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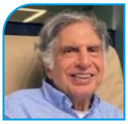
STRATEGIC PERFORMANCE MEASURES IN PRIVATE SECTOR

CHAPTER 9



" If you want to walk fast, walk alone, If you want to walk far, walk together."

Ratan Tata

Strategic Performance Measures in Private Sector

- Role of Quality
- Interlinking of CSFs & KPIs

Financial	Financial & Non-Financial	Social & Environmental
• Gross Profit • Return on Capital Employed • Return on Investment • Residual Income • Earning per Share • Economic Value Added • Net Present Value	• Balanced Scorecard • Performance Pyramid • Building Block Model	Triple Bottomline

STUDY MENTOR

Path to Exemption

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SR. No.	CHAPTER CONTENT	PAGE No.	READ ①	UNDER-STAND ②	REVISE ③	STREN-GTHEN ④	EXPER-TISE ⑤
	How to Achieve		FIRST ATTEMPT PASS			RANK 11-50	RANK 01-10
1	Performance Management System in Private Sector						
2	Interlinking of Critical Success Factors & Key Performance Indicators to Performance Measurement						
3	Performance Measures						
4	Pros & Cons of the use of Performance Measures						
5	Financial Performance Measures						
6	Gross Profit						
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	How to Achieve		FIRST ATTEMPT PASS			RANK 11-50	RANK 01-10
14	Balance Scorecard						
15	Performance Pyramid						
16	Building Block Model						
17	Triple Bottom Line						
18	The Role of Quality in Performance Measurement Systems, Especially in Context of Management Information						

1 PERFORMANCE MANAGEMENT SYSTEM IN PRIVATE SECTOR

Performance management shall be considered as essential aspect of management accounting. Performance management system in the private sector may be seen as a four-stage solution for striving towards sustainability

Four stage solution

Appropriate organisational structure must be determined.	Evaluate the degree of delegation & identify the responsibility centres.	Establish (both financial and non-financial measures) target for each measure.	Review KPI targets (Key Performance Indicator) and take corrective action (if required).

Stage 1	Organisational structure outlines the roles of individuals in the organisation and decides the way in which authority and responsibility is allocated among them and how they are coordinating with each other to attain organisational objectives. The importance of organisation structure in the context of performance management shall be seen as – In the absence of clear lines of responsibility, responsibility accounting (stage 2) can't be implemented effectively because performance measurement is directly linked with organisational structure.
Stage 2	Responsibility accounting helps in the collection, summarization, and reporting of information where individual managers are held accountable for certain costs, revenue, or assets of the firm. Responsibility centres are marked with the intent to appraise the performance of the manager against established KPIs (performance measures) for each of the CSFs identified.
Stage 3	Critical Success Factors (CSFs) pertaining to each of the organisational objectives in light of corporate strategy shall be identified, and corresponding Key Performance Indicators (KPIs) and targets shall be established to empower the performance management system to measure and evaluate the performance of managers (who are entrusted with the decision making of a particular responsibility centre) as required under stage 2.
Stage 4	Established set of KPIs under stage 3 shall be used as parameters for the evaluation of the performance of managers of responsibility centres, and corrective action shall be taken if divergence exists; between the actual and expected (or benchmark) performance levels.

- The use of responsibility accounting to assist performance management is appropriate where top management entrusts the managers with decision making pertaining to the responsibility centre they manage.
- To enhance the application of responsibility accounting in decision-making, it is essential for an organisation to attach a level of responsibility (decentralised power) to different divisions/ departments and designate it as either a cost, profit, revenue, or investment centre.
- Certain function- based responsibility centres will never change their nature, but others can, which means a responsibility centre may be capable of changing its nature (due to changes in organisational structure and delegated responsibility and authority). For example, a faculty department in the university is a cost centre, but if it starts conducting MDP (management development programme) and undertakes research and consultancy projects, it may become a profit centre.

2 INTERLINKING OF CRITICAL SUCCESS FACTORS

For an efficient performance management system, the identification of the performance measures (both financial and non-financial) and the further establishment of indicator(s) and target(s) corresponding to each such measure are essential. Usually, a performance matrix is used wherein, against each strategic objective, a set of measures and targets are listed, and actual performance is also recorded to determine the divergence.

The performance measures shall encompass those aspects (such as profitability, market share, quality, etc.) or areas of action (i.e., activities, processes, and parts thereof) that are vital for the attainment of strategic objectives. These aspects or areas are known as Critical Success Factors (CSFs). Mind it, CSFs are specific to the industry and segment in which a business firm is operating; organisation must identify them.

To review the performance and take corrective actions, mere identification of CSFs and establishing the targets will not be enough. An effective review system must be in order, which comprises Key Performance Indicators (KPIs) on a single and handy dashboard to indicate performance on a real-time basis. Key performance indicators are performance management instruments used to measure and monitor the achievement of objectives so as to determine the level of success of your actions.

It is clear from the above discussion that CSFs and KPIs are not one and the same thing but related to each other. The CSFs are the areas that are critical for the attainment of corporate objectives, whereas KPIs are signals of performance in such areas.

To illustrate, for an IT Department, a Critical Success Factor could be restoring normal service, and in order to achieve that, a logical KPI would be the Average Turnaround Time, with a target of 4 hours. The Average Turnaround Time and its target of 4 hours are the KPIs that represent 'how' the IT department achieved its Critical Success Factor.

An effective performance management system warrants that KPIs must be established in such a manner that if meets the target, then deliver the CSFs and the CSFs, in turn, must be constructed in a way that ensures that the company's strategic vision is delivered if the CSFs are met.

How to identify CSFs and KPIs

Rockart highlighted the four prime sources of CSFs:

- Structure of a particular Industry
- Competitive strategy, industry position, and geographical location
- Environmental Factors
- Temporary Influences

Apart from the four aspects specified above, another important point is the functional area of the manager who is identifying the CSFs, because the priority of a purchase manager can't be the same as that of a personal manager. To overcome this, CSFs need to be identified organisation wide.

The KPI targets are more formally called thresholds, and the thresholds must be ascertained with a great deal of industry analysis as well as internal analysis. KPIs shall be SMART (specific, measurable, attainable, relevant, and time-bound).

Specific --> should be clearly defined; **Measurable -->** have means to quantify;
Achievable --> can be achieved, i.e., should be realistic; **Relevant -->** to the organization's strategic goals; Time **Constrained -->** have a designated start and end dates.

George T. Doran first used “SMART” in the November 1981 issue of Management Review, but the attribute of MBO (management by objective by Peter F. Drucker) inspired the origin of SMART.

Note - A single CSF can also have more than one KPI if required.

CSFs-based application of Core Competencies leads to Competitive Advantage

If any organisation is able to use its core competencies to exploit the CSFs, it will surely have an edge over rivals, which will position the organisation in a better strategic position and lead to competitive advantages.

The terms– goals or objectives are often used interchangeably, although one key difference is that it should always be possible to quantify an objective. Goals, conversely, cannot be quantified and are therefore open ended.

C PERFORMANCE MEASURES

Performance management system plays a key role in registering improvement to better-off the strategic position. But it has a prerequisite, and that is measuring and evaluating the existing performance using a set of performance measures. An ideal performance measure (as part of a performance management framework) should –

- Support corporate strategy, its communication, and its implementation.
- Measure performance from a financial, non-financial, quantitative, and qualitative perspective.
- Properly support decision-making.
- Recognise the long-term objectives as well as the short-term objectives of the organisation.
- Provide a reasonable incentive to the manager to keep them motivated so that they make decisions that are in the best interests of the overall company (goal congruence).
- Include only those factors for which the manager (of the responsibility centre) can be held accountable.

Performance Measures

- Pure Financial Indicators
  - Gross Profit
  - Return on Capital Employed (ROCE)
  - Return on Investment (ROI)
  - Residual Income (RI)
  - Earning Per Share (EPS)
  - Economic Value Added (EVA)
  - Net Present Value (NPV)
- Tools Comprising Non Financial Indicators in additon to Financial Indicators
  - Balanced Scorecard
  - The Performance Pyramid
  - Building Block Model
  - Triple Bottom Line (TBL)

AN INTRODUCTION TO STRATEGIC PERFORMANCE MANAGEMENT

CHAPTER 8

“ Respect, Recognition, and Reward flow out of Performance.”

N. R. Narayana Murthy

Strategic Performance Management

Role in Business Integration
- Value Chain
- McKinsey's 7S

Behavioural Aspects
- Accountability
- Management Style

Predicting and Preventing Corporate Failure
- Quantitative Models
- Altman Z-Score
- Beauer's Univariate
- Taffler and Tishaw's
- The ZETA Model
- Tafflers' PAS

Qualitative Models
- Argenti's score

Performance Measurement

Strategic Performance Issues in Complex Business Structures
- Virtual/Hollow/Network Organisations
- Strategic alliances
- Joint ventures
- Franchising
- Licensing
- Multinationals
- Complex Supply Chains

Strategy

Influence of Organisation's Structure, Culture and Strategy on Performance Measurement

PREVIEW

STUDY MENTOR

Path to Exemption

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	How to Achieve		FIRST ATTEMPT PASS			RANK 11-50	RANK 01-10
1	What is Strategy						
2	What is Performance Management						
3	Interlinking of Performance Management & Strategy						
4	Importance of Interlinking of Performance Management & Strategy Multifolds under Modern & Dynamic Business Environment						
5	Business Integration						
6	Value Chain/Value Chain Analysis						
7	Description of Activities & Margin						
8	How does an Organisation use Value Chain to gain & Sustain Competitive Advantage?						
9	Linkage of Value Chain Analysis & Performance Management						
10	McKinsey's 7S						
11	Elements of 7S						
12	Types of Organisational Structure						

SR. No.	CHAPTER CONTENT	PAGE No.	READ ①	UNDER-STAND ②	REVISE ③	STREN-GTHEN ④	EXPER-TISE ⑤
	How to Achieve		FIRST ATTEMPT PASS			RANK 11-50	RANK 01-10
13	Effective Use of 7S framework for Business Integration						
14	McKinsey's 7S Model & Performance Management						
15	Influence of Culture on Performance Measures						
16	Strategic Performance issues in Complex Business Structures						
17	Complex Business Structure - Problems & Solutions Thereto						
18	Behavioural Aspects						
19	Predicting & Preventing Corporate Failure						
20	Why do Companies Fail?						
21	Need for Predicting Corporate Failure						
22	Predicting Corporate Failure						
23	Quantitative Models						
24	Qualitative Models						
25	Preventing Corporate Failure						

A PERFORMANCE MANAGEMENT AND ITS LINK TO STRATEGY

1 What is Strategy

A pattern of activities that seek to achieve the objectives of the organization and adapt its scope, resources, and operations to environmental changes in the long term". However, Michael E. Porter defines strategy as a competitive position, "deliberately choosing a different set of activities to deliver a unique mix of value."
It is all about achieving a sustainable competitive advantage.
It is worth noting that the effectiveness of a strategy depends on the efficiency of strategic planning and control.

To illustrate - Biscuit manufacturers know their consumer base is price sensitive; hence, rather than increasing pricing, they are reducing the quantity of packs. In economic terms, this is called Shrinkflation (a form of inflation that consists of reducing a product's size while maintaining its retail price; most common in FMCG, especially food and beverage). The company believes that by implementing this strategy, it will be able to maintain its revenue and margins.

1990
Rs. 5 = 10 Biscuits

2020
Rs. 5 = 5 Biscuits

Shrinkflation

2 What is Performance Management?

- Determining an appropriate organisation's structure, level of decentralisation, etc.
- Establishing a responsibility centre and assigning responsibility to the manager.
- Establishing a performance measurement system and fixing the yardsticks.
- Reviewing the performance periodically and taking corrective measures where performance is not acceptable.

In simple words, performance management systems help an organisation in measuring how well it is performing against its goals and objectives and identify areas where performance can be improved in order to help the organisation achieve those goals and objectives.

3 Interlinking of Performance Management and Strategy

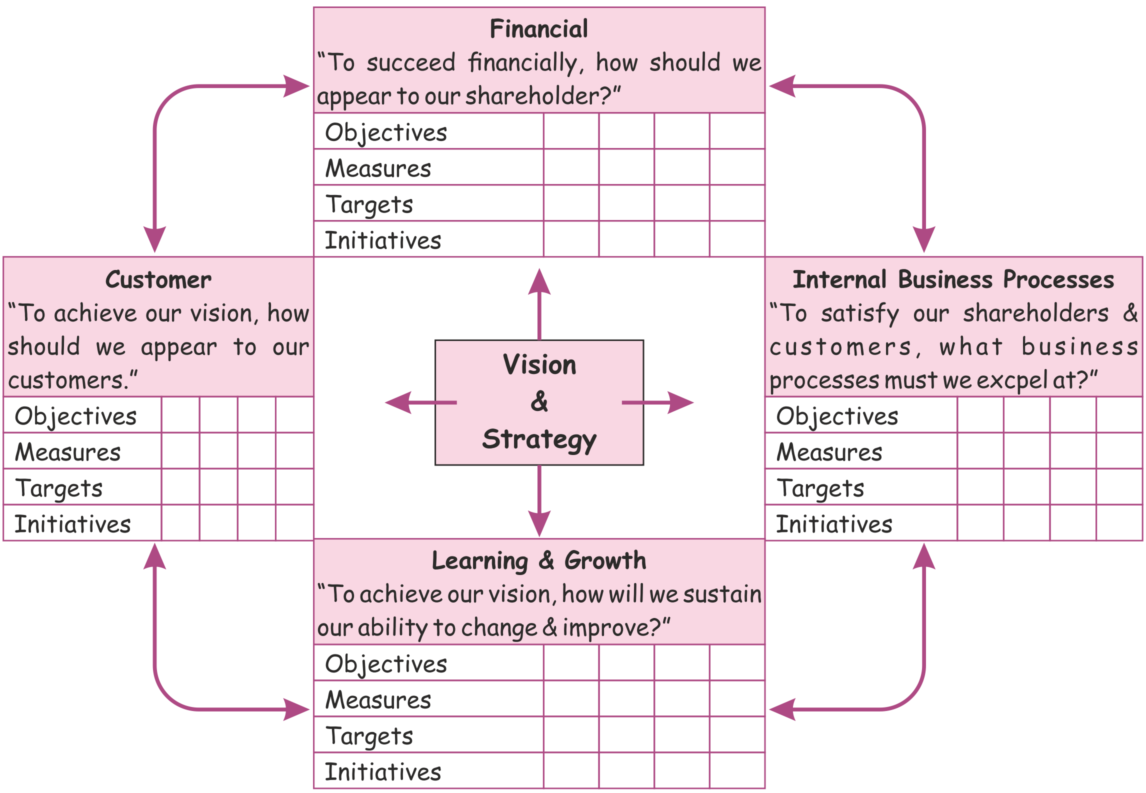
Effectiveness of strategy depends upon the efficiency of strategic planning and control. Informed decision making is an essential requirement for efficient strategic planning and control.

Moreover, performance can be measured and evaluated in terms of those yardsticks (Critical Success Factors (CSFs) and Key Performance Indicators (KPIs) thereto), which are critical for the attainment of the goals and objectives that are linked with strategy. In this way, the performance and goals of individuals are aligned with the performance and objectives of the organisation where they are working.

Performance management can bring ease in strategic planning and control for management of any business, whereas strategy acts as a guiding force for establishing performance indicators and parameters thereof.

To illustrate - Tools used for measurement and evaluation of performance includes Balanced Scorecard (shown in Figure A.1) and Performance Pyramid (shown in Figure A.2). Both models keep strategy as either a focal point or a starting point.

4 Balance Scorecard



6 Importance of Interlinking of Performance Management and Strategy Multifolds under Modern and Dynamic Business Environment

Historically, performance management has tended to focus on either people management (e.g., performance appraisals) or performance monitoring (e.g., reporting on key performance indicators). But as business environments become increasingly dynamic and competitive, it is increasingly important for managers to develop coherent business strategies and to have tools and processes in place that provide relevant and reliable information to support strategic decision making, planning, and control.

A performance management system should be derived from the company's strategic objectives so that it supports those objectives. It should also change over time as the strategies of the organisation change and should be flexible enough to remain coherent with the objectives of the organisation.

B ROLE OF PERFORMANCE MANAGEMENT IN BUSINESS INTEGRATION USING MODELS SUCH AS VALUE CHAIN AND MCKINSEY'S 7S

1 Introduction

Business may be seen as a grouping of specialized departments or functions. But in practical reality , value is added by the activities and processes that business performs. Such business processes and activities may stretch a number of departments. Hence, these business processes and activities need to be linked or integrated effectively across the organisation to create value.

Whatever business structure (be it functional, line, entrepreneurial, matrix, etc.) is adopted, the need to integrate the different aspects of the business is inevitable to create value.

1 Business Integration

Business integration brings all aspects of business into alignment so that business objectives can be achieved through effective implementation of strategies while making efficient use of the available set of resources.

Resources available to businesses are usually scarce in nature, hence the multifold importance of business integration.

Four aspects in particular need to be linked as part of the business integration effort: people, operations, strategy, and technology. Performance management improves as a result of the integration of these four aspects.

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ALL INDIA RANK 07 CA PRAKHAR LADDHA
ALL INDIA RANK 10 CA ANSHUL SINGHAL
ALL INDIA RANK 10 CA RONAK JAIN
ALL INDIA RANK 11 CA LISA AGARWAL
ALL INDIA RANK 15 CA RISHU VARSHNEY
ALL INDIA RANK 16 CA ADITYA LAKHOTIA
ALL INDIA RANK 18 CA BISWAJIT DAS
ALL INDIA RANK 20 CA MRIDULA SUBHRAMANYAM
ALL INDIA RANK 24 CA GOVIND JAKHOTIA
ALL INDIA RANK 26 CA SHIVANI RAICHURA
ALL INDIA RANK 27 CA ISHA DELIWALA
ALL INDIA RANK 30 CA ANKIT BANSAL
ALL INDIA RANK 31 CA BHAVIN SHAH
ALL INDIA RANK 32 CA MANSI GUPTA
ALL INDIA RANK 35 CA SNEHIL JAIN
ALL INDIA RANK 41 CA ARHAM MEHTA
ALL INDIA RANK 42 CA AKSHIT AGARWAL
ALL INDIA RANK 46 CA VISHAL MALARA
ALL INDIA RANK 47 CA UJWAL VAKHARIA
ALL INDIA RANK 47 CA LISA AGARWAL
ALL INDIA RANK 48 CA SHRUTI GUPTA
ALL INDIA RANK 48 CA SNEHA K
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