



Dynamic Performance Management: Seven Steps to Full Potential

Most businesses are swamped by key performance indicators (KPIs) and management dashboards that end up being little more than a distraction. It is generally accepted that only a few key metrics have a large influence on cash flow, but arriving at a full understanding of those key metrics and how they interact with each other is difficult.

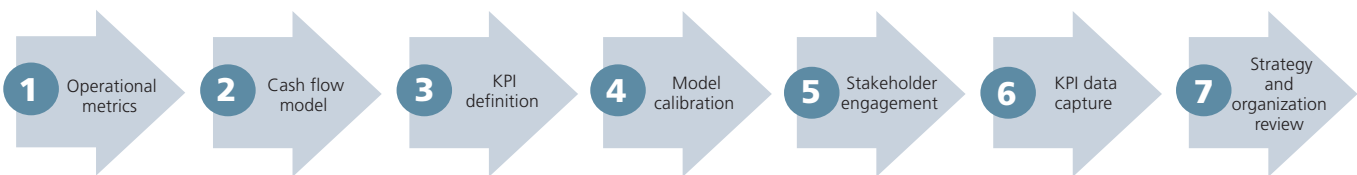
L.E.K. has developed a Dynamic Performance Management (DPM) approach which addresses this problem through a seven step process. The insights from DPM include identification of the most critical KPIs, the mechanism to deliver a step change in profitability, a strategy refresh based on higher performance levels and an organization empowered to deliver continuous improvement. In our experience, it is not unusual for this process to deliver viable profit improvement opportunities in excess of 30%. The seven steps are described in Figure 1.

For many years, L.E.K. has worked with major organizations to help them become more profitable by leveraging these techniques. As with all transformative change, successful delivery relies on leadership and commitment from the very top of the organization. It also relies on the availability of new information from within the organization and the distribution of new KPI data to wherever it is needed.

The exciting advances in mobile and digital technology are dramatically speeding up the process of collecting new data, combining it with external information and legacy systems, and delivering real-time monitoring through mobile devices. In the past, the lack of flexibility in traditional information management systems often led to long delays in new KPI measurement and dissemination.

Every part of the organization creates metrics that seem relevant to them, but the resulting mountain of KPIs is very rarely calibrated, linked or traded off against the overall long-term value of the business. The reporting structure and management information in

Figure 1
L.E.K.'s Seven Step DPM Process



Source: L.E.K. analysis

Dynamic Performance Management: Seven Steps to Full Potential was written by **Peter Smith**, a Partner at L.E.K. Consulting. Peter is based in London.

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Executive Insights

most organizations adds to the confusion. In far too many cases, segmentation is based on classifications that are easily tracked but offer little or no strategic insight. Limited discussion takes place among the powerful domains within the business about the linkages and collaborations that are necessary to optimize overall performance.

The organizational implications of DPM can be far-reaching. Most performance systems are focused vertically through the organization, with vision, goals, strategy, plans and budget targets set by processes that are all led from the top down. As a result, conservatism and the protection of silos can often prevail: Business Unit and functional leaders use the budget process to protect their domains and try to ensure that they can always outperform their targets. The risk is that the business sets less demanding goals than it should, which often leads to pedestrian outcomes.

L.E.K. aims to change all of this with the seven step Dynamic Performance Management framework.

Step 1: Define a set of operational metrics from the ground up that reflect the way the business really works

The first requirement is to define the boundaries of the business units — we refer to these entities as cash generating units (CGUs). The definition of CGUs must be centered on the interfaces at which customers actually pay for goods and services, so there is a clear linkage to the economic drivers of future cash flow.

Once the CGUs have been defined, the customer journeys for each can be traced and the most important sets of activities that serve the customers can be identified. For each activity there will be

performance metrics that relate to the inherent trade-offs between cost, quality and timing, and, at the interfaces between the activities, there will be interdependencies and / or trade-offs that also need to be measured and tracked (see Figure 2).

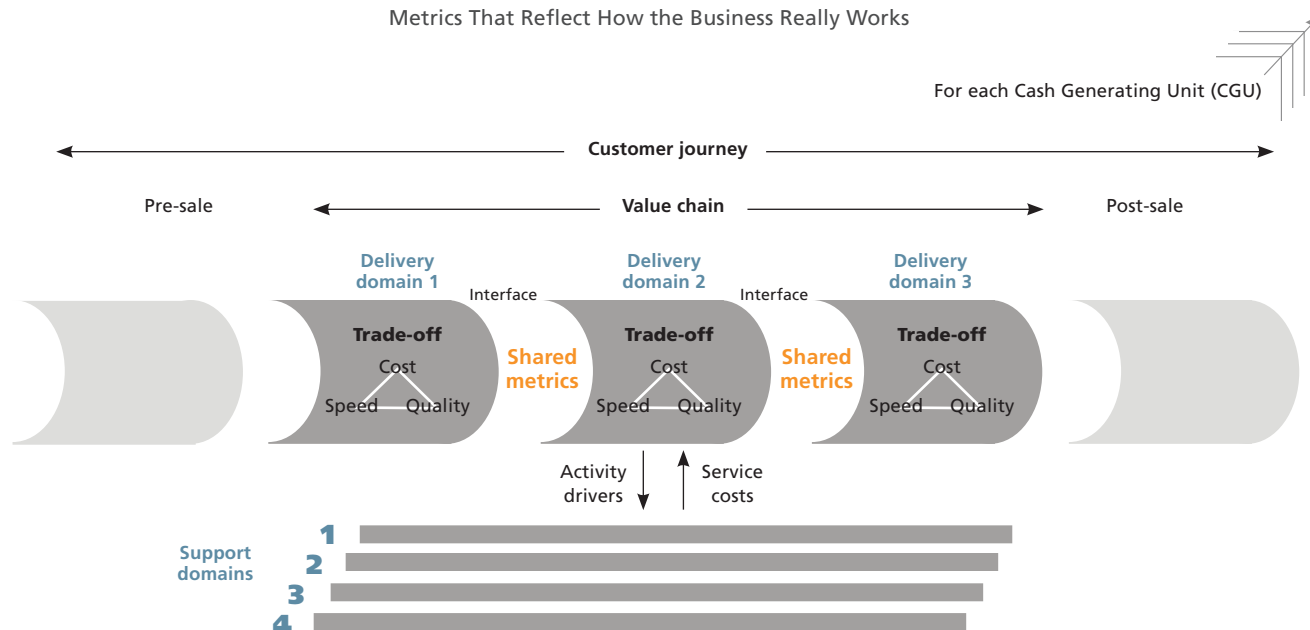
The performance indicators must be defined in such a way that the impact of external factors (commodity prices, competitor influences, financial parameters, etc.) is fully separated from those factors that can be controlled and owned internally.

Mapping the activities throughout a CGU and identifying meaningful metrics can be an insightful exercise in itself, but the second step in the process, which links them to future cash flow, allows confidence in the measures to build up as the model is calibrated and then refined through iteration.

Step 2: Link the metrics together in an economic framework that models a good approximation of future cash flow

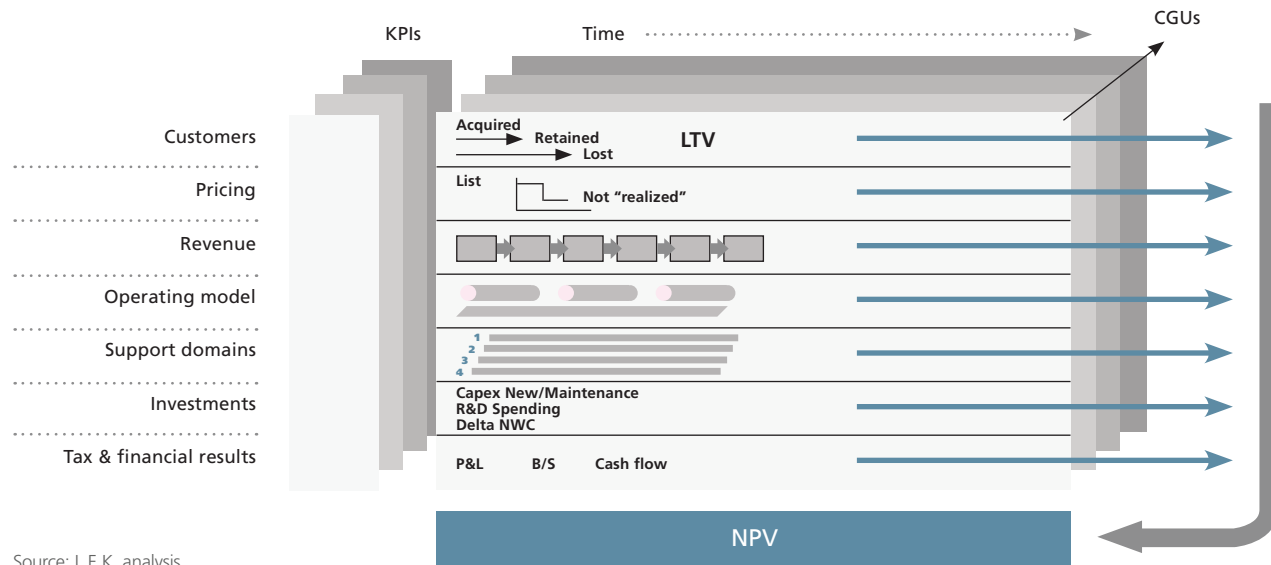
A network of metrics must be created to capture the end-to-end process of cash flow generation using a set of operational measures that are meaningful to the people who deliver the products and services to customers. It is vital that these metrics can be owned and controlled by those directly responsible for the activities so that they feel accountable for them. The economic framework can, and should, incorporate elements such as customer lifetime value (LTVs), all of the elements of realized pricing, parameters that act as “leading indicators” of revenue, the operational performance metrics described in Step 1, the key drivers and costs of support functions, and all of the other key drivers of cash flow (see Figure 3).

Figure 2
Metrics That Reflect How the Business Really Works



Source: L.E.K. analysis

Figure 3
Economic Framework to Model Future Cash Flows



Source: L.E.K. analysis

Step 3: Establish which of the metrics really matter, and refine the model to incorporate them more effectively

The next step is to refine the model and measurement process to drill down into the critical handful of KPIs. This often requires measurement of the KPIs at a more granular level to show their impact on the business at all levels from the shop floor to the boardroom. Alternatively it may involve creating some additional measures in order to understand activities that fall between two important metrics in the original process mapping (see Figure 4).

The analytical demonstration of the most important KPIs for the business can create some valuable surprises. Often a metric emerges that might not have been identified previously and that when focused upon, allows significant value to be unlocked. In all cases, some KPIs will be found that have not been measured with the right frequency, accuracy, consistency of definition or timeliness. This was the case for a hard metal machining business that turned titanium forgings into finished parts for the aerospace industry. The company saw a 10% improvement in cash flows within just a few months after conducting a DPM project. The core KPIs included the quantification of steel-cutter tip life for the first time, identifying a 50% cost saving for these expensive components, and a focus on waste that led to a “closer to form” forging process and a 25% reduction in waste titanium removed during roughing and finishing operations.

Step 4: Calibrate the model and examine the sensitivities and trade-offs between the metrics and scenarios

With the core KPIs known and linked in a cash flow model, the

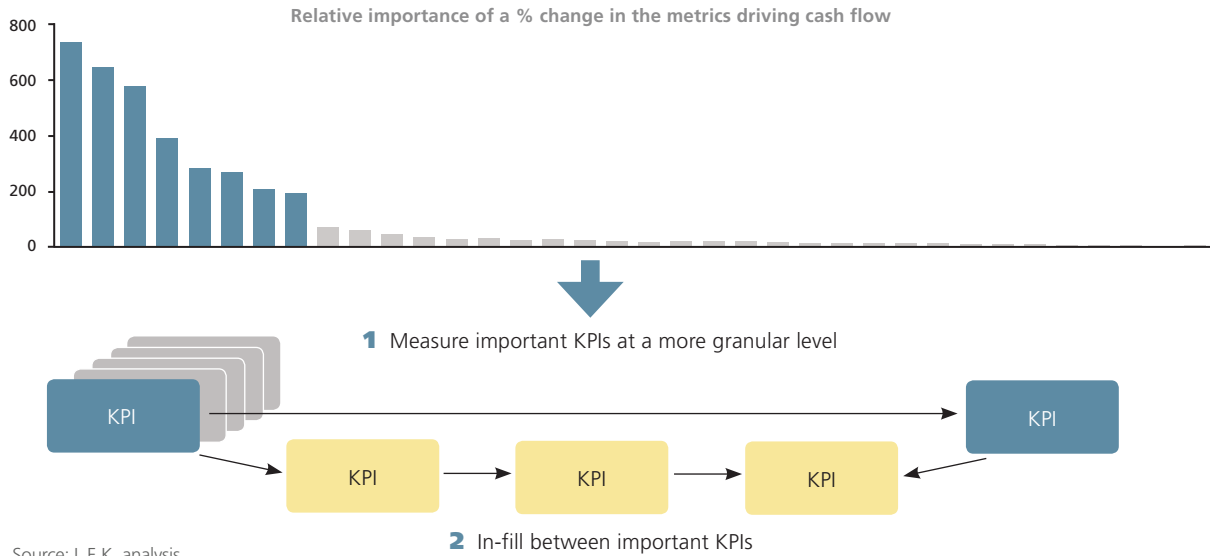
business has a tool that it can use to quickly run all kinds of sensitivities and trade-offs between the metrics and strategic scenarios for short-to long-term horizon planning. The model also facilitates the immediate quantification of potential investment decisions.

L.E.K. was engaged by a motor insurance company that was in a period of fast growth and so had not prioritized efforts to understand customer segmentation and lifetime value. Our DPM modeling highlighted a series of missed opportunities. We showed that the customers who were over 35 were nearly eight times more valuable to the business than the under-35s. As a result of our work, the company made a significant shift in its strategic direction.

Step 5: Share this understanding of the business economics across the whole senior management group

How much time do most heads of operational activities and functions spend discussing how they can work together to improve the key metrics driving the overall business results? In our experience, executive teams spend time together justifying additional resources or investment requests, but the commitment to measurable outputs and time frames resulting from those investments is rare. DPM allows these discussions to be centered on collaborative ways to achieve higher targets for a handful of the most important operational metrics they own, control and share. That is exactly what happens when the discussion can be focused on the understanding of business metrics that have been categorized in the matrix in Figure 5.

Figure 4
Critical KPI Identification



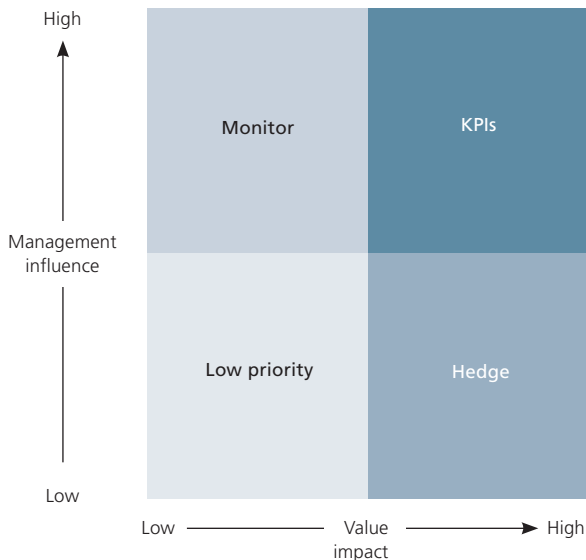
Step 6: Define the KPIs precisely and set up systems to capture and disseminate the required data

Establishing the precise and correct definitions for the KPIs and setting up the measurement systems to capture, analyze and report on the data is a crucial step in the DPM process (see Figure 6).

We frequently find that key metrics (such as productive utilization of labour), known throughout the business to be important, are measured in a myriad of different ways that render the aggregation of the data for management decision-making useless.

Recent developments in digital and mobile technology have transformed our ability to overcome problems of this nature. The collection of data from multiple points across the organization, the combination and analysis of information from multiple new sources and legacy databases, and the transmission of the new metrics to mobile devices as live management information have all suddenly become feasible options in remarkably short timescales (days or weeks) and at low (negligible) cost. This digital enablement has solved one of the major obstacles to the implementation of revolutionary performance improvement.

Figure 5
KPI Prioritization Matrix
The understanding of the business economics across the senior management team

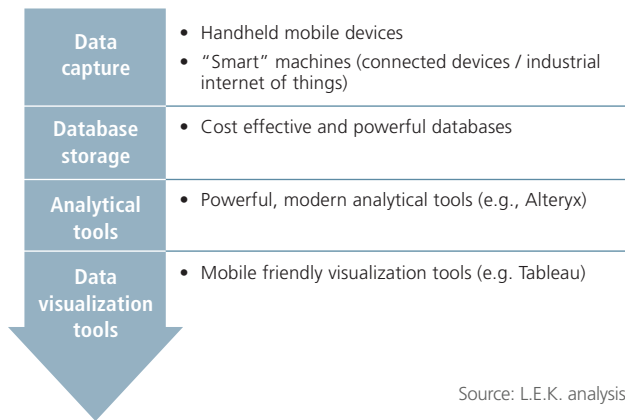


Source: L.E.K. analysis

Step 7: Review the implications for the strategy, organizational structure and culture

The DPM analysis will have major implications on a business' strategy, organizational structure and culture. A step change in the company's performance will open up new opportunities for business development, requiring strategic review. Moving to a horizontal alignment and a massively improved understanding of who owns the key performance levers will require substantial organizational change and a new incentive structure based on the core KPIs. If the shift in the way the business operates is likely to be very significant for many departments, a corporate values and culture audit should be considered to ensure as smooth a transition as possible.

Figure 6
Data Capture Process and New Supporting Technologies



Source: L.E.K. analysis

DPM as a Tool for Transforming Profitability

The benefits of the DPM process are far-reaching. They include:

1. Immediate performance improvement generated from focus on important KPIs that can be driven upward
2. Dramatic increase in the understanding and collaboration between business domain leaders
3. Speed of evaluation of alternative strategic scenarios via simple assumptions about operational metrics
4. Alignment between “live” management information, budgeting and longer-term planning
5. Immediate quantification of investment decisions based on the planned consequences for KPIs
6. Catalyst for a complete refresh of strategy, organization and culture
7. Opportunity to renew incentives and reward mechanisms linked directly to KPI movements

The DPM process is tough to implement well. To make it work, the CEO must be the driving force behind the transformation and his executive team needs to be fully engaged.

The rewards are also considerable, with the realignment of the business on just a few KPIs creating economic opportunities that are transformative.



About the Author

Peter Smith is a Partner in L.E.K. Consulting’s London office. He has led a series of assignments in the aerospace, defense, aviation and travel sectors, and also has deep experience in industrial products and services. He has been with the firm for more than 27 years and is mainly active in the corporate strategy side of our business and leading performance improvement work in Europe.

About L.E.K. Consulting

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