



TenStep Supplemental Paper

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Measuring Performance through Value-Based Management

Service Co. is a logistic company that has a wide network of operations scattered across the globe. The company's country managers are accountable through their separate profit and loss accounts and profits are rewarded with bonus. To keep pace with competitors, the company undertook a few initiatives:

- Re-engineering processes
- Eliminating duplicate activities
- Enhancing quality, punctuality, and customer satisfaction by streamlining operations

After two years of planning to implement creative solutions, the company faced resistance from country managers. This was because the manager's performance would be dependent on cross-country and cross-functional processes.

The company decided to retain the existing compensation system but insisted that the new processes be implemented. This was again met with fierce resistance because managers stood to lose control of activities under the new system, and activity performance was used to determine profit.

To top it all, the company was forced to downsize, resulting in poor customer service and declining standards. In situations like this, the challenge is to ensure that measurement systems facilitate performance.

Value Based Management (VBM)

The VBM methodology comprises the following steps:

- Identifying, understanding and prioritizing the needs of key stakeholders
- Setting suitable strategies and goals
- Disseminating information of adopted measures and goals

VBM is a concept that utilizes a holistic approach to decide on an appropriate tool to measure performance.

Performance Management

Performance management helps to achieve goals and helps employees adapt to changing demands. The main purpose of this measure is to influence employee behavior and to give them a clear voice.

- **Measures should direct actions.** Measurement mechanisms must indicate the organization's direction in order to identify milestones. Managers need to be clear on the plans, goals and measures of the company.



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- **Financial and Non-financial measures.** Financial measurements are an important and dominant decision-making tool. However, to achieve the required financial performance, accountants need to learn about non-financial measures as well.

Non-financial measurements convert behavior into countable units like cycle time. For example, consider a service representative who attends the customer call order - the representative has to spend time (which is cost) and execute the order perfectly (quality). More orders have to be processed (quantity) and converted into measurable terms.

- **Balance and Perspectives.** It is important to be concerned about perspectives when setting measures to address those perspectives. For example, the measurements of cash flows and return on equity should be constructed from the owners' perspective of the efficiency of investments. On the other hand, from the employee's perspective, the same returns would be considered indicators of the timely payment of salary and an increased bonus.

Framework

VBM provides an integrated measurement and management framework defined by three levels of performance:

- **Organization.** This portrays the organization as an aggregate entity whose accomplishment is equal to the sum of the performances of all the processes. Strategies and measures like return on equity, profit margin, customer satisfaction, etc. will be developed to set up links and to perform activities.
- **Process.** This explains the groupings of related activities that occur in many departments. The performance of a process is the sum of the performances of all activities within the process. Processes can be broken into sub-processes, which are assisted by support processes. The activities in support processes are:
 1. Employing the right people in the right place
 2. Timely training programs
 3. Provisions for upgrading existing communication channels
 4. Supporting activities to cope with change
- **Activity.** This explains the activities done by people or machines in a department. Here, activity is defined as a set of tasks, and every task will have a common activity driver. Activity must also offer the means to implement activity-based budgeting.

Summary

Performance management influences human behavior and is crucial for an organization to move ahead.