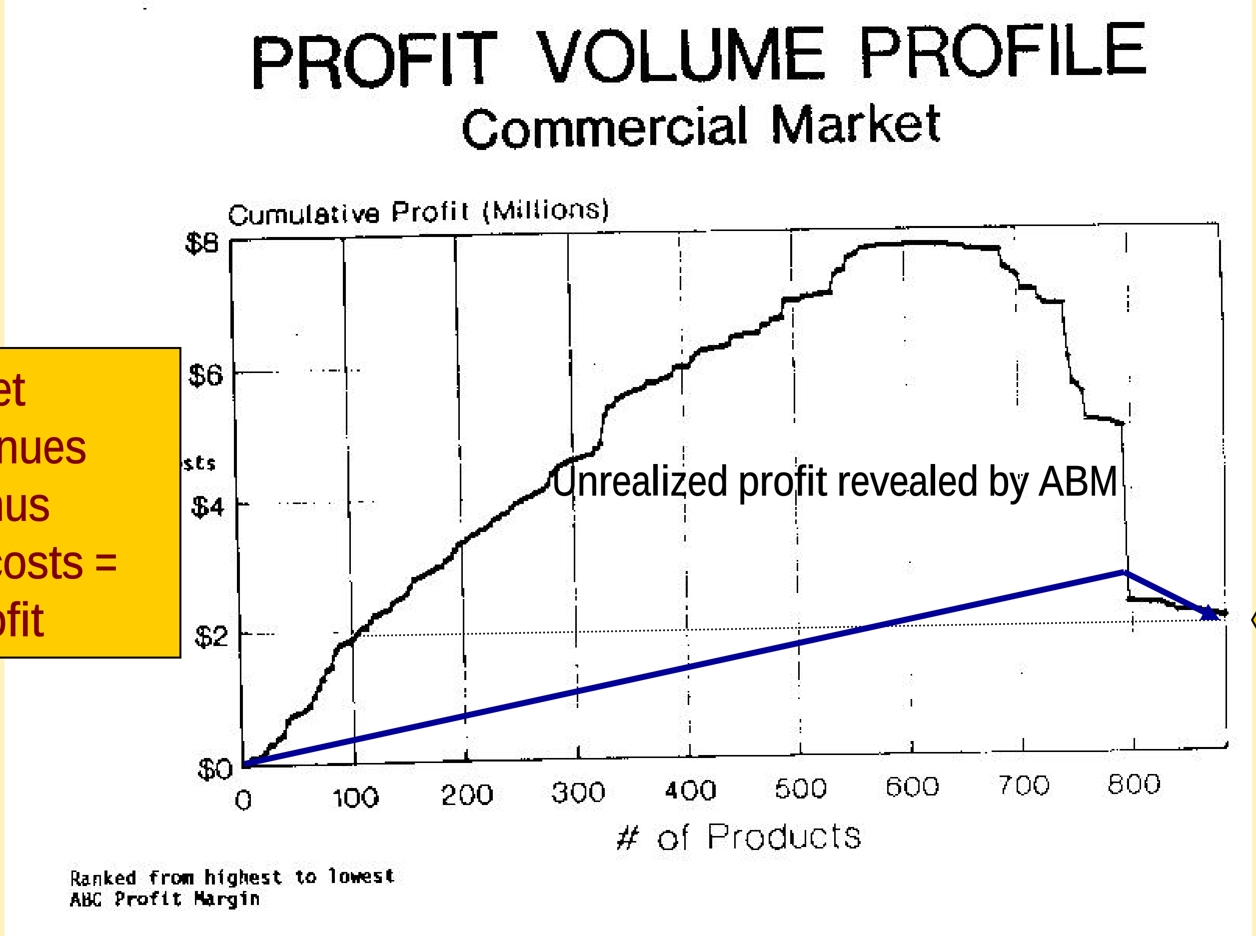


Expanded ABM

ABC/M Cost Assignment Network



$ 30 sales
- 28 expenses
= $ 2 profit

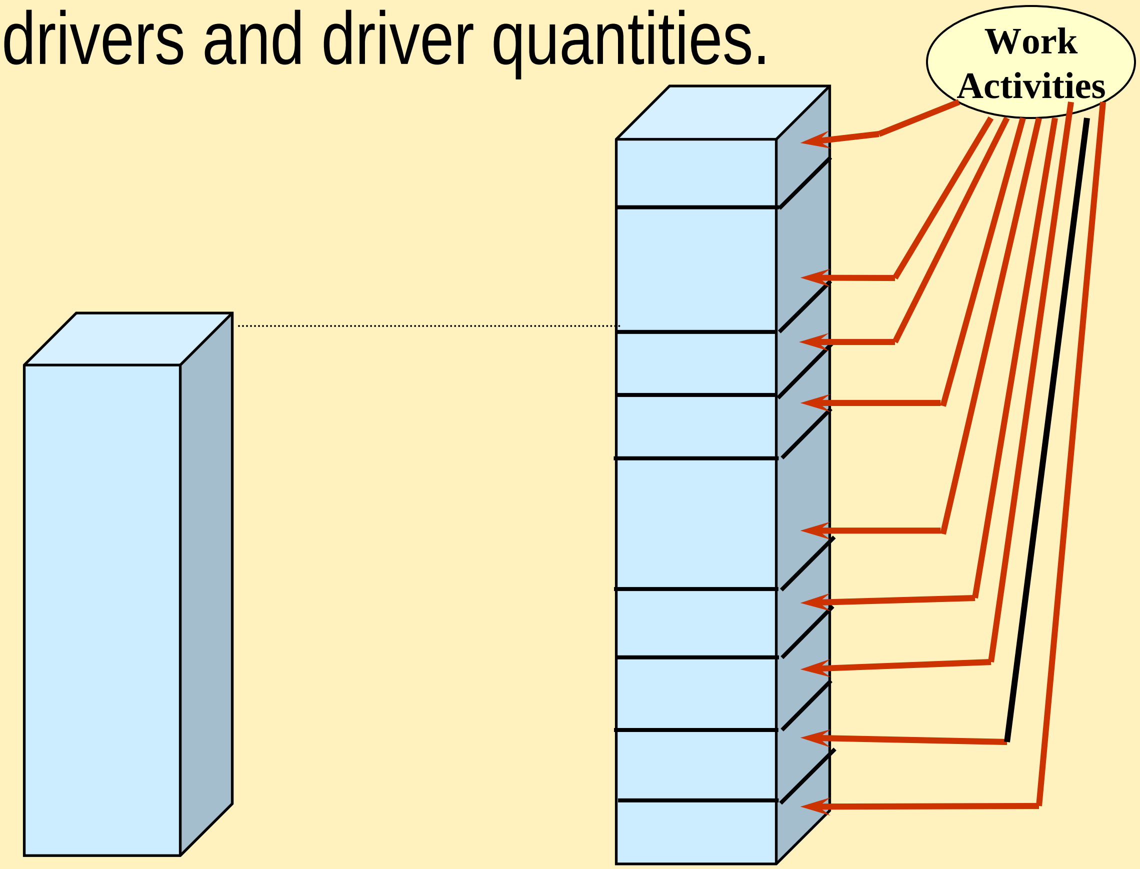


Net Revenues Minus ABM costs = profit

$ 2 profit

Bill of Activity Costs

ABM provides insight for the product's or service's cost drivers and driver quantities.



each activity's driver quantity

X

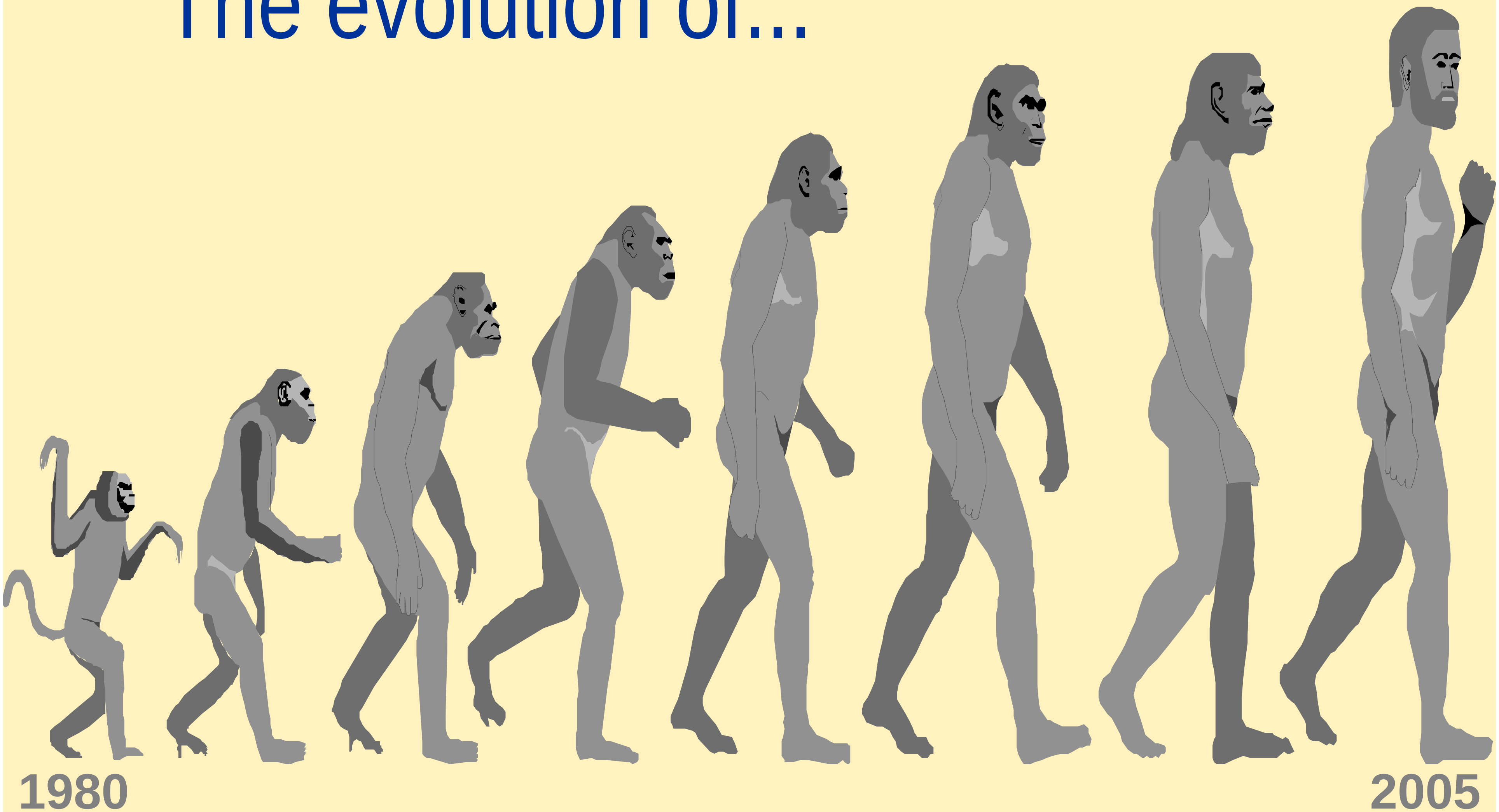
unit activity driver cost

(eg. # of registrations)

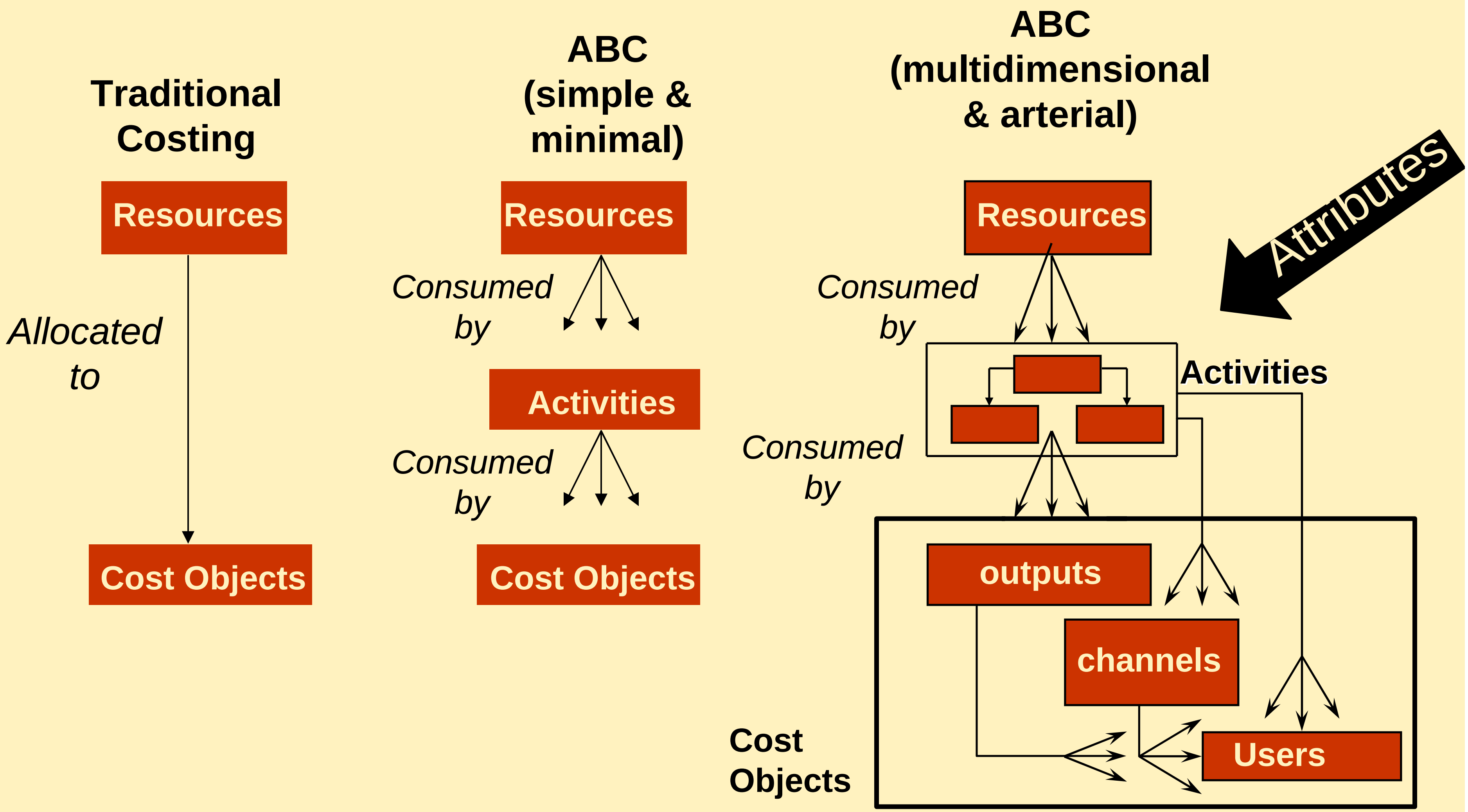
Price/Fee (Revenue)

Activity Costs

The evolution of...



Darwin's Evolution of Cost Accounting Methods



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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.

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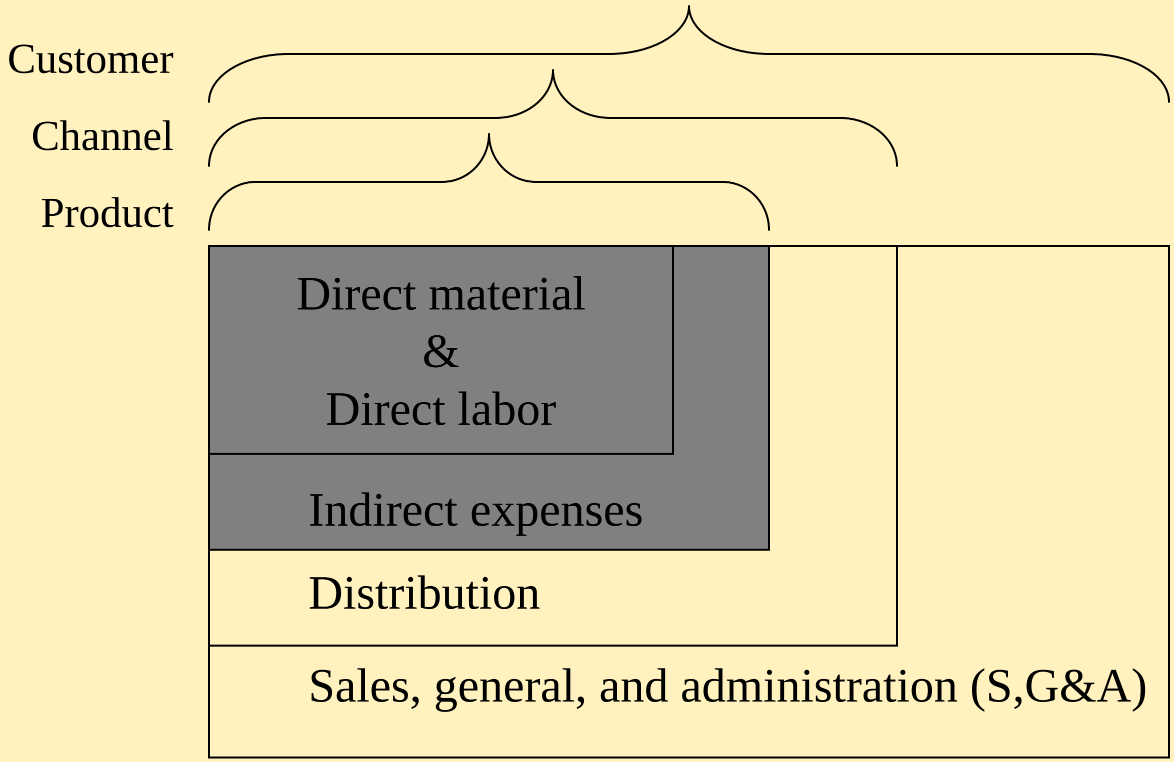
CEO Concerns

Source: Gartner, 2004: "Bank CEOs Rate Business & Technology Concerns"

Adding S,G, & A Cost Objects

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



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

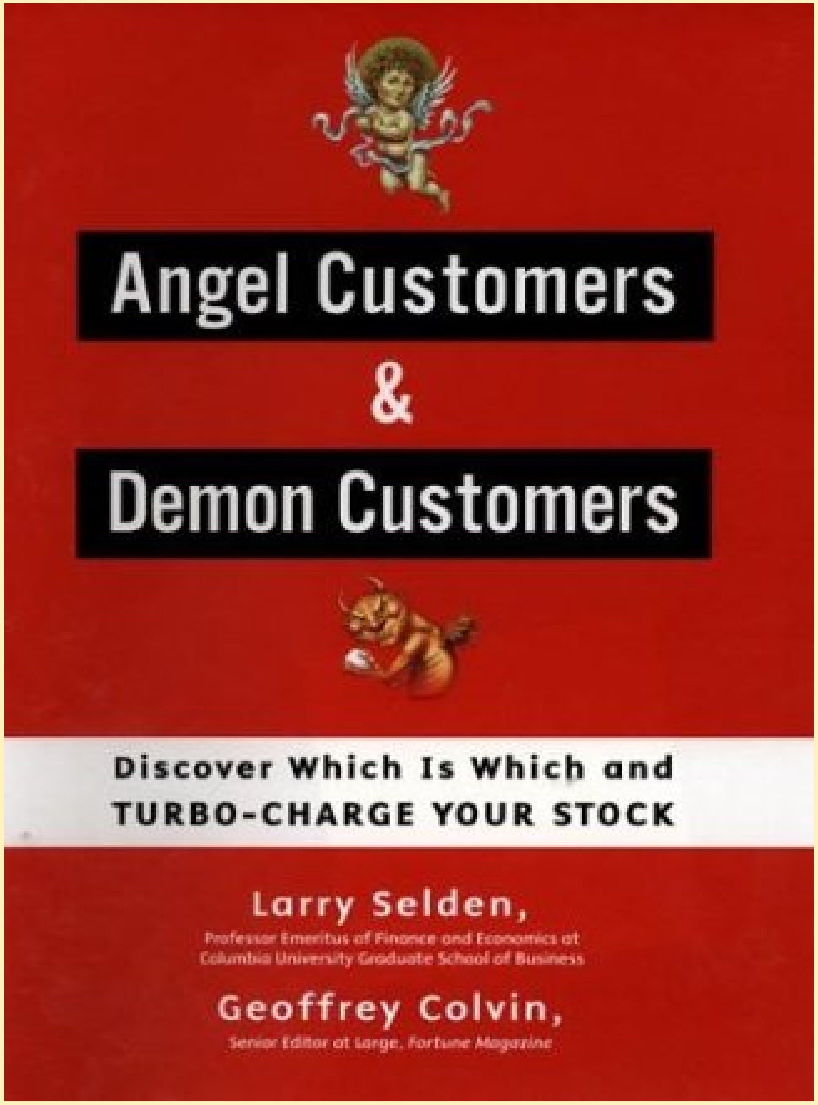
- **<u>Less</u> profitable customers**

  They make you jump through flaming hoops!

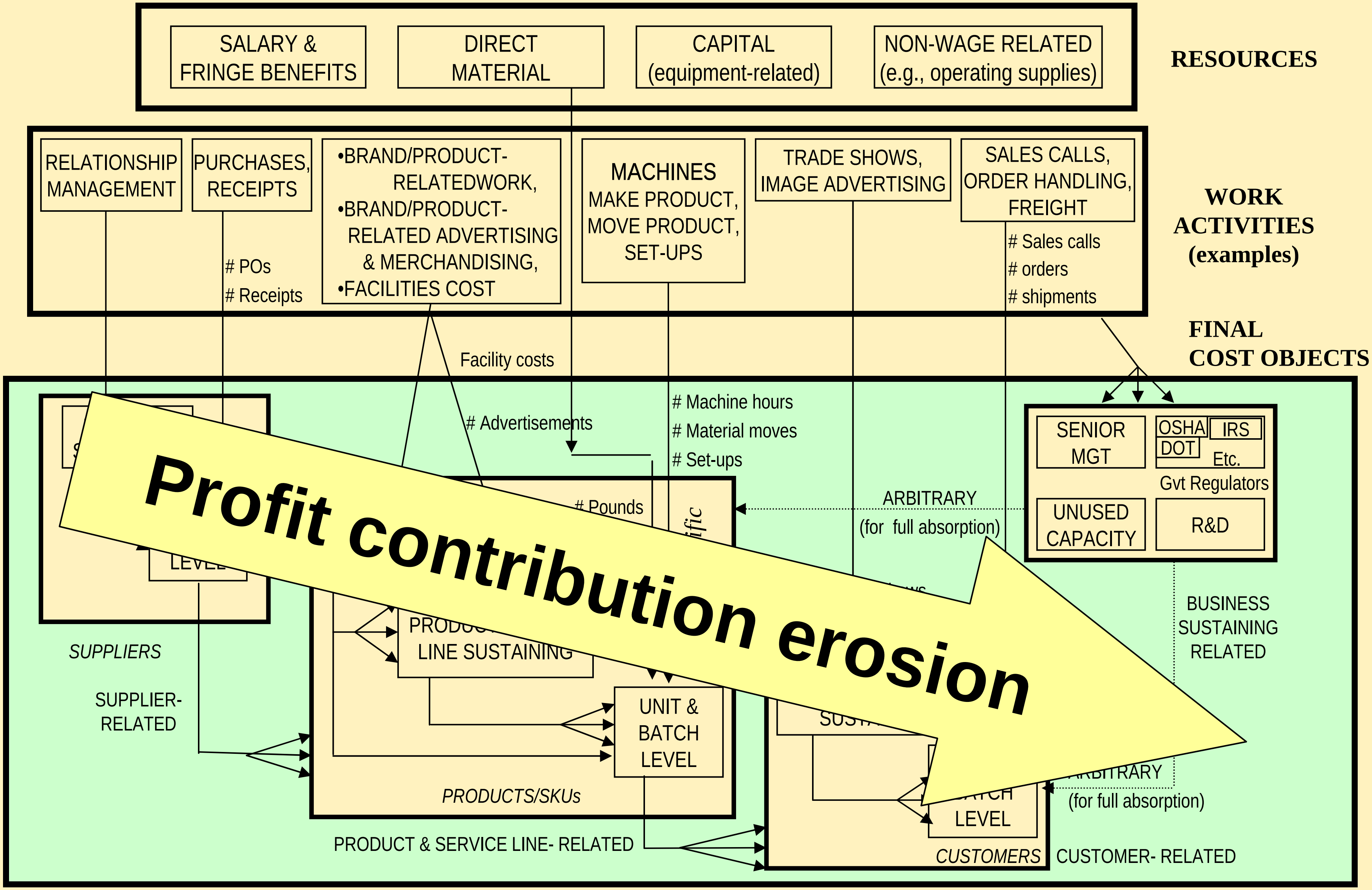
- **<u>More</u> profitable customers**

  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


Angel Customers
&
Demon Customers
Discover Which Is Which and
TURBO-CHARGE YOUR STOCK
Larry Selden,
Professor Emeritus of Finance and Economics at
Columbia University Graduate School of Business
Geoffrey Colvin,
Senior Editor at Large, Fortune Magazine

ABC/M Profit Contribution Margin



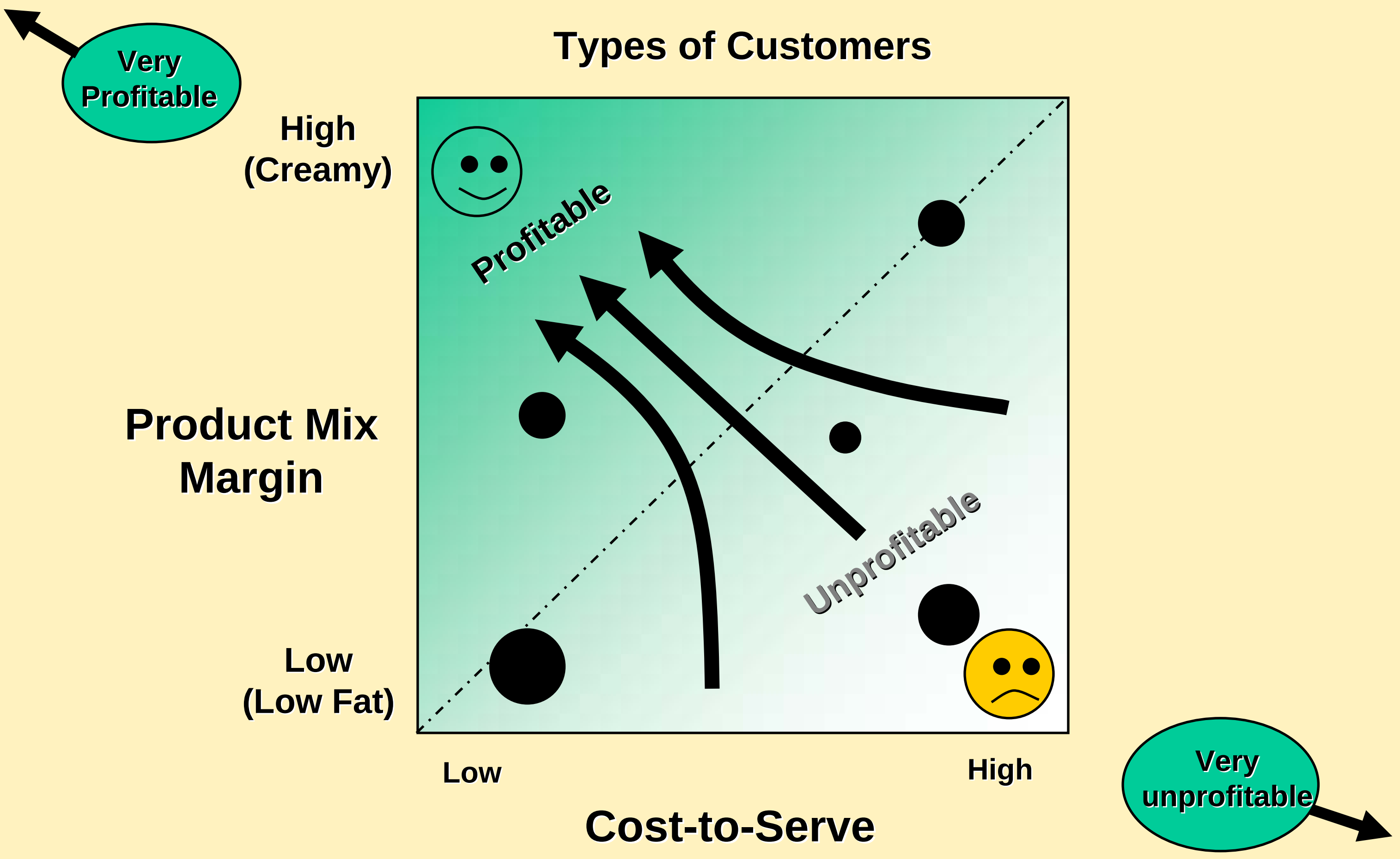
ABM Customer Profit & Loss Statement

CUSTOMER: XYZ CORPORATION (CUSTOMER #1270)

Sales	$$$	Margin $ (Sales - ΣCosts)	Margin % of Sales	
Product-Related				
Supplier-Related costs (TCO)	$ xxx	$ xxx	98%	Product-related costs
Direct Material	xxx	xxx	50%	
Brand Sustaining	xxx	xxx	48%	
Product Sustaining	xxx	xxx	46%	
Unit, Batch*	xxx	xxx	30%	
Distribution-Related				
Outbound Freight Type*	xxx	xxx	28%	Channel & Customer-related costs
Order Type*	xxx	xxx	26%	
Channel Type*	xxx	xxx	24%	
Customer-Related				
Customer-Sustaining	xxx	xxx	22%	
Unit-Batch*	xxx	xxx	10%	
Business Sustaining	xxx	xxx	8%	
Operating Profit		xxx	8%	

* Activity Cost Driver Assignments use measurable quantity volume of Activity Output
(Other ActvityAssignments traced based on informed (subjective) %s)

Migrating Customers to Higher Profitability



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What is Performance Management … and Why?

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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	Dentist B
Sales = $750,000	Sales = $375,000
profits = $100,000	profits = $40,000
Age 61	Age 21

Which is more profitable?
Which is more valuable?

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Current vs. Long-Term Potential Value

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

high

current
profit
contribution
(static)

low

… you'd view existing customers in different categories.

substantial

limited

future potential
(long-term)

Current vs. Long-Term Potential Value

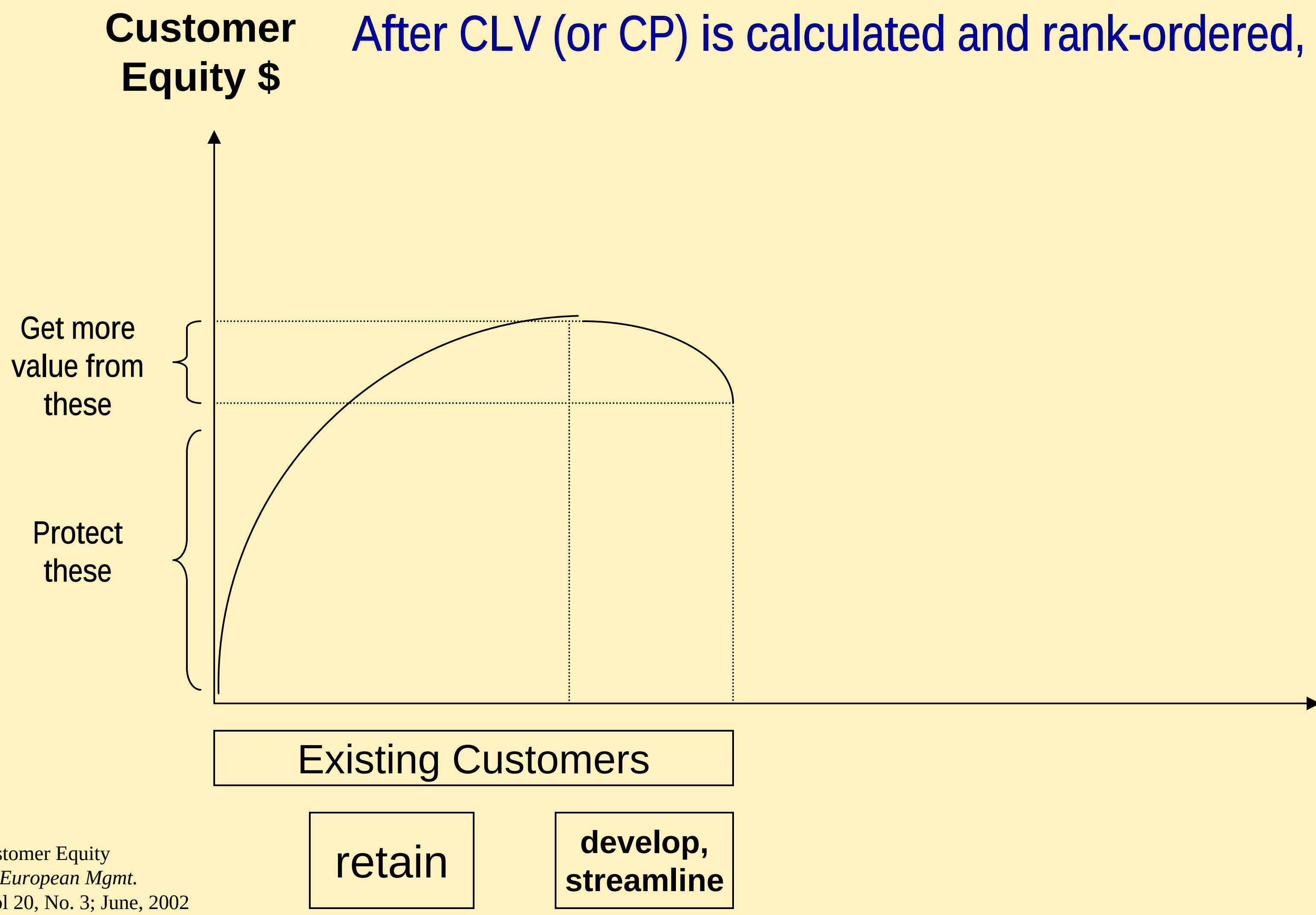
There appear to be obvious customer strategies for each category.

current profit contribution (static)	substantial	limited
high	most favored status	defend & retain
low	maximize	manage up or out

future potential (long-term)

Value Creation via CLV

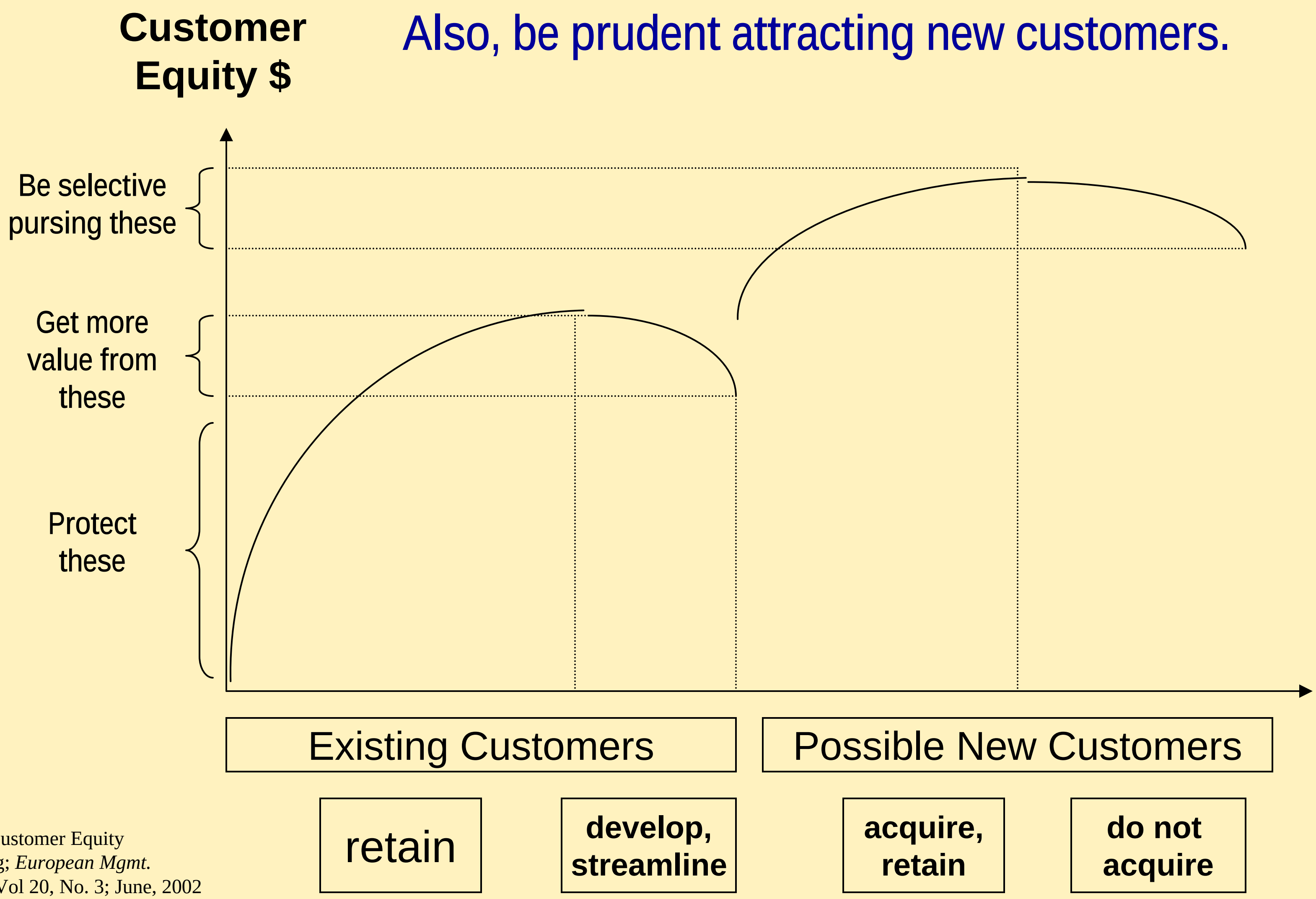
After CLV (or CP) is calculated and rank-ordered, then ...



Source: Customer Equity Marketing; *European Mgmt. Journal*; Vol 20, No. 3; June, 2002

Value Creation via CLV

Also, be prudent attracting new customers.



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 preciously 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?

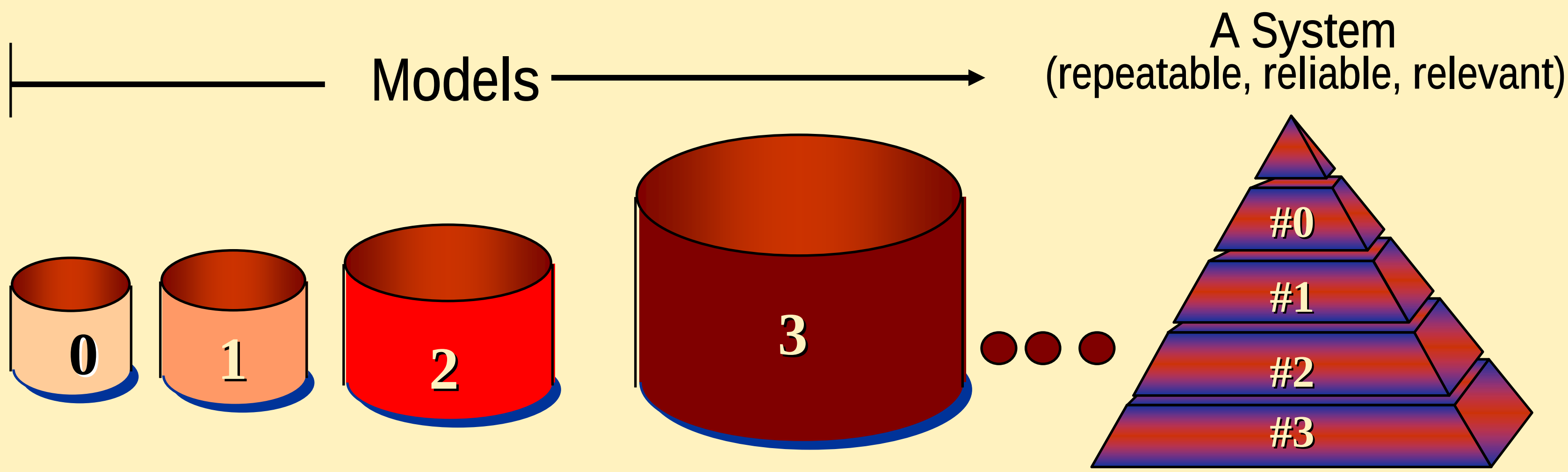
How much should we spend attracting, retaining, growing, or recovering each customer segment?

A Shift in the CFO's Emphasis

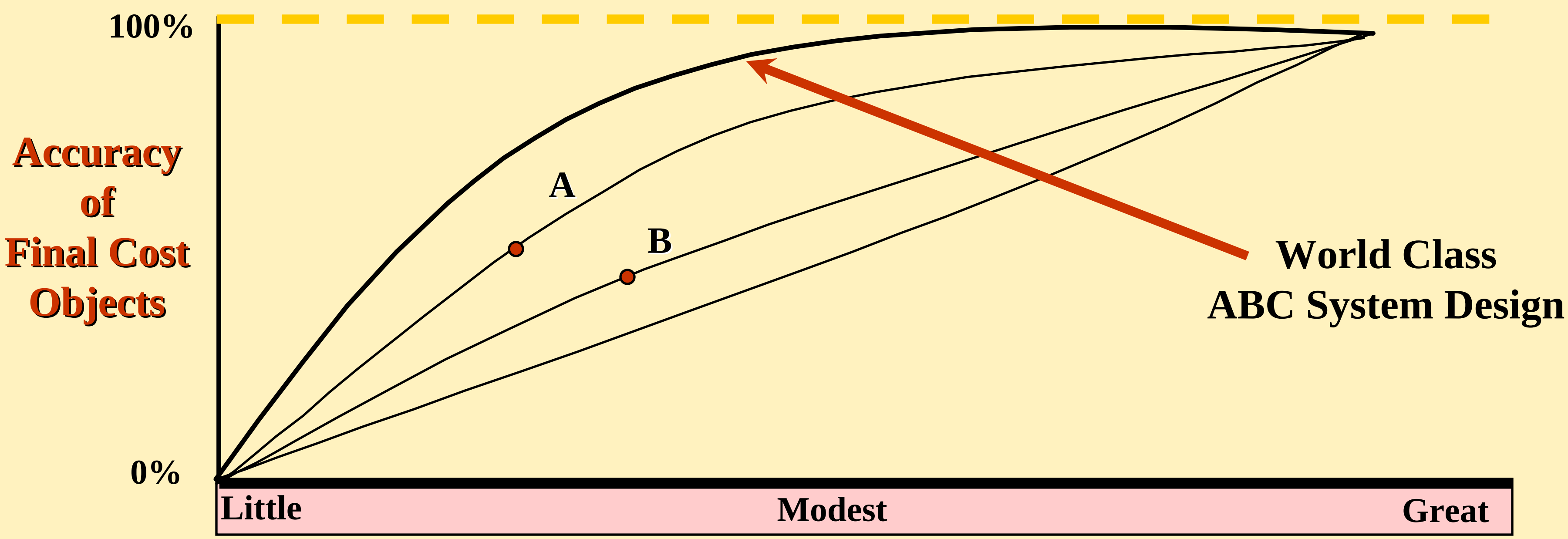
The CFO is now aiding Sales and Marketing.

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



Balancing Levels of Accuracy with Effort



Level of Data Collection Effort

The Power to Know.

What’s the Problem?

Annual Budgeting !! –

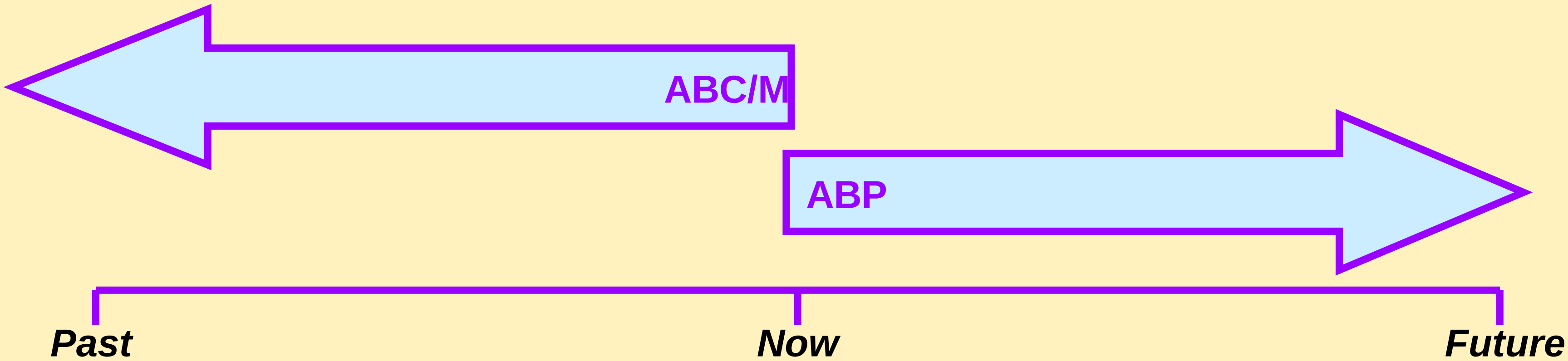
The budget is typically a fiscal exercise by the accountants that is disconnected from the exectutiv team’s strategy

The Annual Budgeting Process is Disconnected From Strategy

1st Quarter						
	Strategic Objective	Identify Projects, Initiatives, or Processes	Measure	KPI Target	KPI Actual	comments / explanation
Executive Team	X			X		
Managers and Employees		X	X		*their score*	*X*
					<----- period results ------->	

But this problem is solved if management funds the managers' projects.

Historic Reporting vs. Predictive Costing



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

- <u>Activity-Based Planning</u>
  - **Predictive**
  - **Requires capacity analysis**
  - **Starts with estimated outputs**
  - **Applies ABC/M rates**
  - **Solves for Resource “expenses”**

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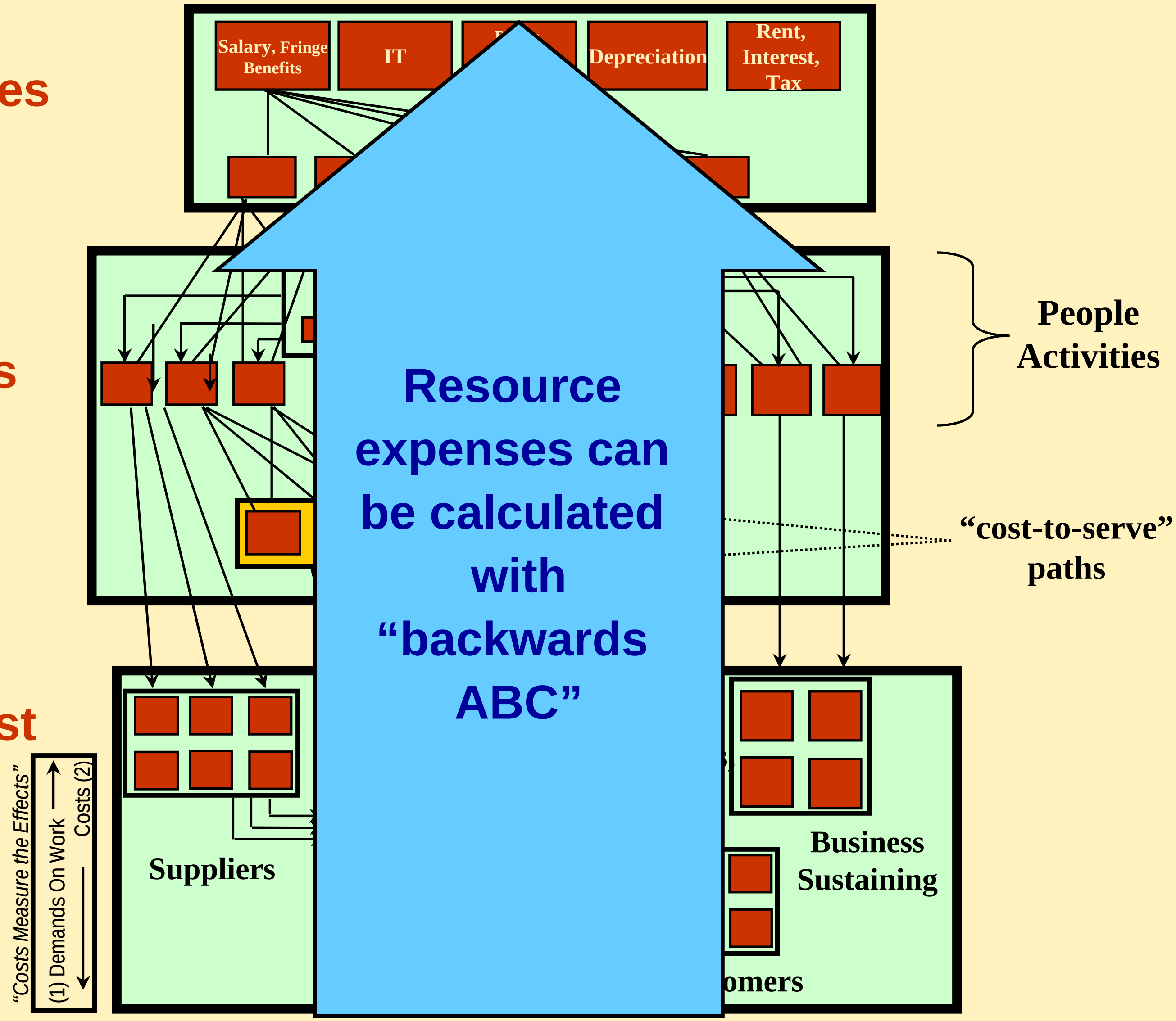
The Challenge of projecting "what-ifs"

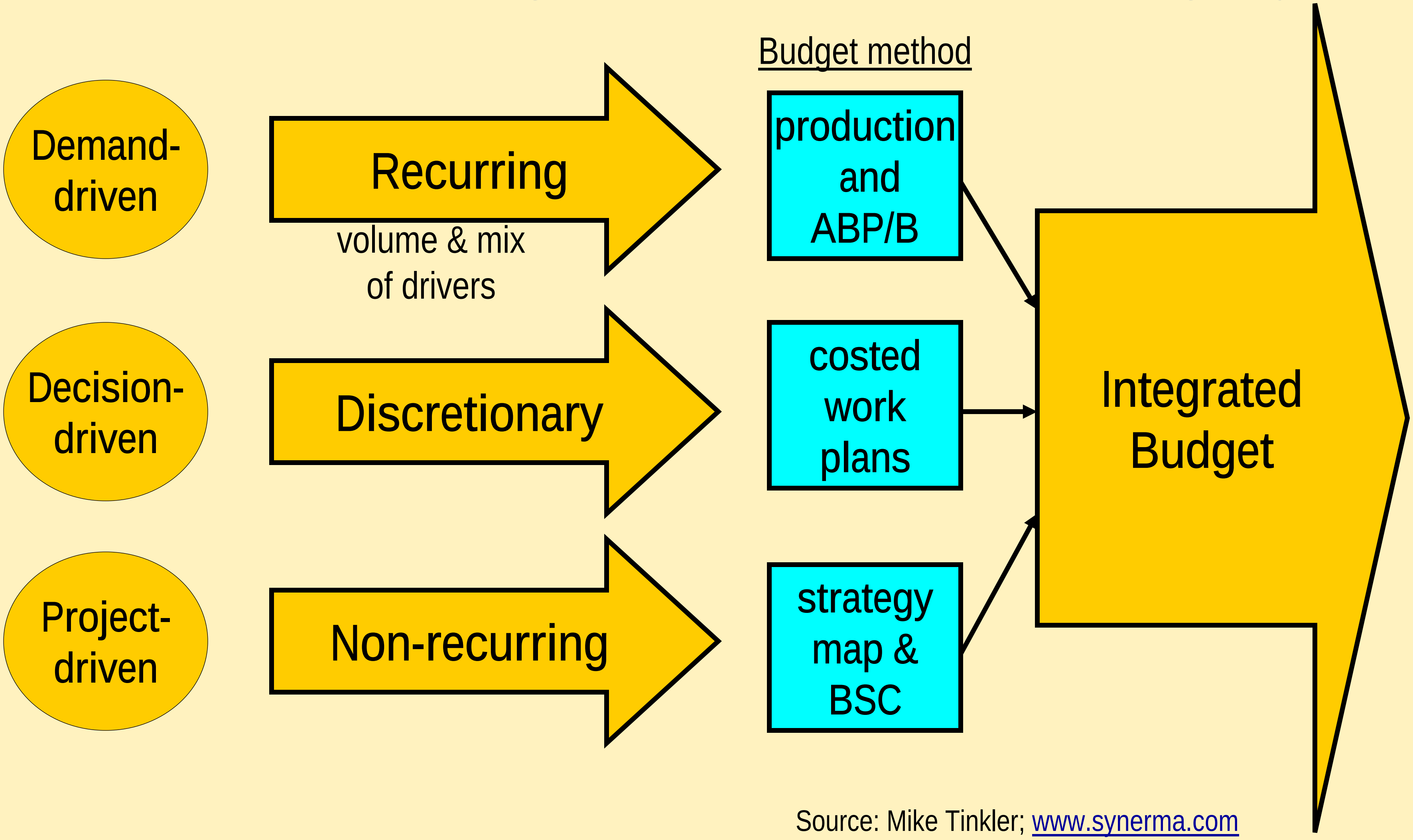
Resources

Work Activities

Final Cost Objects



Match the Budget Method to its Category



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 … “

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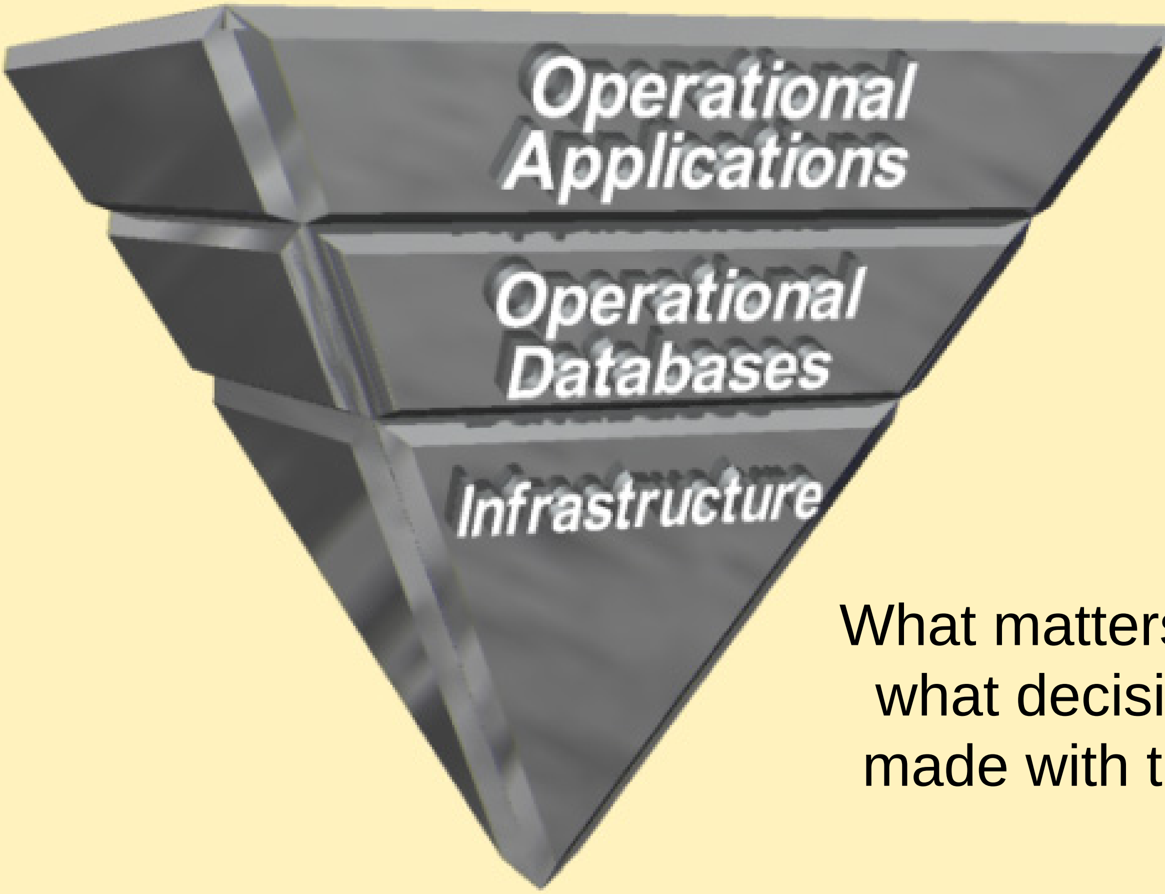
Value Multiplier through Integration

(4) What's the Problem?

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

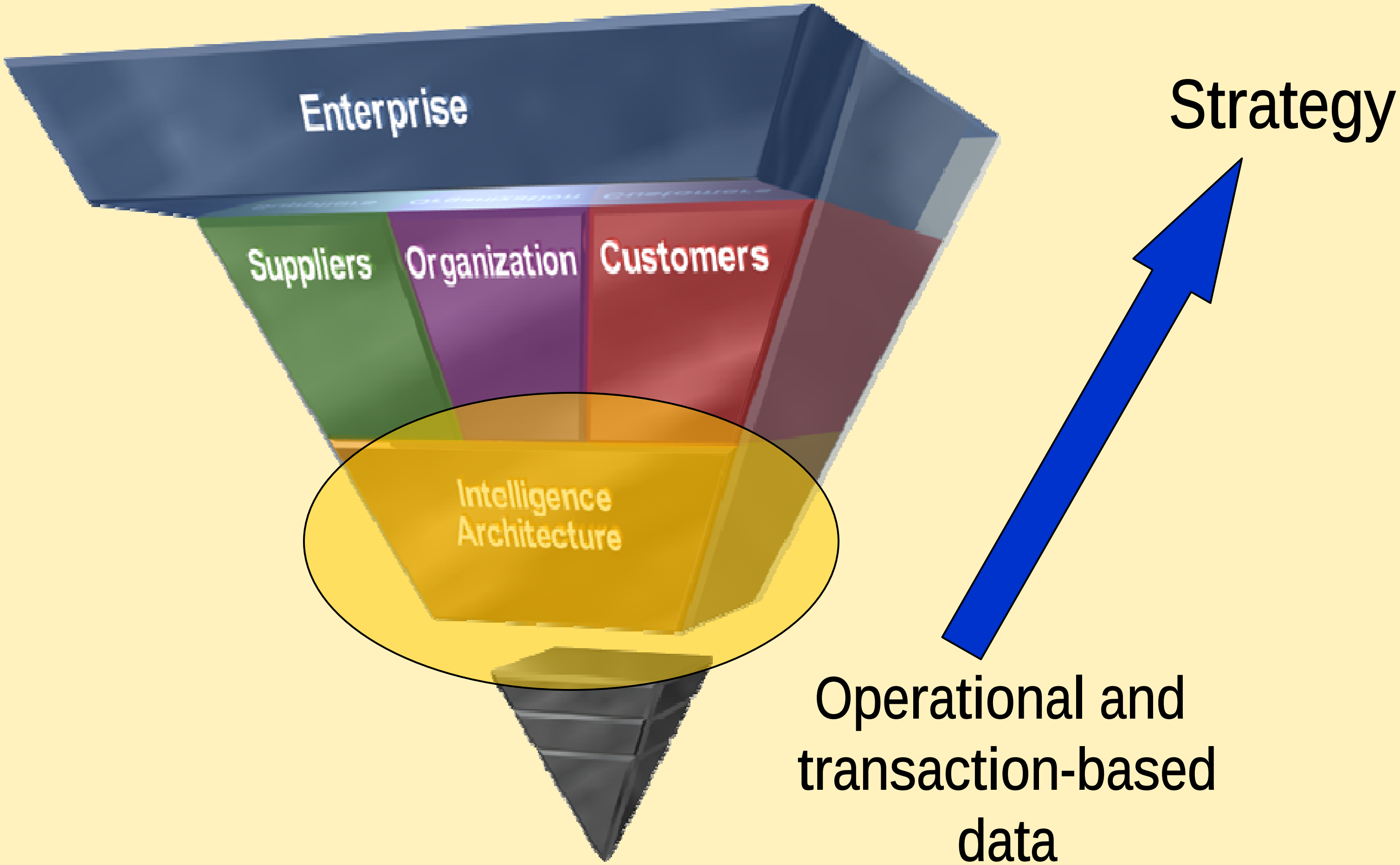
Business intelligence is the value multiplier.

The Database Core



What matters more is what decisions are made with the data.

The Gap Between Strategy and Transaction Systems



The Power to Know.

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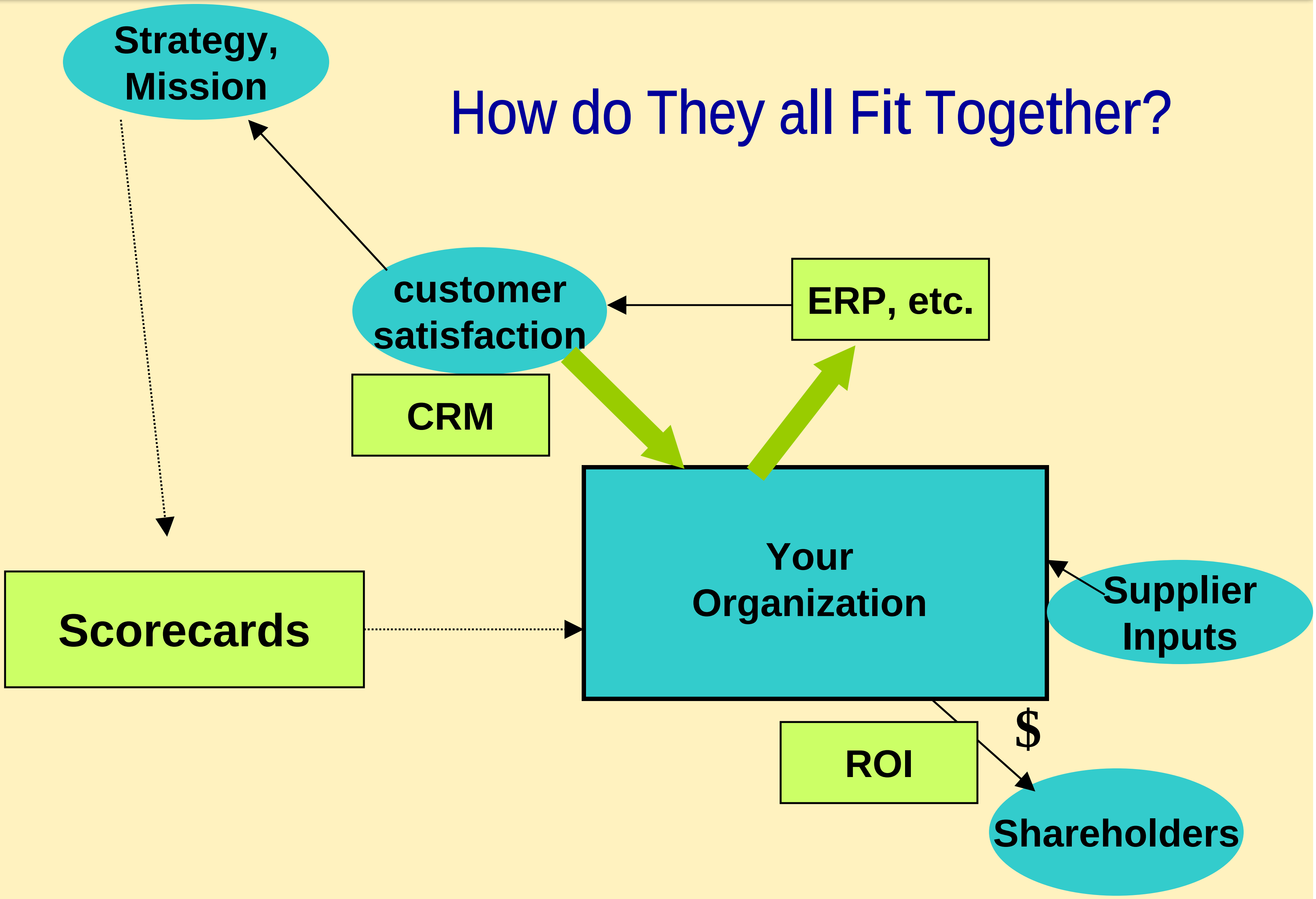
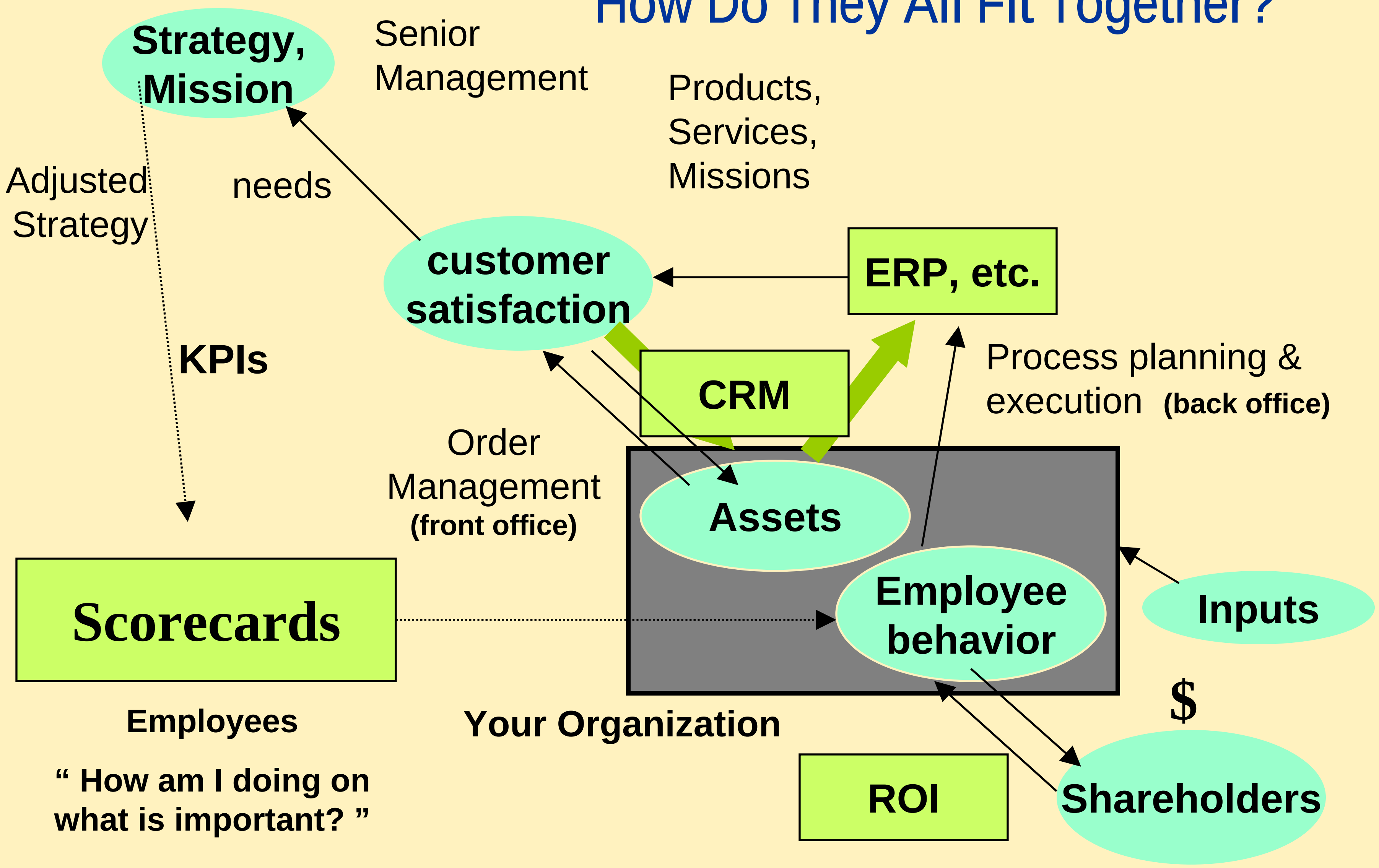
Value Multiplier through Integration

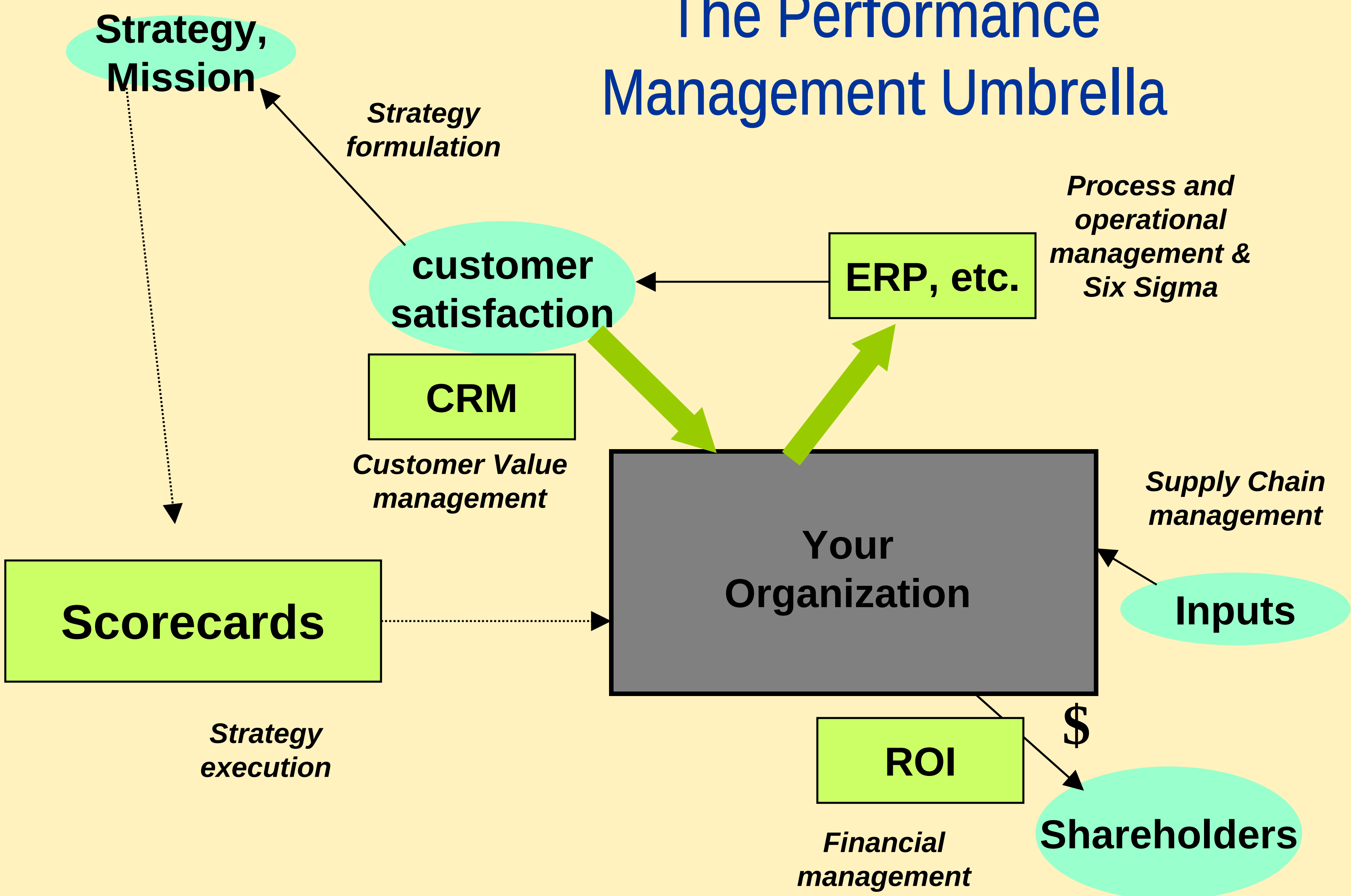
How do They all Fit Together?



How Do They All Fit Together?



The Performance Management Umbrella



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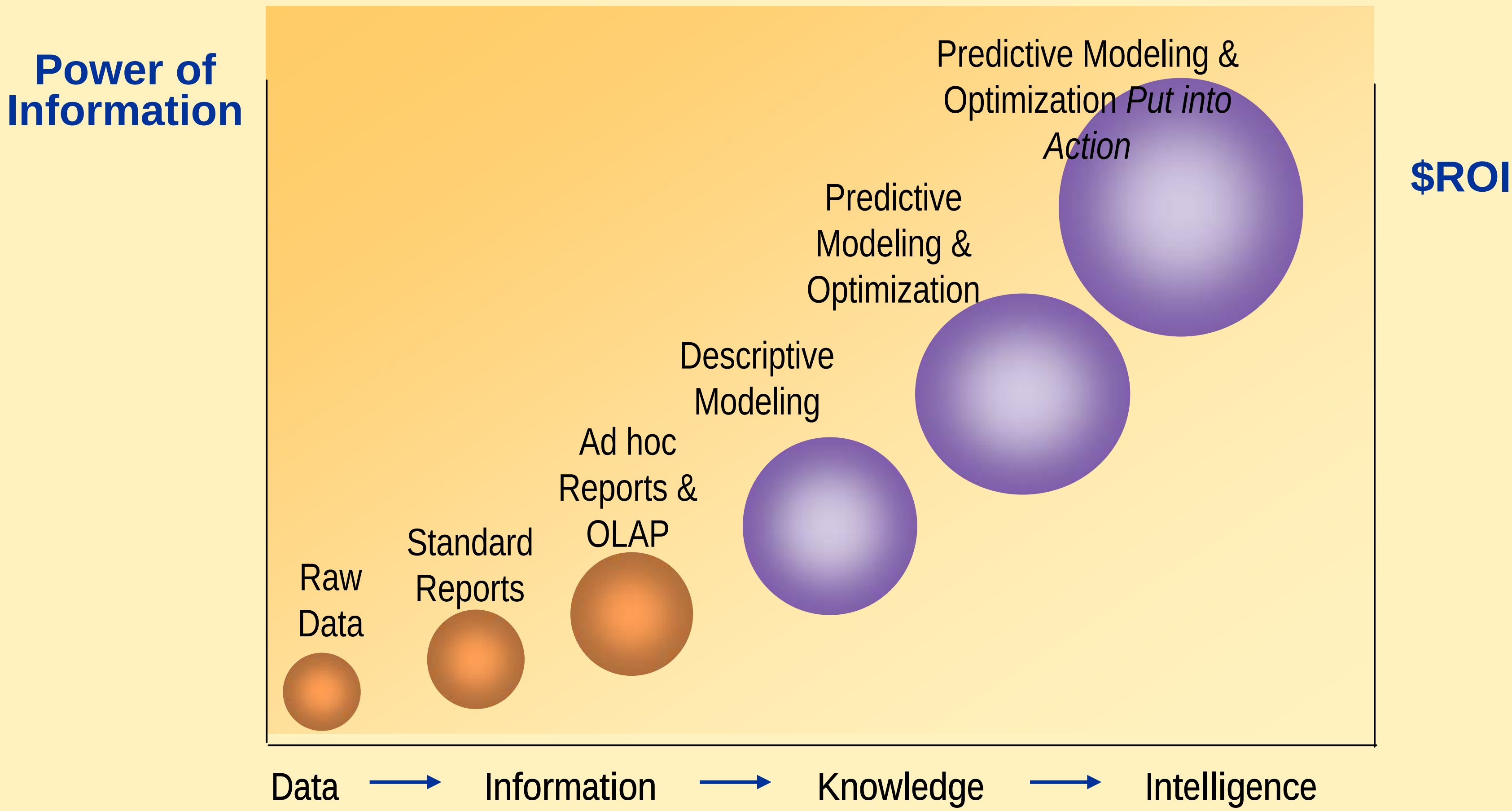
The Intelligence Hierarchy



The Buy-in to Performance Management

Why has the adoption rate for PM's methodologies been so slow?

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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**

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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.

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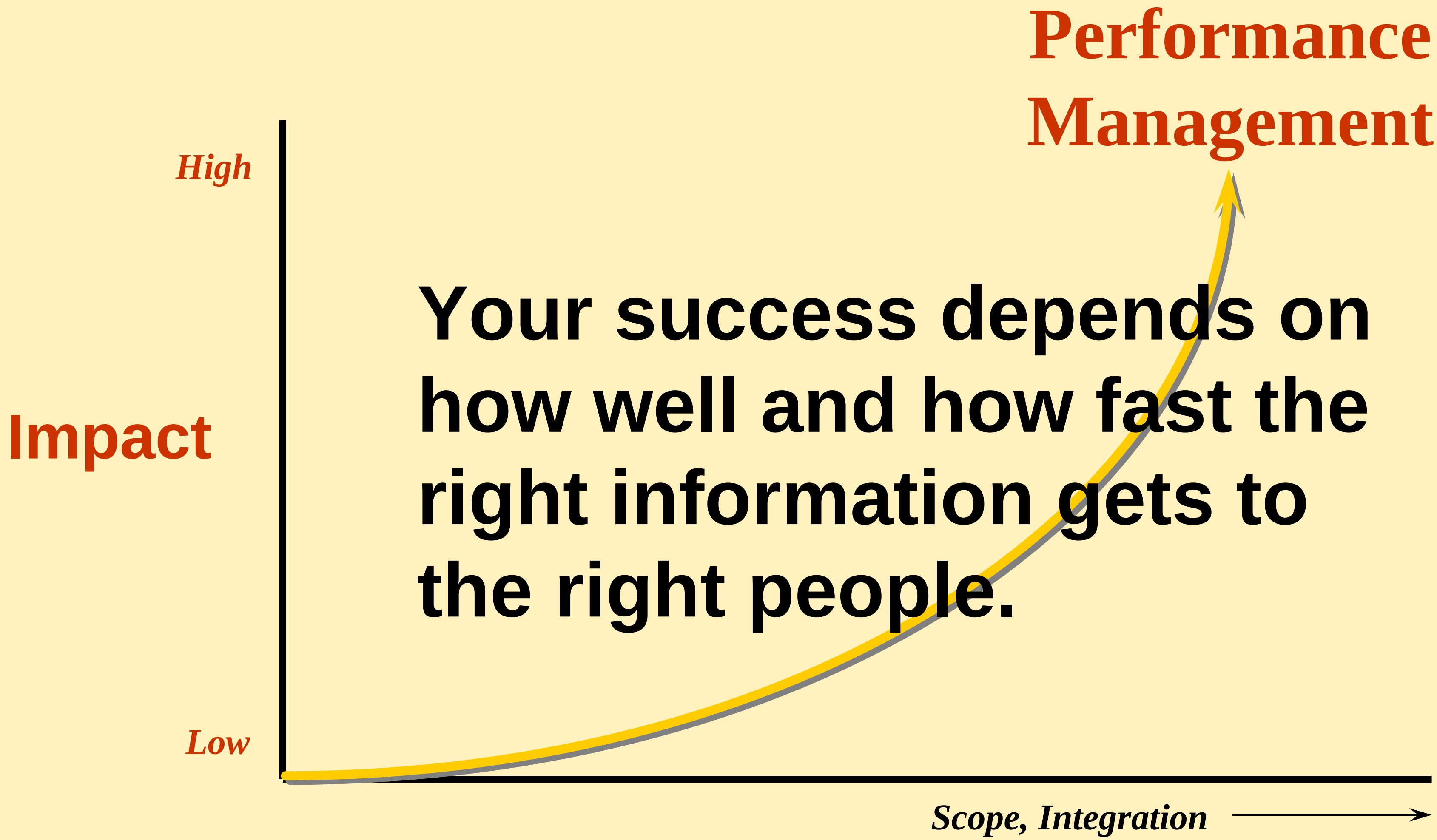
Creating Vision is Not Mystical.

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.



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