

Is Your Company's Performance Metrics Improvement Efforts?

Does your company have a laundry list of performance metrics it regularly watches yet it's not getting the improved results you were hoping for? It might be because you are measuring the wrong things—or worse—competing things.

by Kate Vitasek

The Importance of Using Cross-Functional Process Metrics

Companies should align targets and metrics across their organizations. To achieve overall corporate success, strategic cross-functional *process* measures must be in place that serve as cross-functional regulators. By defining metrics for core processes and linking them to the individual functional areas, organizations can align their resources and efforts to their overall strategy, in turn, driving the organization towards fulfillment of its overall goals.

For example, a typical fulfillment process includes several activities such as order management, pick/pack/ship, and transportation. Often companies measure only part of the fulfillment process, such as the pick/pack and ship process that is performed at the distribution center. A classic example is a company that has a distribution center goal of 98% fill rate within 48 hours. The trouble with this approach is twofold.

To begin with, some distribution centers (DCs) do not start the clock for measurement until an order is dropped at the DC. If a customer's order is put on hold and delayed, the DC still reports it as "on time" when, in fact, it did not meet the 48-hour goal because it sat on hold.

The second issue is that even if an order ships on time, it may not get to the customer on time due to transportation issues. A better cross-functional metric would be 98% order fulfillment within five business days (or customer request). An example of how individual functional measures roll up into a cross-functional process metric is illustrated on page 15.

Functional Metrics Can Drive Sub-Optimization

A survey of University of Michigan Business School executive development program attendees revealed that managers have looked on as others in their company engaged in activities that clearly hurt the firm, but helped a key measure look strong.¹ This concept, known as sub-optimization, has been widely studied.

Studies have proven that high performance levels in one area does not necessarily lead to high levels of overall company performance. Simply stated, employees oftentimes optimize their specific areas which has a negative impact (or sub-optimizes) the organization as a whole.

There are many examples of this. Take the *Fortune* 500 food manufacturing company that wanted to reduce its costs. This company built in incentives to reward its procurement people for purchase price variance and its manufacturing personnel for machine efficiency. In its zeal to meet its target of decreasing purchasing costs by 10%, the procurement team purchased a less-expensive raw material.

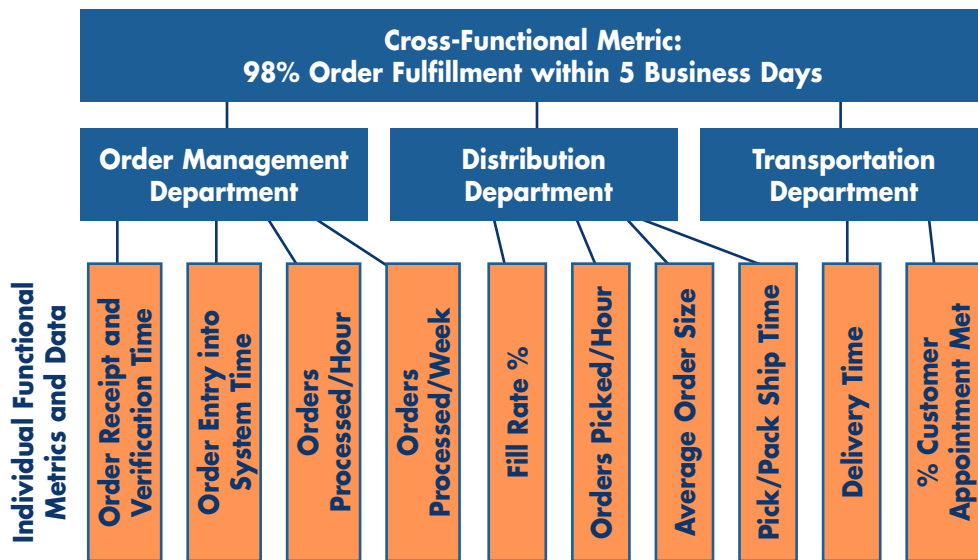
These inferior components slowed down the production equipment throughput and created excess waste, which in turn, actually increased the overall cost of goods for the company. The results: the procurement manager was paid his bonus, the manufacturing manager was cited for poor performance, and the company's overall bottom line decreased.

The lesson is simple. Functional metrics can often drive sub-optimization, waste time and money, and sap an organization of its vital energy.

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Program Sabotaging Your Performance



Process versus Results Metrics: Know the Difference, Use Them Properly

While cross-functional process metrics are key to avoiding sub-optimization, many companies do not realize the difference between a process and a results metric. Knowing the difference between these two metrics is important in helping a manager pick the right ones to manage his business.

One way to distinguish the difference between a process and a results metric is to understand the outcomes of a process yield results metric. A typical DC measures percent on-time shipment (e.g., fill rate). This is a results metric of the shipping process. However, just because the DC is achieving a 99% fill rate doesn't mean that the customer is happy.

Companies need to run their businesses with input and activities (e.g., process) metrics that drive the desired outcomes. An improvement in the right processes will drive the improvement in the result. By understanding the causal relationship between process drivers and result indicators, one can proactively drive performance.

Understanding Trade Offs

Companies must also consider the various trade offs in functional measures that will yield the most optimal overall performance. As such, it is important to align targets and metrics across an organization.

One company wanted to slash costs so it cut its sales force travel budget by 50%—only to find that reducing sales force contact with customers jeopardized key account relationships. Or, consider the company that extended quoted lead times in its effort to improve its on-time delivery performance, only to discover that it started losing customers to its competitors.

Having a well-balanced portfolio of metrics is critical to managing performance. This means employing metrics that measure the various aspects of a business, including service, quality, and productivity/costs. This also means having a thorough understanding of inter-dependencies and trade offs of the firm's various metrics.

Using Metrics Indexing to Get the Big Picture

Some companies try to address a cross-functional metrics perspective by using "bundled" measures. This concept is known as "indexing." To develop a cross-functional metrics index, a company groups related measures that are represented by a single number that is a weighted view of scores in the individual participating measures. The Perfect Order Index is the most widely used metrics index and is a good example.

A perfect order has typically been defined as on time, complete, damage free, and

having the correct invoice. It is calculated by multiplying the metrics to each other. For example, if a firm is experiencing 95% on-time delivery, fill rate, correct invoice, and damage-free shipments, the resulting perfect order index would be 81.4% (95% x 95% x 95% x 95%).

Had each of the measures been 90%, the perfect order index would drop significantly—to 65.6%. Using an index versus looking at the individual metrics can help a company get at the heart of what really matters for a customer-focused firm, which is, "Did the customer get what he wanted, when he wanted it, and how he wanted it?"

Although improving customer service is the primary objective of a perfect order, cost savings can be a big factor as well. The cost of doing "wrong" can be very high. While it is difficult for a company to pinpoint the cost of an imperfect order, some obvious costs are the resources and costs required to correct an order, such as shipping a replacement product, refunding the purchase price, or providing a credit.

In some industries like the retail environment, costs for failure to comply with the retailer's specific order requirements can add up to millions of dollars of compliance charges. Unfortunately, this money comes straight out of profits. The biggest cost, however, is probably not in fixing the order or in compliance fees...but rather in the costs associated with a lost customer or a lost account. ■

¹ Gregory P. Reilly and Raymond R. Reilly, "Improving Corporate Performance Measurement," *Journal of Cost Management*, July/August 2001.

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