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PERFORMANCE MANAGEMENT

GARY COKINS

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 to increase value from their organization. Why not? Because they can achieve improvements in these areas only 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!

Performance management is about giving managers and employee teams of all levels the capability to improve their organization's direction, traction, and speed—and most important, 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 process of managing strategy begins with focus. You never have enough money or resources to chase every opportunity or market on the planet. You have to believe that you are continuously limited to scarce and precious resources and time, so focus is key and strategy yields focus.

There is evidence that it is a tough time to be a chief executive. Surveys by the Chicago-based employee recruiting firm Challenger, Gray & Christmas repeatedly reveal increasing rates of job turnover at the executive level compared to a decade ago.[1] In complex and overhead-intensive organizations where constant redirection to a changing landscape is essential, the main cause for executive job turnover is the failure to execute their strategy. There is a big difference between formulating a strategy and executing it. What is the answer for executives who need to expand their focus beyond cost control and toward economic value creation and other more strategic directives? How do they regain control of the direction, traction, and speed for their enterprise? Performance management provides managers and employee teams at all levels with the capability to move directly toward their defined strategies like a laser beam.

WHAT IS PERFORMANCE MANAGEMENT?

Performance management (PM) is the framework for managing the execution of an organization's strategy. It is how plans are translated into results. Think of PM as an umbrella concept that integrates familiar business improvement methodologies with technology. In short, the methodologies no longer need to be applied in isolation—they can be orchestrated. The whole is greater than the sum of the parts. Each methodology can give good results, but when you integrate them, you get more. This makes PM a value multiplier.

All organizations have been doing performance management before it was labeled with this name. So the good news is that performance management is not a new buzzword and method that everyone has to learn. Rather, it is the assemblage of *existing* methodologies that most everyone is already familiar with, and most organizations have already begun the journey of implementing some of them. But as just mentioned, these methodologies typically are implemented in isolation from each other. It is as if the implementation project teams live in parallel universes. PM serves as a value multiplier by integrating the methodologies.

PM is sometimes confused with human resources and personnel systems, but it is much more encompassing. It comprises the methodologies, metrics, processes, software tools, and systems that manage the performance of an organization. PM is overarching, from the C-level executives cascading down through the organization and its processes. To sum up its benefit, it enhances broad cross-functional involvement in decision making and calculated risk taking by providing tremendously greater visibility with accurate, reliable, and relevant information—all aimed at executing an organization's strategy. But why is supporting strategy so key? Being operationally good is not enough. In the long run, good organizational effectiveness will never trump a mediocre or poor strategy.

There is no single PM methodology, because PM spans the complete management planning and control cycle. Performance management is not a process with recipe steps or an information system that you purchase on a disc. It is the integration of typically disconnected decision making. Think of PM as a broad, end-to-end union of solutions incorporating three major functions: collecting data, transforming and modeling the data into information, and Web-reporting it to users. Many of PM's component methodologies have existed for decades, while others have become popular recently, such as the balanced scorecard. Some of PM's components, such as activity-based management (ABM) described in this book, are partially or crudely implemented in many organizations, and PM refines them so that they work in better harmony with its other components. Early adopters have deployed parts of PM, but few have deployed its full vision. In the first few decades of the twenty-first century, the surviving organizations will have completed the full vision.

Many organizations seem to jump from improvement program to program, hoping that each one might provide that big, elusive competitive edge. Most managers, however, would acknowledge that pulling one lever for improvement rarely results in a substantial change—particularly a long-term, sustained change. The key to improving is integrating and balancing multiple improvement methodologies. You cannot simply implement one improvement program and exclude the other programs and initiatives. It would be nice to have a management cockpit with one dial and a simple steering mechanism, but managing an organization, a process, or a function is not that easy.

CONFUSION AND AMBIGUITY WITH PERFORMANCE MANAGEMENT

There is confusion about terminology. For example, there are several variants of PM including business performance management (BPM), enterprise performance management (EPM), and corporate performance management (CPM). Consider them all to mean the same thing. But a larger problem is that PM is typically defined too narrowly as being only about better strategy, budgeting, planning, and finance with an emphasis on measurement. It is much more.

As mentioned, PM tightly integrates the business improvement and analytic methodologies executives, managers, and employee teams are already familiar with. These include strategy mapping, balanced scorecards, managerial accounting (including activity-based management), budgeting and forecasting, and resource capacity requirements. These methodologies fuel other core solutions such as customer relationship management (CRM), supply chain management (SCM), risk management, and human capital management (HCM) systems, as well as Six Sigma. It is quite a stew, but they all blend together.

The executive team should always begin with a vision statement—and preferably not those hollow words framed in the organization's lobby or laminated on small cards for employee purses and wallets. The vision statement answers the question "Where do we want to go?" PM relies on the strategy map and its companion scorecard to answer in a mechanical way "How will we get there?" The remainder of the PM components answer "What will power us there?"

But PM also addresses trade-off decisions that will always be present because conflicts are natural conditions of any organization. For example, there will always be tension between competing customer service levels, process efficiencies, and budget or profit constraints. Managers and employee teams are constantly faced with conflicting objectives and no way to resolve them, so they tend to focus their energies on their close-in situation and their personal concerns for how they might be affected. An organization also constantly faces risk, threats, and opportunities. Problems surface when risks are not anticipated or there is minimal risk mitigation and when good opportunities are missed. PM addresses all of these issues by escalating the visibility of actual and potential quantified outputs and outcomes—in other words, results. PM provides explicit linkage between strategic, operational, and financial objectives and provides predictive what-if scenario testing of the enterprise-wide impact of decisions.

In the end, organizations need top-down guidance with bottom-up execution. PM does this by converting plans into results. PM integrates operational and financial information into a single decision-support and planning framework. Simply put, PM helps an organization to understand how it works as a whole.

Performance Management for the Public Sector

Performance management (PM) is not just an integrated set of decision support tools but is also a discipline intended to maintain a view of the larger picture and to understand how an organization is working as a whole. PM applies to managing any organization, whether a business, a hospital, a university, a government agency, or a military body—any entity that has employees and partners with a purpose, profit-driven or not. In short, PM is universally applicable.

In the not-for-profit and public sector, including government agencies at all levels and the military, there appears to be a convergence toward many of the management practices of the commercial sector. One obvious difference, however, is the relevance of "making a profit." That does not mean public sector agencies are given license not to use resources effectively or, in some cases, charge fees to users to achieve a full cost recovery (i.e., a zero profit) as funding. Accountability increasingly appears as a mandate for public sector organizations. If you do a word search on the words "performance-based" and "government" on the Internet, you may be surprised by the large number of references.

Although PM often refers to for-profit concepts, such as measuring and managing customer value and product profits, the majority of PM principles can also apply to public sector organizations.

ALIGNING EMPLOYEE BEHAVIOR WITH STRATEGY

"Alignment" is a key word frequently mentioned in PM. 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 and pursuing the most important priorities. The economics then fall into place.

How well the executive management communicates its strategy to managers and employees, if at all, remains a challenge. Exhibit 1.1 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.

If asked to briefly articulate their executive team's strategy, how many employees could do it? Probably very few—maybe none. The consequence of this is critical. If employee teams and managers do not understand their executive team's strategy, how do we expect them to understand that what they do each week and

Exhibit 1.1 The Communication Challenge

Source: Gary Cokins, *Performance Management: Finding the Missing Pieces (To Close the Intelligence Gap)* (Hoboken, NJ: John Wiley & Sons, Inc., 2004). Reprinted with permission of John Wiley & Sons, Inc.

"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.*

month contributes to realizing that strategy? In short, there is a communication gap between senior management's mission or vision and employees' daily decisions and actions. An integrated suite of methodologies and tools—the PM solutions suite—provides the mechanism to bridge the business intelligence gap between the chief executive's vision and employees' actions.

PM can close this communication gap. Methodologies with supporting tools such as *strategy mapping* and PM *scorecards* aid in making strategy everyone's job. PM 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. PM 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 (i.e., "Always pad your first budget submission") are displaced by guiding principles.

BUSINESS INTELLIGENCE GAP

The gap between the executive team's strategy and employee operations is more than a communication gap. It is an intelligence gap as well. Most organizations are deluged with data, and the amount keeps growing. Estimates are that amount of information doubles every 1,100 days.[2] Yet the amount of time available to deal with information remains constant at 1,440 minutes per day. What complicates matters is the challenge of determining the important and relevant data to focus on versus data that are simply nice to know. Additional challenges involve collecting and moving data, transforming it from a raw reported state into meaningful information that can be leveraged, and having accurate, clean, and nonredundant data, or worse yet inconsistent data. To resolve these problems, PM is based on a common enterprise information platform (EIP) that provides a one-version-of-the-truth database rather than disparate inconsistent data that annoy both employees and customers.

But those are problems that advanced information technologies, such as data warehousing, can overcome. 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*. Their data are often disconnected, inconsistent, and inaccessible, resulting from too many nonintegrated single-point solutions. They have valuable, untapped data hidden in the reams of transactional data they collect daily. Unlocking the intelligence trapped in mountains of data has been, until recently, a relatively difficult task to accomplish effectively. Typically you find different departmental data warehouses built on different platforms using combinations of tools, some nonstandard, some with expired maintenance support, and some prebuilt in a tool purchased from a vendor no longer in business. This results in unintended barriers blocking systems from cleanly communicating among themselves. All organizations are reaching a point where it is important for computers to talk to other computers.

Fortunately, innovation in data storage technology is now significantly outpacing progress in computer processing power, heralding a new era where creating vast pools of digital data is becoming the preferred solution. Information technologies—namely data warehousing; data mining, with its powerful extraction, transform, and load (ETL) features; and business analytics (e.g., statistics, forecasting, and optimization)—all produce decision-relevant information from diverse data source platforms transparently. That is, these technologies convert raw data into intelligence—the power to know. As a result, these superior tools now offer a complete suite of analytic applications and data models that enable organizations to tap into the virtual treasure trove of information they already possess and enable effective performance management on a huge scale.

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. PM correlates disparate information in a meaningful way and allows drill-down queries directly on hidden problem areas. It helps assess which strategies are yielding desired results without the need to wade through a mountain of raw data. Executives and employee teams need to be alerted to problems before they become “unfavorable variances” reported in financial statements and requiring explanation. PM aids employees and managers to manage change *actively*—and in the right direction.

But make no mistake in interpretation; PM is much more social than technical. You are dealing with people who all have personal preferences, including appeal for the status quo as well as suspicion and skepticism of change. And elements of PM involve measurements and accountability, so you influence behavior because you typically “get what you measure.” In summary, PM integrates operational and financial information into a single decision support and planning framework.

ACTIVITY-BASED MANAGEMENT: FACTS FOR JUDGMENT AND DISCOVERY

Methodologies like *activity-based management* (ABM) described in this book 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). Having fact-based information is important. After all, in the absence of facts, anybody's opinion is a good one. And usually the biggest opinion wins—which may be your supervisor's opinion or your supervisor's boss's opinion. To the degree that they are making decisions based on intuition, gut feel, outdated beliefs, or misleading information, then your organization is at risk. A major benefit of PM is that when all people get the same facts, then they generally reach the same conclusions on how to act. Good managerial accounting is foundational for PM.

What makes today's PM systems so effective is that *work activities*—what people, equipment, and assets do—are foundational to PM reporting, analysis, and planning. Work activities pursue the actions and projects essential to meet the strategic objectives constructed in strategy maps and the outcomes measured in scorecards. Work activities are central to ABM systems used to measure output costs and customer profitability accurately as well as to assess future potential customer economic value. Knowing costs assists not only in judging results better but also in asking better questions. It is a great discovery tool.

ABM also aids in understanding the drivers of work activities and their consumption of resource capacity (e.g., expenses). With that knowledge, organizations can test and validate future outcomes given different events (including a varying mix and volume of product/service demand). This helps managers and employee teams understand capacity constraints and see that cost behavior is rarely linear but is a complex blend of step-fixed input expenses relative to changes in outputs. Workloads are predicted in resource capacity planning systems to select the best plans. PM combines strategy maps and its companion balanced scorecard with intelligent software systems that span the enterprise to provide immediate feedback, in terms of alerts and traffic-lighting signals to unplanned deviations from plans. PM provides managers and employee teams with the ability to act proactively, before events occur or proceed so far that they demand a reaction.

BALANCED SCORECARD: MYTH OR REALITY?

But cost management cannot be the focus. Cost management must operate as part of the more encompassing PM. And strategy is critical. Leadership's role is to determine strategic direction and motivate people to go in that direction. However, senior executives are challenged and usually frustrated with cascading their strategy down through their organization. Executives and management consultants have hailed the *balanced scorecard* as the new religion to resolve this frustration. It serves to communicate executive strategy to employees and also to help navigate direction by shaping the alignment of people with strategy. The balanced scorecard bridges the substantial gap between the raw data spewed out from business systems, such as enterprise resource planning systems (ERP), and the organization's strategy.

Strategy maps and *scorecards* are two more of the key components in the PM portfolio of methodologies. They enable leadership and motivate people by serving as a guide with signposts and guardrails. Despite much publicity about the balanced scorecard, the *strategy map* that should ideally precede the development of the scorecard is considered to be much more important. 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 people's time by bringing focus. Untested pet projects that do not contribute to the strategy are discarded or postponed.

Scorecards are derived from strategy maps, contrary to a misconception that scorecards are a stand-alone reporting system. Many organizations unwittingly err by beginning their reform of their performance measurement system by first defining their key performance indicators (KPIs) to monitor. They typically select the measures they already have as opposed to the measures they *should* have. The traditional measures they err in choosing are typically without depth. Users can view a result, but whether it is good or bad, they are unable to investigate the underlying cause. By starting with KPIs, they are skipping the critical initial steps. The executive team should first define the strategy map, then employee teams and managers should suggest the few manageable projects that can be accomplished or core processes that they must excel at. Once that is complete, then the employees and managers can properly determine the vital few, not trivial many, nonfinancial measures that indicate progress on those projects or core processes which in turn lead toward achieving the strategic objectives. These steps assure that the managers and employee teams understand the strategy—the major problem affecting failed strategy execution. If defining the KPIs is the initial step, then how does anyone know if those measures reflect the strategic intent of the executive team?

Once the appropriate KPIs are selected, then the scorecard provides ongoing feedback. Imagine if everyone in the organization, from the front-line workers to the executive team, could everyday answer this single question: "How am I doing on what is important?" The organization would remain focused. Note that there are two halves to that question. The first part answers the question: “Am I performing favorably or unfavorably to a target set for me?” But it is the second part that brings the power. By going through the discipline of first defining linked strategic objectives in the strategy map, identifying the few and manageable projects or core processes to excel at with KPIs derived from them, executives have preset and baked in the critical pursuits that reflect their strategic intent.

When all the employees are provided a line of sight from their measured performance up through their supervisors’ and executives’ measures, then everyone can also answer the question “How are *we* doing on what is important?” This aids in everyone’s understanding of how one performance measure affects another. It also involves digging deeper to see causal relationships and manage work activities across the entire enterprise so that everyone is on the same page. If employees are given visibility to the feedback scores on KPIs across the organization, they can communicate with other functions without waiting for instructions to suggest problem resolutions. A scorecard is a powerful mechanism to constantly align the workforce with the strategy. It brings that needed direction, traction, and speed.

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. Strategy maps assure that both financial and their causal nonfinancial measures are linked with if-then relationships—which is one reason you hear the term “*balanced* scorecard.” Going forward, managers and employee teams will need to be much more empowered to make decisions, good ones, it is hoped, in rapidly reduced time frames. A strategy map and its companion scorecard, supported by business intelligence, improve decision making. Together, they describe an organization’s strategic health and consequently its chances for increasing prosperity. The balanced scorecard expresses the strategy in measurable terms, communicating what must be done and how everyone is progressing.

Commercial software plays an important enabling role in 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), such as SAS (www.sas.com), provide powerful forecasting tools.

WHAT IS THE PURPOSE OF PERFORMANCE MANAGEMENT?

So, what is the purpose of PM? PM is the translation of plans into results—execution. It is the process of managing your strategy. Defining and adjusting the organization's strategy is of paramount importance and is senior management's number-one responsibility. For commercial companies, strategy can be reduced to three major choices:

1. What products or service lines should we offer or not offer?
2. What markets and types of customers should we serve or not serve?
3. How are we going to win?[3]

PM provides insights to improve all three choices by aiding managers to sense earlier and respond more quickly to uncertain changes. It does this by driving accountability for executing the organization's strategy to the lowest possible organization levels.

INCREASING FOCUS ON CUSTOMERS

It is a tough time for senior managers. Customers increasingly view products and service lines as commodities and place pressure on prices as a result. Business mergers, employee layoffs, and cutting costs are ongoing. And long gone are the days that private equity firms could squeeze out profits though balance sheet wizardry. Inevitably there is a limit on these approaches to impact profits, an impact that is forcing management to achieve real PM from the underlying business: Managers must come to grip with getting organic profit growth from existing customers and truly managing their resources, not just monitoring them. You can't simply create the scorecard's dashboard to look at the dials; you have to be constantly taking actions to *move* the dials.

If we had to point to one single reason for the interest in performance management, we believe it is the result of the shift in power from suppliers to customers and buyers due four key realizations:

1. It is more expensive to acquire new customers with marketing than to retain existing customers.
2. The source for competitive advantage is shifting—as products and service lines become commodities, thus neutralizing any competitive edge

from them, suppliers must shift to value-added services to differentiate themselves from their competitors.

3. Information technology (IT) automation allows microsegmenting customers to shift from mass selling to formulating unique marketing strategies and differentiated customer service treatment levels to each segment (and ultimately to individuals) based on their unique preferences.
4. The Internet is providing customers and buyers tremendous capabilities for price-comparative shopping and information about any supplier's products, service-line offerings, and deals.

These four factors are simultaneously forcing greater attention than in the past on understanding which of your existing customers are relatively more profitable and which might have future potential value. Collectively, these four factors are like a "perfect storm," bringing turbulence and wreaking havoc on the lives of marketing and salespeople. The marketing function needs to understand the characteristics and traits of their existing customers so that they target their marketing budget to acquire new customers with traits like the more valuable existing ones and not waste spending on acquiring less profitable (or unprofitable) customers. The salespeople must accept that their role is no longer about just increasing sales but rather increasing sales *profitably*.

Earlier it was mentioned that performance management is not a process or a system but rather the integration of multiple methodologies. Is there a way to visualize performance management as a framework?

PERFORMANCE MANAGEMENT FRAMEWORK FOR VALUE CREATION

One of the most ambiguous terms in discussions about business and government is *value*. Everybody wants value in return for whatever was exchanged to get value. We can have endless philosophical debates about the definition of value. The ancient Greek philosophers have already put a lot of time into that. The much more interesting question for the twenty-first century is "Whose value is more important?" There will always be three groups that believe they are entitled to value: customers/users, shareholders/stakeholders, and employees. Are they rivals? Is there an Adam Smith–like invisible hand controlling checks and balances to maintain an economic equilibrium so that each group gets its fair share? And, for example, after the expected cost savings from a project are realized in part or whole, how will the financial savings be divided among these groups?

Exhibit 1.2 illustrates the interplay among the three groups. Customers conclude that they received value if the benefits or pleasure they received from a product or service exceeds what they paid for it. At the opposite end of the exhibit are the owners, shareholders, and lenders. They also have entitlement to value. As risk-taking investors and lenders, if their investment return is less than the economic return that they could have received from equally or less risky investments, then they are disappointed; they would feel they got less value.

The weighting scale in Exhibit 1.2 indicates that there is a trade-off between customers and shareholders. Under certain conditions, increasing customer satisfaction can result in reducing shareholder wealth. For example, in a case where the enterprise adds product features, functions, and/or services but without a commensurate price increase or gain in market share and sales volume, then the customers gain value while the shareholders lose value.

Exhibit 1.2 also involves supplier-employees, which includes the executive management team. A perceived entitlement to employees is their job value. For many employees, this is their security and financial compensation. Heroes of the twentieth-century labor union movement, such as Walter Reuther of what is today's AFL/CIO labor union in the United States, confronted Henry Ford for "a fair day's

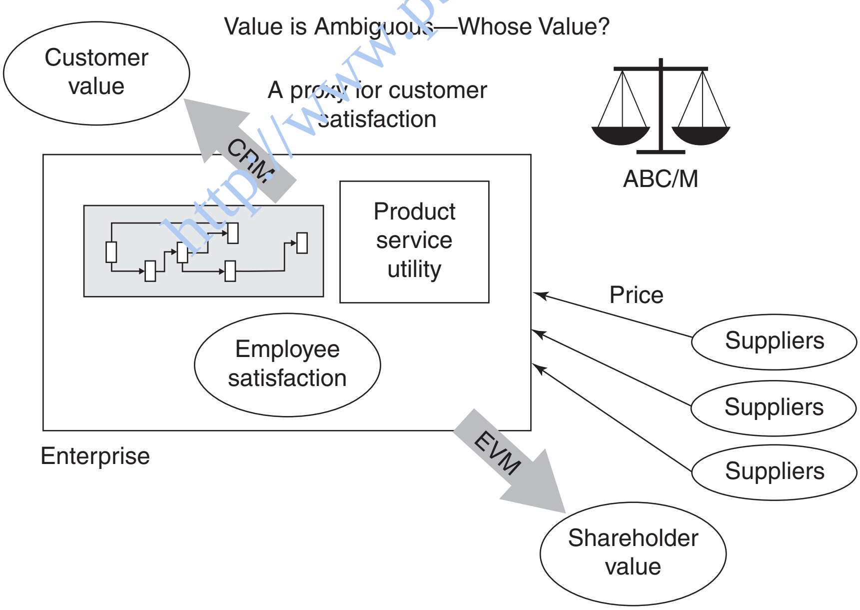

Exhibit 1.2 A Proxy for Customer Satisfaction

pay" for hourly workers. In today's more mobile knowledge worker labor pool, employees who are dissatisfied with their job value simply vote with their feet by switching to pursue a greater-value job with another employer. Or they become contractors and establish their own value with their own fees or billing rate.

PERFORMANCE MANAGEMENT OPERATING AS AN INTEGRATED SYSTEM

Exhibit 1.3 decomposes Exhibit 1.2. It illustrates the interdependent methodologies that comprise performance management for a commercial organization. Look at the boxes and ellipses and ask yourself which is the most important one. This is a trick question because the answer depends on who you are. If you are the chief executive or managing director, it must be the ellipse "Mission and Strategy" located in the upper left corner. That is the primary job of people with these titles: to define and constantly adjust their strategy as the environment changes. That is why they are paid high salaries and reside in large corner offices. However, after

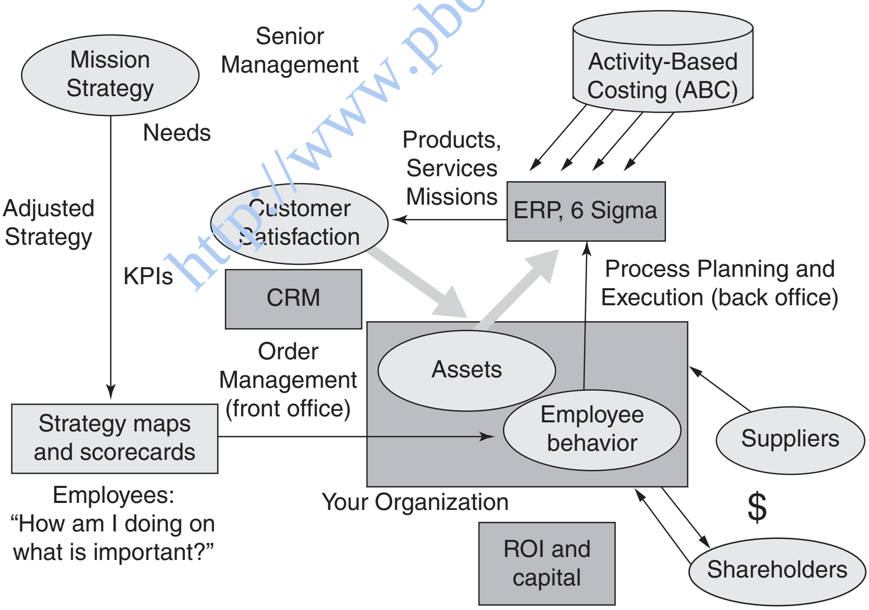

Exhibit 1.3 Performance Management Framework

the strategy definition is complete and maintained as current, then the core business processes take over, and there are competent process owners held accountable to manage each one.

Most readers will likely select "Customer Satisfaction" as the most important box or ellipse. This is a good choice because customer satisfaction encompasses four customer-facing trends, including increased focus on:

1. The need for higher customer retention. It is relatively more expensive to acquire a new customer than to retain an existing one.
2. Source of competitive advantage shift due to neutralized advantages from commodity-like products to value-adding service differentiation to customers and prospects.
3. Microsegmenting of customers to focus on their unique preferences rather than spray-and-pay mass selling.
4. The Internet's shift in power from suppliers to customers and buyers.

In Exhibit 1.3, the two ultimate megacore business processes, encompassing the specific ones that are possessed by any organization on the planet, are represented by the two solid inbound and outbound arrows. The two arrows are (1) take an order or assignment, and (2) fulfill an order or assignment. When stripped to its core, that is what *any* organization does. The two arrows are universal regardless of sector or industry—commercial business, governments, military, hospitals, churches. Can you name an organization that does not receive tasks and then attempt to execute them? Exhibit 1.3 reveals that the field of IT has named the support systems for these two mega processes as *front-office* and *back-office* systems. Other IT systems serve as components in managing the value chain. It is easy to conclude that a customer focus is critical.

The customer-facing front office systems are customer intelligence (CI) and customer relationship management (CRM) systems. This is also where sales and work order management systems reside. The back-office systems are where the order-fulfilling, process planning, and execution resides—the world of ERP and Six Sigma quality initiatives. The output from this execution box is the product or service or mission intended to meet customer needs. Imagine the three arrows continuously circulating the customer orders in the counterclockwise direction. To the degree that that the customer revenues (or fund transfers for public sector or not-for-profit organizations) exceed all of organization's expenses, including the cost of capital, then profit (and free cash flow) eventually accumulates into the shareholder's ellipse in the exhibit's lower right.

Now note that "needs" to satisfy customers is the major input to the senior management's "Mission and Strategy." As the executive team adjusts its strategy, it may abandon some KPIs (not that those KPIs are unimportant; now they are just less important), add new KPIs, or adjust the KPI weightings for various employee teams. As the feedback is received from the scorecards, all employees can answer that key question: "How am I doing on what is important?" With analysis for causality, corrective actions can then occur. And note that the output from scorecards does not stop at the organization's boundary; it penetrates all the way through to influence employee behavior. This penetration in turn leads to better execution.

AUTOMOBILE ANALOGY FOR PERFORMANCE MANAGEMENT

It was stated earlier that all organizations have been doing performance management well before it was labeled as such. It can be argued that on the date all organizations were first created, they immediately were managing (or attempting to manage) their enterprise performance by offering products or services and fulfilling sales orders. If you will, imagine an organization at start-up as a poorly maintained automobile. We would observe the consequences of unstable business methods: unbalanced wheels, severe shimmy in the steering wheel, poor timing of engine pistons, thick power steering fluid, and mucky oil in the crankcase. Take that mental picture and conclude that any physical system of moving parts with tremendous vibration and part wearing friction dissipates energy, wasting fuel and power. At an organizational level, the energy dissipation from vibration and friction translates into wasted expenses where the greater the waste, the lower the rate of shareholder wealth creation, and possibly destruction of shareholder wealth. In a different case, you may find a car that seems perfect to the customer in every way, but is not priced to make a profit—so shareholders are unhappy. In another, the focus may be on producing at the least cost to the point of undermining customer satisfaction.

Now imagine an automobile with its wheels finely balanced and well lubricated. The performance framework (i.e., the automobile) remains unchanged, but the shareholder wealth is created more rapidly because there is balance in quality, price, and value to all. No vibration or friction. That is how good performance management integrates the multiple methodologies of the PM portfolio of components and provides better decision analysis and decision making that aligns work behavior and priorities with the strategy. Strategic objectives are attained, and the consequence is relatively greater shareholder wealth creation.

The concept of value is embedded in Exhibit 1.3. The three groups entitled to value are defined in this way:

1. **Shareholder value.** This is measured by economic value management (EVM) methodologies, which detect whether the profit margin generated from satisfying existing and future customers is also sufficient to reward shareholders and lenders beyond risk-adjusted investment returns that those investors and lenders could achieve elsewhere, including financial returns from financial market instruments, such as U.S treasury bonds. With financial intelligence, accounting profits are not economic profits.
2. **Customer value.** The *front office's* customer intelligence and customer relationship management systems are intended to maximize communications, interactions, and sensitivity to each customer's unique needs. CI and CRM enable differentiated treatment levels, deals, and offers to more valuable customers.
3. **Supplier-employee value.** The *back office's* enterprise resource planning, advanced planning systems (APS), and process improvements ensure effective execution to *fulfill orders*. The PM strategy mapping and scorecard systems ensure that specific groups of people, equipment, and other assets are working on high priorities and performing in high alignment with senior management's strategies.

Activity-based costing (ABC) data, a key component in performance management, permeates every single element in this scenario to help balance these sometimes competing values. ABC itself is not an improvement program or execution system. ABC data serve as a discovery mechanism and an enabler for these systems to support better decision making. For example, ABC links customer value management (relying on customer intelligence [CI] and/or customer relationship management [CRM] systems) to shareholder value creation, which is heralded as essential for economic value management. The tug-of-war between CI/CRM and shareholder wealth creation is the trade-off of adding more value for customers at the risk of reducing wealth to shareholders. Ultimately, businesses will discover that customer value management is the *independent* variable in the equation to solve for the *dependent* variable for which the executive team is accountable to the governing board: shareholder wealth creation. Performance management provides the framework to model this.

How does this work? When combined with effective forecasting and risk management tools, ABM enables the only financial calculation engine that can quantitatively translate changes in customer value to measure the impact on shareholder value. We know all these components connect, but we struggle with how they do it. But research and work remains to be done, as described by this observation:

> "Customer value can be regarded as the key driver of shareholder value . . . [but] surprisingly, although being of obvious importance, literature taking a more comprehensive view of customer valuation has only recently been appearing. A composite picture of customers and investors is hardly found in business references."[4]

Is Exhibit 1.3 the best diagram to represent the broad, not narrow, picture of performance management? Probably not. But it is a start. Professional societies, such as the cost management organization CAM-I (www.cam-i.org), management consultants, and software vendors have their own diagrams. Perhaps a business magazine or Web portal can have a contest where diagrams are submitted and voted on by readers. But the key point is that performance management is not the narrow definition of "better strategy, budgeting, planning, and finance"; it is much broader.

PERFORMANCE MANAGEMENT: MAKING IT WORK

Rising specialization, complexity, and value-adding services cause the need for more, not less, PM. Despite the impact that technology and more flexible work practices and policies have on continuously changing organizational structures, without ongoing adaptation, the correct work at acceptable service levels will not get done. All employees must have some grasp of managing for results. Somehow their collective performance must be coordinated. A united and sustained performance is a challenging part of management. PM aids in accomplishing this goal.

WHERE DOES INFORMATION TECHNOLOGY FIT?

Where do software and data management fit in? Software is a set of tools that serves as an enabler to the PM solution suite of methodologies. However, in the big picture, 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, software is no longer the impediment it was in the mid-1990s. 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 the abilities of most organizations 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 important, used. Casual users, not just trained technicians and statisticians, can readily 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 watch for high performance. Such leaders 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 cannot have access to it? What good is using data if you cannot use that data wisely? Information technologies enable performance management, but performance management is much more. It forms the foundation to escalate managing into a formal discipline.

Always remember that the main idea is not to examine business improvement methodologies in isolation but rather as an integrated solution set.

ENDNOTES

1. Alan Webber, "CEO Bashing Has Gone Too Far," *USA Today*, June 3, 2003.
2. Bill Jensen, *Simplicity* (New York, NY: Perseus Publishing, 2000), 11.
3. Alan Brache, *How Organizations Work* (Hoboken, NJ: John Wiley & Sons, Inc., 2002), 10.
4. J. Bayon, J. Gutsche, and T. Bauer, "Customer Equity Marketing," *European Management Journal* (June 2002, 20, 213–222).