



---

## **Surface disconnects between accounting and operations management**

### **– be highly competitive and create great returns**

---

*Performance Management Institute, Inc. (PMI) enables companies to create their own toolkits to survive and thrive in today's market.*

*The methodology provides the CEO and CFO with the means to show leadership and their whole team how to solve any business problem together.*

*By zeroing in on key behaviors that affect profit and cash, everyone can prioritize on the core drivers and focus their teams on leveraging those drivers to deliver results.*

*The PMI approach also allows scaling to be done more easily as new management is brought on, because the senior leaders' acumen has gone from informal personal wisdom to a formal business resource.*

### **One Example of how it works:**

A NAPA Auto Parts Distributor used PMI's operations finance toolkit as a core engagement and participation mechanism for generating self-managing leadership – creating an entire team with acute business acumen.

**The Situation and the 1<sup>st</sup> Deliverable:** For over a decade, the company had been experiencing swings of profit and cash flow in the tens to hundreds of thousands of dollars a month. In less than 4 total days over a two-month period, a senior leadership group was able to pinpoint a pivotal issue, and begin to create immediate and significant positive change in financial performance by doing spot inventory counts of high volume and cost items.



**Rick Call – CEO.** From a cover story in the local newspaper's Business Section about making some acquisitions later in the 2<sup>nd</sup> year after launching the Performance Management Group.

## Challenge:

After well over a decade of contraction, the company, with current revenues under \$10 million, was able to go into acquisition mode to build its top line and create synergies. The key factor in the change was engaging a team of non-financial leaders and associates in becoming co-architects of the financial outcomes with the CFO and the CEO. The monthly Performance Management Group huddles have continued for the last several years under their own steam, with no further outside support after initial launch.

PMI, working with the CFO and CEO, used its Operations Finance Toolkit to provide the capacity for converting the numbers into a coherent whole, both mathematically and visually, providing the 'whole picture'. This enabled non-financial folks to be able to see, understand, and work with the common sense

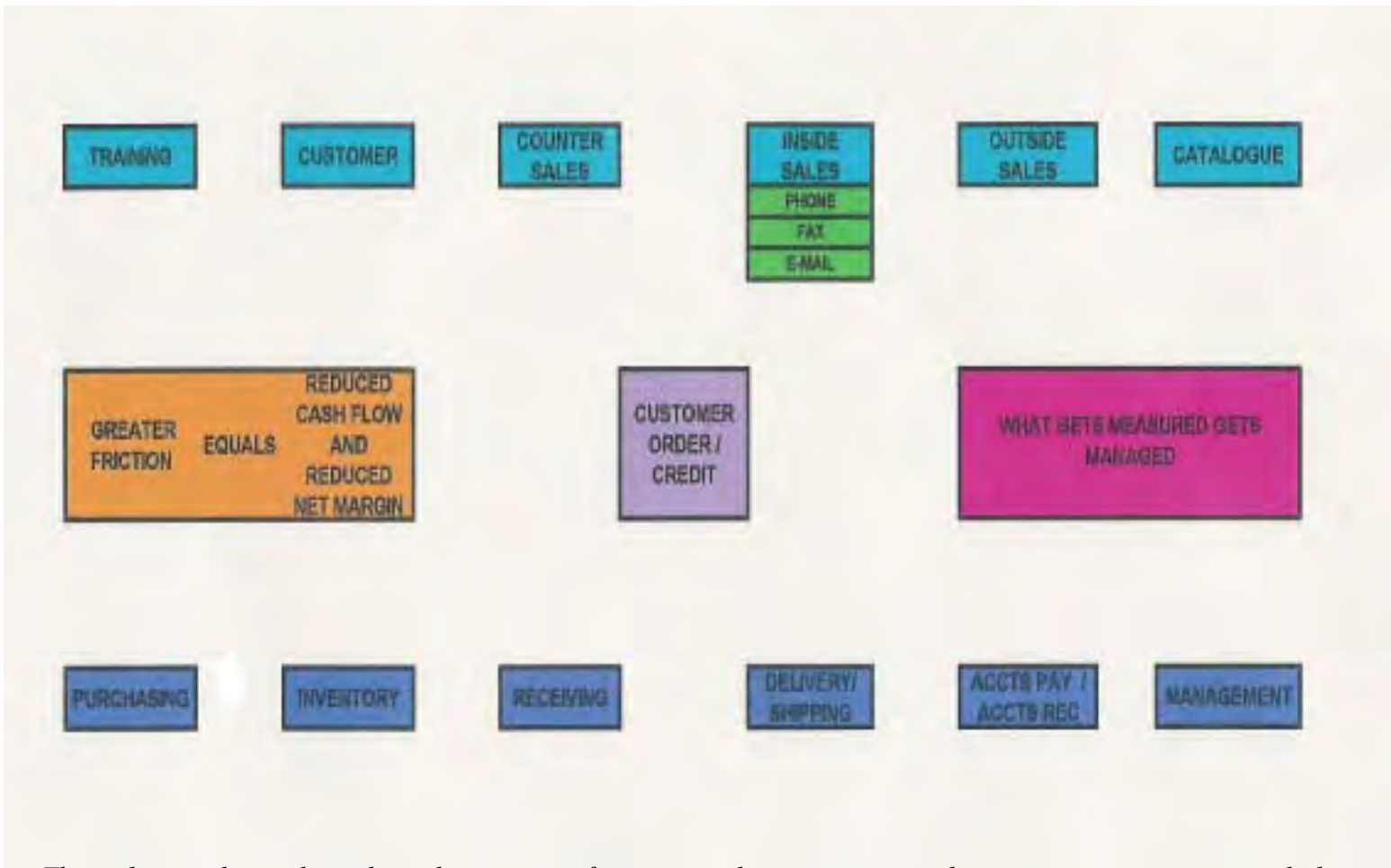
behind financial information, so they could connect that to their daily actions and decisions.

## The CFO Speaks!

**“It just blew me away that they (our Performance Mgmt. Group) were grasping that - Hey, we can set our own course here!” – Ken Thengval**

“The thing that intrigued me the most at a meeting with our banker was a comment by one of the attendees about getting people to change their behavior based on the results that are presented to them through the PMI Scoreboard and Dashboard. That is something we have been trying to do for 15 or 20 years.

***How do we get our financial and non-financial people excited about their individual role, and how that role can have an impact on the profitability and cashflow of the company?”***



*This shows the value throughput map for a retail operation, with customer contacts in light blue on the top, and back office functions in dark blue. The driving equation is: – Greater friction between hand-offs = (equals) reduced margins and operating cashflow.*

**Results:** “As I mentioned, when I printed out the monthly dollar trends for our 6<sup>th</sup> huddle, **I was amazed to see that the impacts of our operations finance practices were already significant. Although we had only begun this in November, we had already seen enough results to return our investment in PMI thus far.** Now that we were beginning to benchmark the key indicators, I was confident we could create the multiples

that PMI said we could expect, and I was understandably gratified they actually occurred so much faster than we expected.” Ken

*“After trying to solve every issue at once, we finally had clarity on which one to focus on first to get the most impact, and then where to go next”*

**Purchasing Manager**

*In the first Dollar Trend graph, we see the previous year by month, primarily characterized by large peaks and valleys of profit and operating cashflow, within the revenue pattern shown in yellow on the top line.*



*In the second Dollar Trend graph, we see half the months of the first year on the left, and the first six months with the PMG Huddles on the right.*



*The 66 to 75 % reduction in the peaks and valleys shows what can happen when people doing the work can collaborate with the C Suite folks to achieve mutually created goals.*

During the PMI Discovery Process, the Performance Management Group (PMG) unearthed 4 pages of system disconnects (over 40) in the company's value chain. Although they did find 5 key system KPI (Key Performance Indicators) candidates, the PMG

consensus after discussion was that two of them were actually costing more than all the rest combined. By focusing on the Inventory overages and underages, plus the other three KPIs identified, they were able to make remarkable improvements.

| KREMER/HOOD PERFORMANCE MEASURES ASSESSMENT          |   |                                     |  |  |                                     |  |   |  |                                     |  |
|--|---|-------------------------------------|--|--|-------------------------------------|--|---|--|-------------------------------------|--|
| Maryland Assn of CPAs<br>(Company Name)              |   |                                     |  |  | 2005<br>(Year)                      | T = Tracked<br>P = Projected                                 |   |  |                                     |  |
| Three Bottom Lines<br><i>Define overall measures</i> |   |                                     | Key Financial Drivers<br><i>Define specific measures</i> |  |                                     | Key Number <sup>A</sup><br><i>Define behavioral measures</i> |   |  |                                     |  |
| T  |   | P                                   |  |  | T                                   |  |   |  | P                                   |  |
| <input checked="" type="checkbox"/>                  | Operating Cash Flow (OCF)                               | <input type="checkbox"/>            | 631  |  | <input checked="" type="checkbox"/> | Fixed Asset Investment                                       |   |  | <input checked="" type="checkbox"/> |  |
| <input checked="" type="checkbox"/>                  | Assets  | <input checked="" type="checkbox"/> | 3967   |  | <input checked="" type="checkbox"/> | ↓ Receivable Days  |   |  | <input type="checkbox"/>            |  |
| <input checked="" type="checkbox"/>                  | Liabilities   | <input checked="" type="checkbox"/> | 2725   |  | <input type="checkbox"/>            | ↓ Inventory Days   |   |  | <input type="checkbox"/>            |  |
| <input checked="" type="checkbox"/>                  | Net Profit  | <input checked="" type="checkbox"/> | 93   |  | <input checked="" type="checkbox"/> | ↑ Payable Days   |   |  | <input type="checkbox"/>            |  |
| <input checked="" type="checkbox"/>                  | Sales   | <input checked="" type="checkbox"/> | 5183   |  | <input checked="" type="checkbox"/> | ↓ COGS/Sales   |   |  | <input checked="" type="checkbox"/> |  |
| <input checked="" type="checkbox"/>                  | Expenses  | <input checked="" type="checkbox"/> | 5089   |  | <input checked="" type="checkbox"/> | ↓ MSGA/Sales   | Budgetary Control                             |  | <input checked="" type="checkbox"/> |  |
| <input checked="" type="checkbox"/>                  | Return on Sales (ROS)<br>Net Profit/Sales<br>times (%)  | <input type="checkbox"/>            | 1.83%  |  | <input checked="" type="checkbox"/> | ↑ Sales/Net Fixed Assets                                     |   |  | <input type="checkbox"/>            |  |
| <input checked="" type="checkbox"/>                  | Asset Turnover (AT)<br>Sales/Total Assets<br>equals (=) | <input type="checkbox"/>            | 1.31%  |  | <input checked="" type="checkbox"/> |  | membership change/budget controls             |  | <input checked="" type="checkbox"/> |  |
| <input checked="" type="checkbox"/>                  | Return on Assets (ROA)<br>Net Profit/Total Assets       | <input type="checkbox"/>            | 2.44%  |  | <input checked="" type="checkbox"/> |  | prof dev product performance                  |  | <input checked="" type="checkbox"/> |  |
| <input checked="" type="checkbox"/>                  | OCF/SALES   | <input type="checkbox"/>            | 12.20%   |  | <input checked="" type="checkbox"/> |  | member satisfaction                           |  | <input type="checkbox"/>            |  |
|  |   |                                     |  |  | <input checked="" type="checkbox"/> |  | call center content                           |  | <input type="checkbox"/>            |  |
|  |   |                                     |  |  | <input checked="" type="checkbox"/> |  | web hits/ call ins                            |  | <input type="checkbox"/>            |  |
|  |   |                                     |  |  | <input checked="" type="checkbox"/> |  | efficiency/ productivity? Linked to financial |  | <input type="checkbox"/>            |  |

<sup>A</sup> Any critical number that gives a metric for focusing on workflow, and how that flow of work relates to both the customer (ext. or int) and overall financial results. Can be a bottom line, key driver, sub-driver, or key performance indicator.

PDT: "People Doing Things" © 2003-2004 Ballard/Kremer/Hood

This material is from the Financial Scoreboard and *Managing by the Numbers* by Kremer, Rizzuto, an [Visit www.financialscoreboard.com](http://www.financialscoreboard.com)

The Performance Measures Assessment above is a sample from one of PMI's partners – The Maryland Association of CPAs and its Business Learning Institute.

In the left column is shown the 3 Bottom Lines, with their key elements, and the most useful and generally unused financial driver – Operating Cashflow (OCF) over Sales (how many dollars of OCF go into the bank account for every dollar of sales).

In the right column are more of the 12 key drivers, and the 5-6 most crucial KPIs (Key Performance Indicators) for the whole system

## An Integral Operations Finance Toolkit

*“The thing that I really like about the PMI Scoreboard, that I have never seen in other software, is the ability to track your Operating Cashflow to make sure that what you’re doing isn’t just digging a bigger hole as far as debt is concerned. It shows how to maintain the growth of the company without running out of cash. It’s a very effective tool. It also makes the ‘lights go on’ in the minds of our people who have not had much, if any, formal financial education.”*

**A Step-by-Step Process:** PMI’s Methodology works initially with both the CEO/GM, and then with the CFO/Controller, to surface disconnects between the accounting and operations management. Then a senior leadership group representing the whole system is developed with the capacity to solve any problem collaboratively.

**Ken explains** “We have tried any number of pay-for-performance approaches over the years, and any time we got to the point where it could be highly rewarding to our employees, we’d have a few that would really see how they could work the system, and they would have a windfall, but they rest never would catch on. So we’d pay out to the people who figured it out, but the company didn’t improve enough to warrant even the bonuses that were paid out.

It had been a few years since we had cashflow on a monthly basis, and even when we had it, it was the Indirect Method. It was always so confusing. The description off to the left was Accounts Receivable, then the increase was bracketed, and decrease was open. People wouldn’t be able to make any sense out of it. Even I got confused sometimes, wondering - what does that really mean?

Plugging it into the PMI Scoreboard, right off the bat you could see Collections, and we could look across and see, we had Sales of x, but only collected y. It immediately answers the question for anybody about what’s going on with cash.

In the past, everybody would be focused on Sales, and “Yeah!” we hit our target! But, wait a minute, we fell six figures short on Cash. Then following it on down through, we have really come to grips with the fact that

there is a lot more to this whole operation than making a sale. We’ve got to get the money in. We’ve got to watch what we’re putting on the shelf, so we don’t over-replace our inventory. The gal in purchasing got all excited about the possibility of having some concrete parameters given to her, instead of just going by her gut. Instead, she could be told, “Here is what we expect to have in Sales, and this is how much we can afford to stock.” If we are doing better, then we can decide to open the gates a little bit more.

Our PMG is a cross-section of the whole company. Among them we have the General Manager, three branch managers, our person in charge of central purchasing, accounts receivable, and our HR person.

When we began, our AR person was under the gun because the week before she had gone on vacation and put a bunch of customers on credit hold without telling anyone. This was an example of the opportunity to create an alert, telling us we needed to communicate, because what she felt was a bad customer, the manager might have felt was one of the best customers. Another thing that came out was the relationship to inventory, and the drive of a lot of managers to want more and more and more on their shelf, but we couldn’t afford everything they wanted.

**The PMG launch event seemed like an insurmountable task, especially because of knowing the 10 people that were going to be in the room, had so little, or no, experience with financials. I was extremely impressed with the continuity and the flow. I don’t think anybody got left behind.** A lot of these people had never seen our financial statements before; or any financial data ever, for some of them. Putting the numbers into the Scoreboard was quite an exercise, but people definitely started seeing the common sense, and how inter-related it all was.”

**1<sup>st</sup> Step - The Reality Check:** Ken and Rick, as the decision team, went through a whole system reality check to surface all their key insights regarding the entire organization. That became the basis for designing the PMG launch, where the group went through a similar process in two half-day Kaizens (a ‘lean manufacturing’ term for rapid problem-solving event), in which both Rick and Ken stayed quiet, to let the team have its own discovery journey.

***“We started to see the ‘lights go on’ in people’s minds.”***

The entire PMI Discovery Process also opened up lots of talking about the different procedures throughout the organization, and especially about the dis-connects, specifically in the hand-offs between key customer value functions. At that point where one person is handing off a task to someone else to finish off, a lot of things can go wrong. Lots of good conversation was generated, and everyone left amazed that they had just spent 4 ½ hours. It seemed to go a lot faster than that. That morning really stretched them. They also went out with very full heads.”

**Driving Company Value:**

“We have a 4 – 5 year outlook to get the company marketable. Just recently, our CEO was reading from a distribution management trade publication. There were probably 8 or 10 items on the list for enhancing business value, and I would say at least 6 of them are in the PMI Scoreboard approach. This approach definitely has its place for owners looking to build the value of the business.” Ken

***Building Leadership Team Alignment By Co-creating The Scoring System***  
708 Gravenstein Hwy. N. #135 • Sebastopol • CA 95472 • 707•829•3976  
[www.financialscoreboard.com](http://www.financialscoreboard.com) • [www.financialdashboard.com](http://www.financialdashboard.com)  
jballard@financialdashboard.com