PREFACE

In the preface of my earlier book, *Activity-Based Cost Management: An Executive Guide* (John Wiley & Sons, 2001), I stated: "Sometimes luck beats planning. I have been fortunate in my professional career—a career that began in 1973 as an accountant and continued into operations management and management consulting. Without realizing it—through this series of different jobs and management consulting assignments—I somehow earned a reputation as an internationally recognized expert in activity-based cost management (ABC/M). In truth, I am always learning new things about how to build and use managerial systems. I'm not sure that any expert in ABC/M exists. I'm just fortunate to have been formally working with ABC/M since 1988 when I was introduced to ABC/M."

My training was in industrial engineering and operations research, and I attribute that foundation to letting me think about how organizations work as a set of intermeshed systems—like linked drive gear teeth. In the 1990s my work assignments began to weave in strategy and nonfinancial performance measures. This book reflects my observations from these work experiences and from some exceptional people I have been fortunate to interact with.

ORGANIZATIONAL DIRECTION, TRACTION, AND SPEED

Direction, traction, and speed. When you are driving a car or riding a bicycle, you *directly* control all three. You can turn the steering wheel or handle bars to change direction. You can downshift the gears to go up a steep hill to get more traction. You can step on the gas pedal or pump your legs harder to gain more speed.

However, senior executives who manage organizations do not have *direct* control of their organization's traction, direction, and speed. Why not? Because they can only achieve improvements in these through influencing people—namely, their employees. And employees can sometimes act like children: They don't always do what they're told, and sometimes their behavior is just the opposite!

This book is about giving managers and employee teams of all levels the capability to improve their organization's direction, traction, and speed—and most importantly, to move it in the *right* direction. That direction should be as clear and focused as a laser beam, pointing toward its defined strategy.

THE RELENTLESS PRESSURE TO PERFORM

There are never-ending obstacles and challenges for managers seeking to line up and leverage an organization's energies, and these obstacles often surface as questions. In an unforgiving economy, executives from all functions are asking tough questions:

- Chief executive officers are asking, "How can we position the company for profitable growth by integrating our strategy with daily operations? How can we foster innovation without losing control? How do we win?"
- Chief financial officers are asking, "How can we move beyond the role of the cost-cutting police to be viewed as a strategic partner? How can we report reliable profit and cost data, rather than misleading information flawed with improper arbitrary cost allocations? How can we provide more visibility?"
- Senior human resource and information technology managers ask, "How can we appear to be a service provider and establish service level agreements with equitable charge-back reporting to our users? How do we prove our value to the organization?"
- Sales and marketing executives are asking, "How do we identify and retain our more profitable customers? How do we profitably add services to our increasingly commoditylike products and base service lines in order to differentiate ourselves from competitors?"

Each of these questions arises due, in part, to the complexity of today's organizations, but the questions are not really new. What is new is the pressure to get the correct answers from increasingly complex and interdependent processes. Furthermore, some problems are made more difficult to solve by information technology systems that were, ironically, implemented as solutions, not problems—such as diverse nonstandard software packages, legacy systems, and incompatible computing platforms.

To make matters worse, employees and managers who are tasked by these executives to improve performance are stymied by their own questions:

- How do I reduce my budget without sacrificing service or quality levels?
- How efficient do I have to become to support my expected future workload volume or a new program with my current budgeted resources?

- How do I get out of this pickle? I'm now a process owner and being held accountable—but I have minimal influence and control!
- Do I need to expand warehouse space to handle my expected volume? Or, alternatively, can I ship direct? Which choice is better?
- What will be the impact of discontinuing some products? of changing delivery frequency and routes? of changing packaging formats?
- Who in my supply chain is creating costly waste? Where is there redundant work among us?

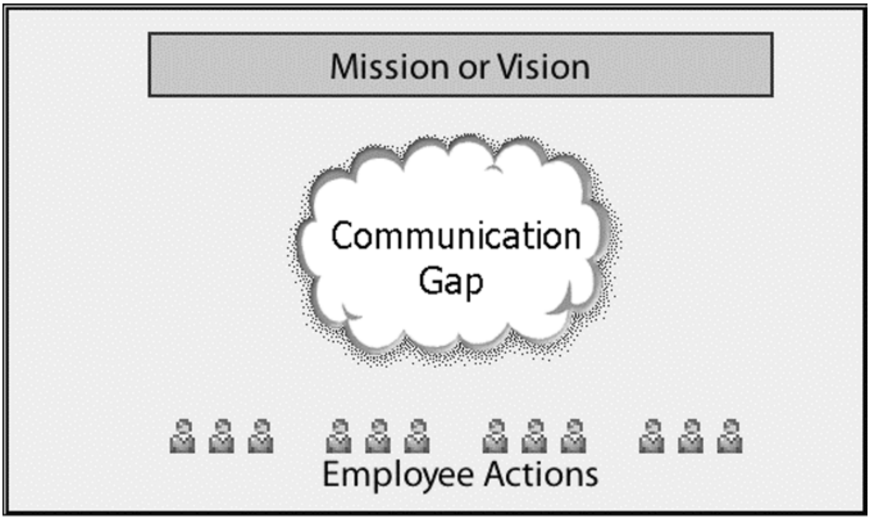
The managers' dilemma is that they cannot get answers to these questions from their transaction-based operational systems. Their execution systems are adequate for processing and filling an order, but not for showing them where to improve or what to change in order to better align their employees' work with the organization's strategy. Enterprise resource planning systems (ERP) have become popular as a tool to fill orders and attempt to plan for future orders, but although ERP provides some cross-functional visibility of operations, ERP tools (or the planning and operation control systems) are not designed for producing the analytical intelligence that is central to managing performance. ERP systems deluge employees with data, but not necessarily with *business intelligence* for decision support.

ALIGNING EMPLOYEE BEHAVIOR WITH STRATEGY

"Alignment" is a key word I will frequently mention. Alignment boils down to the classic maxim, "First do the right things, and then do the right things well." That is, being effective is more important than being efficient. Organizations that are very, very good at doing things that are not important will never be market leaders. The concept of work alignment to the strategy, mission, and vision deals with focus. The economics then fall into place.

Another challenge involves how well executive management communicates its strategy. Figure A illustrates this. Most employees and managers, if asked to describe their organization's strategy, cannot adequately articulate it. Many employees are without a clue as to what their organization's strategy is. They sometimes operate as helpless reactors to day-to-day problems. In short, there is a communication gap between senior management's mission or vision and employees' daily actions.

Performance management can close this communication gap. Methodologies with supporting tools like *strategy mapping* and performance measurement



"Many leaders have personal visions that never get translated into shared visions that galvanize an organization. What is lacking is a discipline for translating individual vision into shared vision."

Peter Senge, *The Fifth Discipline*

Figure A The Communication Challenge

scorecards (discussed in Part Two) aid in making strategy everyone's job. Performance management allows executives to translate their personal visions into collective visions that galvanize managers and employee teams to move in a value-creating direction. The traditional taskmaster/commander style of executives who attempt to control employees through rigid management systems is not a formula for superior performance. Performance management fosters a work environment in which managers and employees are genuinely engaged and behave as if they were the business owners. Destructive beliefs and unwritten rules that are commonly known in an organization's culture (such as "Always pad your first budget submission") are displaced by guiding principles.

But this gap is more than a communication gap. It is an intelligence gap as well. Even organizations that are enlightened enough to recognize the potential value of their business intelligence and assets often have difficulty in actually realizing that value as *economic value*. Most companies are still unable to get the business intelligence they need; and the intelligence they do get is not delivered quickly enough to be actionable. Methodologies like *activity-based management* (ABM), discussed in Part Three, provide a reliable, fact-based financial view of the costs of work processes and their products, services, and customers (service recipients and citizens for public sector organizations).

IMPACTS OF ACCELERATING INNOVATION AND INFORMATION TECHNOLOGY

Why have stock share prices plummeted for some of the world's most successful, market-leading companies? Why are companies experiencing wave after wave of employee layoffs in order to meet or beat their so-called target earnings projection, rather than achieving it with top-line sales growth? It is apparent that many companies are struggling with slimmer profit margins and less predictable financial results.

Part of this problem involves the increasing speed of change. The half-life of technologies, organizational structures, processes, policies, and procedures is shrinking all the time. For example, the annual budget quickly becomes obsolete before it is finalized and certainly after it is published, so it is typically replaced with quarterly rolling forecasts. Another example is the shortening of product and service line life cycles. Increasingly products are perceived as commodities that competitors can quickly copy and produce soon after new products are launched by others. Consequently, product differentiation is giving way to value-added service differentiation as a way to retain increasingly demanding customers. (And few companies adequately measure this increasingly important cost-to-serve for various customer segments, which means they don't know which customers are more or less profitable!)

Innovations in technology—particularly communication and computing advances—that spawned dramatic economic gains in the 1990s have also led to new types of organizations, such as third party logistics firms (3PLs) in physical distribution and contract manufacturers, that require tightly compressed business planning and decision-making cycles.

Trends that were once tracked by quarters now fluctuate from week to week. Yesterday quickly becomes ancient history, and it is often not a very good predictor of tomorrow. Without business intelligence, companies are swiftly punished. But the cost of incomplete or inefficiently generated intelligence can be huge—not only in missed revenue opportunities, but in real cash outlays wasted on niche software products and incompatible applications that are expensive to integrate and maintain. Worse yet, new software systems often do not provide one consistent version of the truth, and they can leave decision makers doubtful of their organization's outcomes and output. In short, poor business intelligence leads to uninformed decisions and misguided strategies.

BALANCED SCORECARD: MYTH OR REALITY?

This book will describe how *strategy maps* and *scorecards* enable leadership and motivate people by serving as a guide with signposts and guardrails. Strategy maps explain high-level causes and effects that facilitate making choices. With strategy maps and their resultant choices of strategic objectives and the action items to attain them, managers and employee teams easily see the priorities and adjust their plans accordingly. People don't have sufficient time to do everything everywhere, but some try to. Strategy maps and their companion scorecards rein in the use of peoples' time by bringing focus. Untested pet projects are discarded.

Scorecards are derived from strategy maps, contrary to a misconception that scorecards are simply a stand-alone reporting system. However, scorecards solve the problem of excessive emphasis on financial results as the measure of success. Consider that telephone calls are still "dialed" even though there are hardly any dial phones left. A car's glove compartment rarely stores gloves. Eventually, the motion picture "film" industry will rely on digital technology, not film. Similarly, "financial" results will likely be shared with more influential nonfinancial indicators, such as measures of customer service levels. Going forward, managers and employee teams will need to be much more empowered to make decisions, hopefully good ones, in rapidly reduced time frames. Scorecards, supported by business intelligence, improve decision making.

Commercial software plays an important enabling role in performance management (PM) by delivering an entire Web-based and closed-loop process from strategic planning to budgeting, forecasting, scorecarding, costing, financial consolidations, reporting, and analysis. Commercial software from leading vendors of statistics-supported analytics and business intelligence (BI), like SAS (www.sas.com), provide powerful forecasting tools.

LEADERSHIP RISES FROM TAKING CALCULATED RISKS

Organizations need to overturn decades of traditional business practices. They must now manage the total enterprise by aligning themselves, their customers, and their suppliers in one strategic direction. Leadership's role is to determine the direction and motivate people to go in that direction. After a strategic direction is defined or adjusted, then the senior executives are challenged with cascading it down through their organization and across to their trading partners.

There is a large distinction between managing and leading. Leadership is often characterized as directing, aligning, visioning, rewarding, energizing, or cheerleading. In contrast, managing is associated with doing. The border between the two, where management ends and leading begins, has to do with risk taking and being decisive. Management is characterized as avoiding risks, whereas leadership is characterized as taking risks. Improved leadership can result from removing risks, or at least minimizing them into *calculated* risks. Uncertainty and risk are never removed, but they can be diminished. Risk-avoiding managers can evolve into leaders by drawing on more courage to take calculated risks. My father once told me that life is ten percent what happens to you and ninety percent how you deal with it. Leading is always about courage and making choices.

POSITION STATEMENT

My basic beliefs are simple and few:

- The discipline of managing is embryonic. Unlike the fields of medicine or engineering, which through codification have advanced their learning decade by decade, managing is more comparable to an apprenticeship program. We learn from observing other managers, whether their habits are good or bad. The introduction of performance management, with an integrated suite of tools and solutions, can make managing a discipline on par with the other mature fields. And managing with reliably calculated risks converts managers into leaders.
- We substantially underestimate the importance of behavioral change management. Each year that I work, I increasingly appreciate the importance of change management—considering and altering people's attitudes and behavior.
- Strategy is of paramount importance. Strategy is all about choices and focus. Given limited resources, executives must get the most from them. However, the most exceptional business processes and organizational effectiveness will never overcome a poor strategy. Defining strategy is the responsibility of senior management, and it may indeed be their primary job, with everything else they do being secondary.
- Power is shifting irreversibly from suppliers to buyers due to the Internet. As the need to increase customer satisfaction increases, senior executives must make this central to formulating their strategies. With power shifting to the customer, pressure on suppliers and service providers will be relentless. Consolidations of businesses are predictably in the future.

- Intangible assets, like employees and branding, are becoming far more important than tangible assets.
- All decisions involve trade-offs that result from natural conflicts, such as customer service level objectives and budgeted cost (i.e., profit) objectives. It is essential to balance the overall enterprise's performance with better trade-off decision making, rather than allow political self-interests to preside.
- It is critical to operate with reliable, fact-based data. For example, organizations need visibility of accurate costs, but most receive flawed and misleading cost information from arbitrary cost allocation methods. They do not receive visibility to their hidden costs of marketing and sales channels. They also need increasing transparency of their trading partners' profit and cost structures and their operating data. With the facts comes a better understanding of what drives results and costs. Without agreed-on, reliable facts and an understanding of if-then causality, the organization can stumble, lacking the ability to build strong business cases for ideas.

I ask that the reader patiently absorb my description of the interdependencies of the various aspects of an organization. Learn from this book how methodologies like forecasting demand, measuring performance, measuring segmented profits and costs, and planning for resource levels can themselves be integrated.

My hope is that reading this book will instill an increased sense of confidence that complex organizations can finally see clearly—that employees within such organizations can find the pervasive fog lifted and see how they truly operate. There is hope. It *is* possible to tame an organization's dysfunctional behavior, despite how prevalent it seems.

WHERE DOES INFORMATION TECHNOLOGY FIT?

Before I conclude the preface and discussing my beliefs in greater depth, let me address the role of information technology (IT). Where do software and data management fit in? Software is a set of tools that serves as an enabler to the performance management solution suite of methodologies. However, in the big picture, performance management (PM) software is necessary but not sufficient. Software does not replace the thinking needed for the strategy and planning that is involved in PM—but it can surely enable the thinking process. Software and technology are not at center stage for making PM work. However, unlike the situation in the mid-1990s, software is no longer the impediment it was then. Back then you could dream of what the tools can do today, but the technical barriers were show-stopping obstacles. That is no longer the situation.

Today, advances in software and data management are well ahead of most organizations' abilities to harness what can be done with these tools. Today the impediment is not technology but rather the organization's thinking—its ability to conceptualize how the interdependencies can be modeled, to configure software, and to incorporate the right assumptions and rule-based logic. Commercial software has made great leaps in the ease with which it can be implemented, maintained, and, most importantly, used. Casual users, not just trained technicians and statisticians, can easily use statistical and analytical software programs.

Information technology can substantially aid leaders in managing risk and being more decisive. However, a fool with a tool is still a fool. When world-class commercial software is used by people who understand business, commerce, and government, then look out for high performance. They will collectively aid their companies in achieving that elusive competitive advantage—or, if they are a public sector or not-for-profit organization, they will optimize their service levels with their finite resources.

Executives are recognizing that computers and technology are much more than just information management. The larger picture involves knowledge management. What good is capturing data if people can't have access to it? What good is using data if you cannot use it wisely? Information technologies enable performance management, but performance management is much more. It forms the foundation to escalate managing into a formal discipline.

OVERVIEW OF THE BOOK

Chapter 1 expands on the six beliefs outlined earlier and builds the business case for what is driving the need for PM to evolve into a formal discipline. Part One then describes what *PM* is. Parts Two and Three explain two foundational pillars of PM: performance measurement (strategy mapping, balanced scorecards, and employee communications) and managerial accounting and economics (measuring profits and costs, including activity-based costing, and predicting future resource requirements and expenses).

Part Four describes five core business process solutions that are aided by the measurements derived from Parts Two and Three. Here transaction-based data that was converted into information is further transformed into higher forms of business intelligence for decision support. Part Five concludes with how data management and mining technologies operationalize PM.

This book does not need to be read cover to cover. I see it more as a reference guide or manual. I encourage readers to initially scan the outline and the many illustrations with the purpose of marking which sections are of greatest interest to read first. But remember that the main idea is not to examine business improvement methodologies in isolation but rather as an integrated solution set. Also remember that strategy-aligned performance measurement (Part Two) and measuring resource consuming costs (Part Three) are the underpinnings for the core solutions in Part Four.

I would like to thank my many coworkers in SAS and other individuals, in particular Eleanor Bloxham, who reviewed sections of this book and gave me valuable feedback. I'd like to thank those special people from whom I have learned a nugget of insight, distilled it, and synthesized it into this book. I'd also like to honor in memoriam Robert A. Bonsack—friend, mentor, and craftsman in the field of performance improvement, who twice hired me (Deloitte and EDS).

Finally, I am forever grateful to my wife, Pam Tower, who for the year I was writing this book allowed me to balance—and occasionally misbalance—my job and family.

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