

# ESSENTIAL TOOLS FOR MANAGEMENT ACCOUNTANTS

The tools and techniques to support  
sustainable business success



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Two of the world's most prestigious accounting bodies, AICPA and CIMA, have formed a joint venture to establish the Chartered Global Management Accountant® (CGMA®) designation to elevate and build recognition of the profession of management accounting. This international designation recognises the most talented and committed management accountants with the discipline and skill to drive strong business performance. CGMA designation holders are either CPAs with qualifying management accounting experience or associate or fellow members of the Chartered Institute of Management Accountants.

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# INTRODUCTION

## What is a management accounting tool?

A management accounting tool is a framework, model, technique or process that enables management accountants to: improve performance; facilitate decision-making; support strategic goals and objectives; and otherwise add value.

## Why you should read this book

“Within the area of management accounting there is almost an infinite number of tools, methods, techniques and approaches floating around.”

This is no understatement. At the time of writing there were over 12.9 million results from a Google search on ‘management accounting tools’. There is a huge array of practices and tools available, all promising to help define and manage the organisation’s strategy, resources, customers and costs; and improve overall performance. In this context, managers can often struggle to evaluate and identify the most suitable tools to support their organisation and to implement and manage them effectively.

This book helps management accountants and business managers to identify the right tools from a crowded field and to obtain the full value from such tools. It does this by:

- supporting business in evaluating the value of the top management accounting tools
- helping management accountants and the organisation to select the appropriate tools
- providing guidance and best practice on how to implement the tools effectively.

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## What you will find in this book

This book contains the need-to-know information about the essential management accounting tools, old and new. This includes:

- What is the tool and what value can it bring management accountants and their organisation?
- What are the crucial considerations for implementing and using the tool?
- What actions do you need to consider, and avoid, to maximise its potential?
- What best practice looks like – including real examples and case studies from organisations that have implemented the tool.
- Resources, including further reading and material on each tool, if you want to delve deeper.

Management accounting category	Tool
Governance and risk management	The CIMA Strategic Scorecard®
	Enterprise Risk Management (ERM)
	Risk Heat Maps
	CGMA Ethical Management Reflection Checklist
Strategic planning and execution	Strategic Planning Tools – including mission and vision statements, goals and objectives, SWOT, PEST
	The Balanced Scorecard – including operational dashboards
	Strategy Mapping
	Porter’s Five Forces of Competitive Position Analysis
Performance management and measurement	KPIs – financial and non-financial
	Benchmarking
	The Performance Prism
Planning and forecasting	Rolling Plans and Forecasts
	Activity-Based Budgeting (ABB)
	Scenario and Contingency Planning
	Cash Flow Modelling
Product and service delivery	Activity-Based Costing (ABC)
	Lean
	Quality Management Tools – including TQM, Six Sigma, Cost of Quality and EFQM
Value recognition	Value Chain Analysis
	Customer Relationship Management (CRM)

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## Using this book

Size, sector, culture and leadership in each organisation are different, as is their appetite for change. So there is no one-size-fits-all approach to successfully implementing and realising value from such tools and practices.

This book provides a high-level summary of the benefits and value that essential management accounting tools can bring to the majority of organisations, regardless of size or sector. It provides objective analysis and reviews of the tools' effectiveness as well as considerations and tips on how best to implement and use them.

As mentioned, there is an overwhelming amount of information available on these tools. This book provides an overview and a starting point – it is not a detailed 'how to' guide but a 'which best' and 'how best to' summary.



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## More on tools

This book is the start of an ongoing project on management accounting tools and we will be developing further content and evaluation of the tools. A dedicated section at [cgma.org/essentialtools](https://www.cgma.org/essentialtools) supports these summaries and provides you with greater breadth and depth of information on these and other tools. It also provides further resources and case studies and allows you to rate the effectiveness of these essential tools.

## Have your say

If you have come across better tools; have suggestions on how a tool can be developed and improved; or simply have a question or a comment to share, visit [cgma.org/essentialtools](https://www.cgma.org/essentialtools). You can also use this forum to rate the effectiveness of the tools and discuss them with your peers.

# THE CIMA STRATEGIC SCORECARD®

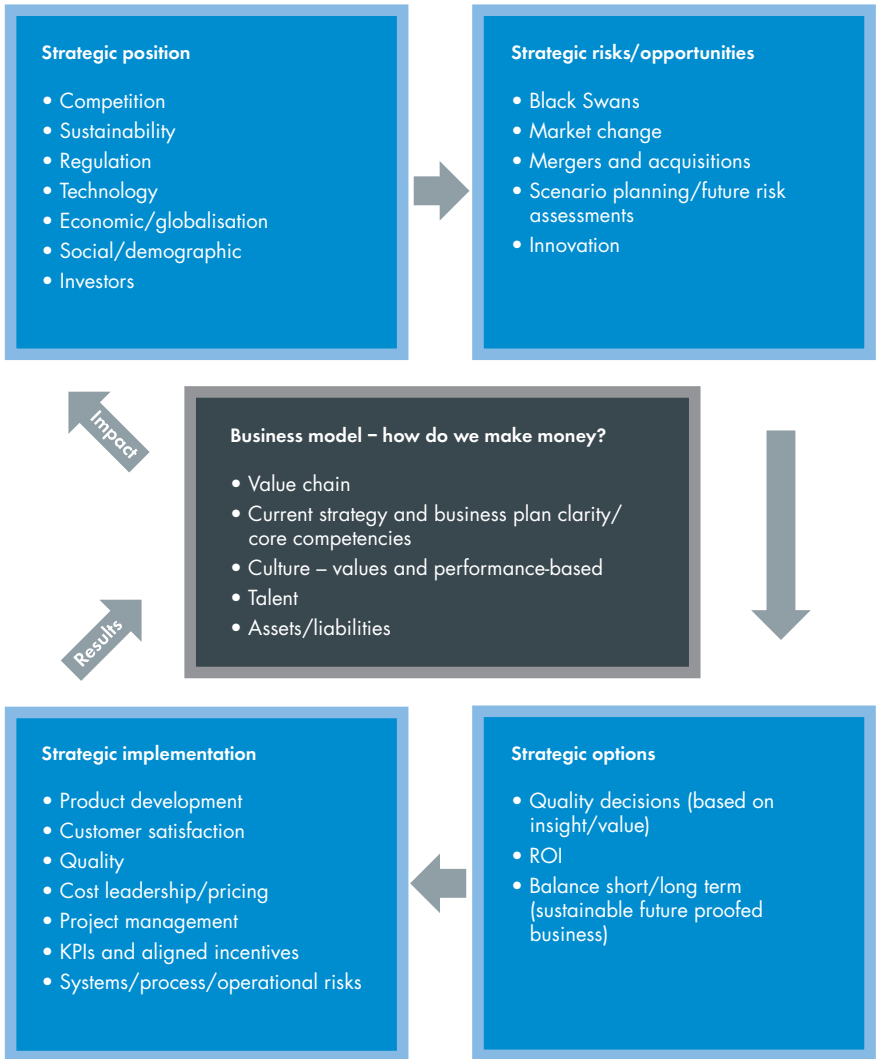
## What is it?

## SCORECARD

The CIMA Strategic Scorecard® was developed in 2004. It was the result of research by CIMA, in collaboration with the Professional Accountants in Business Committee (PAIB) of the International Federation of Accountants (IFAC), into major corporate failures at the time such as Enron and WorldCom. An important finding was that company boards had failed to oversee strategy and risk effectively. The global financial crisis of 2008–09 reinforced these conclusions.

The scorecard therefore aims to help boards of any organisation to engage effectively in the strategic process. It recognises that boards struggle to engage in strategy because of: lack of time and crowded agendas; information overload; lack of robust, board level processes for dealing with strategy; and greater complexity of business.

# The CIMA Strategic Scorecard®



Source: CIMA Executive CPD Academy

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## What benefits does the scorecard provide?

The CIMA Strategic Scorecard® provides a simple, effective process that helps the board to focus on strategic issues and ask the right questions. It is structured around four key dimensions of strategy: strategic position, strategic risks and opportunities, strategic options and strategic implementation. This means that the board can work constructively with management to promote the future success of the organisation. It can help to ensure a high-level perspective on strategy, thus avoiding the ‘comfort zone of detail’.

The discipline of preparing and updating the scorecard also helps management to keep its focus on strategic issues, and facilitates discussion within the executive team so that it can refine proposals prior to exposure to the board. The scorecard can also help to identify gaps in knowledge and analysis, so improving the quality of information presented.

The scorecard framework helps boards, and the businesses they control, to: summarise key aspects of the operating environment; highlight risks and opportunities; identify major strategic options; and chart and track progress against significant milestones.

The implementation of the scorecard is based on the assumption that the organisation has already determined its broad strategic direction and has a strategic plan in place. The scorecard provides a process for developing and moving this strategy forward in a dynamic way. For boards that need to do more foundational thinking about what the company stands for, a good starting point is to develop a ‘board mandate’. See the link in ‘Further resources’ for more information on this, which also links to a useful checklist.

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The format of the scorecard is very flexible and can be adapted to meet the needs of the organisation. For each of the four dimensions, high-level information is provided in a format that provokes high-quality, constructive and effective strategic discussion. Achieving this in practice is a challenge.

The format of the scorecard has evolved since its initial creation, and CIMA is continuing to undertake further development work to strengthen the ability of the scorecard to support the level of strategic and risk discussion necessary to help boards and their organisations to avoid major problems.

## Implementing the CIMA Strategic Scorecard®?

### Questions to consider:

- How are we going to achieve buy-in from both executive management and the board to introduce the scorecard?
- Do we have a strategic plan in place? If not, this will have to be completed first before attempting a scorecard.
- How are we going to present the information for each of the four scorecard dimensions?
- What information do we have already to support a scorecard?
- When are we going to introduce the scorecard? And would it help to have a facilitator?

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## ACTIONS TO TAKE/Dos

- Decide on a target meeting to introduce the scorecard. Introducing it at a strategy planning session can work well.
- Keep it simple – it is better to produce a first draft scorecard reasonably quickly to kick start discussion.
- At the start focus on the headline issues rather than trying to populate with detail. For the purposes of the scorecard, it may be better to flag an issue at board level and then indicate when further information will be provided.
- Appoint a scorecard champion.
- Assess the effectiveness of the scorecard in terms of the quality of the strategic discussion generated at board level.
- Ensure that updates to the scorecard reflect material changes either within the organisation or externally.

## ACTIONS TO AVOID/Don'ts

- Avoid including too much detail. 'Less is more' is the best principle for the scorecard.
- Don't stop modifying the scorecard if it is not engaging the board effectively.
- Do not turn the process of updating the scorecard into an onerous, tiresome chore. Highlight material changes only.
- Avoid holding back information from the board just because it is not yet complete or exact.
- Avoid taking an ad-hoc reporting approach. Agree a schedule with the board as to when you will present the scorecard to them.

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## USING THE SCORECARD IN PRACTICE

### Bringing focus to strategic thinking

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CIMA uses the scorecard for council and executive committee meetings. We have found that it has helped to ensure that the key issues we face remain prominent. It has helped the senior management team to 'force itself' to include only the really high-level issues.

We trialled the scorecard in collaboration with a housing trust. The trial introduced the scorecard as part of an ongoing process to restore confidence after the housing trust had recovered from major difficulties requiring sweeping change in the executive team and trustee board. Participants used the four dimensions of the scorecard as the agenda items for a strategy awayday which ran over two days.

The discussion about strategic options was held just before the end of the first day. This meant that they could continue the conversation informally over dinner. The impetus for introducing the scorecard came from the new chief executive in consultation with the chairman. After the initial awayday, the scorecard was presented at board meetings on a quarterly basis.

Other CIMA members have used the scorecard on their own initiative, often modifying the framework and using it in innovative ways to suit their needs. An internal auditor, for example, used it as the basis for auditing the strategic review process in his organisation.

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Feedback from the executives involved in its implementation included:

"We have discussed more strategy than ever before at a board meeting and we have made decisions."

**Board member**

"We have had a great discussion with the board and I feel that they are totally supportive of our strategy. This process has brought us closer together."

**Member of the executive team**

"The process has brought focus to our strategic thinking and enabled our executive team to discuss the strategic options and engage the board."

**Chief executive**

"It has helped us to focus on the issues that really matter and to avoid the comfort zone of detail."

**Finance director**



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## Related and similar practices to consider

- Balanced Scorecard
- Board mandate
- Boardroom conversations

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

# ENTERPRISE RISK MANAGEMENT (ERM)

## What is it?

## PROCESS

Enterprise risk management (ERM) is the process of identifying and addressing methodically the potential events that represent risks to the achievement of strategic objectives, or to opportunities to gain competitive advantage. Risk management is an essential element of the strategic management of any organisation and should be embedded in the ongoing activities of the business. Two widely referenced frameworks include the US-based Committee of Sponsoring Organizations (COSO) 'ERM – Integrated Framework'; and guidance developed by the UK-based Airmic and The Institute of Risk Management (IRM) – 'A structured approach to ERM and the requirements of ISO 31000'.

The fundamental elements of ERM are the assessment of significant risks and the implementation of suitable risk responses. Risk responses include: acceptance or tolerance of a risk; avoidance or termination of a risk; risk transfer or sharing via insurance, a joint venture or other arrangement; and reduction or mitigation of risk via internal control procedures or other risk prevention activities.

Other important ERM concepts include the risk philosophy or risk strategy, risk culture and risk appetite. These are expressions of the attitude to risk in the organisation, and of the amount of risk that the organisation is willing to take. These are important elements of governance responsibility.

Management responsibilities include the risk architecture or infrastructure, documentation of procedures or risk management protocols, training, monitoring and reporting on risks and risk management activities.

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## ERM process



Source: *How to Communicate Risks Using Heat Maps*, CGMA

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“If a business has its doors open, then it is managing risk in some way. However, that does not mean the organisation has an enterprise-wide, holistic and strategic approach to risk management.”

– Mark S Beasley PhD, Director, ERM Initiative at North Carolina State University, January 2012

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## What benefits does ERM provide?

ERM provides greater awareness about the risks facing the organisation and the ability to respond effectively. It can give enhanced confidence about the achievement of strategic objectives and improve compliance with legal, regulatory and reporting requirements. ERM also provides increased efficiency and effectiveness of operations.

## Implementing ERM? Questions to consider:

- What are the main components or drivers of our business strategy?
- What internal factors or events could impede or derail each of these components?
- What external events could impede or derail each of the components?
- Do we have the right systems and processes in place to address these internal and external risks?

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## ACTIONS TO TAKE/Dos

- Gain support of top management and the board.
- Engage a broad base of managers and employees in the process.
- Start with a few key risks and build ERM incrementally.
- Use existing knowledge, skills and resources in management, internal audit, compliance etc.
- Embed ERM into the fabric of the organisation.
- Take a holistic, portfolio view of risks across the enterprise.

## ACTIONS TO AVOID/Don'ts

- Never treat ERM as a project – ERM is a process.
- Don't get bogged down in details and history – ERM should be strategic and forward-looking.
- Avoid relying only on a few key staff – make ERM everyone's job.
- Don't take a silo or stove-pipe approach to risks. Don't ignore how risks might impact on other parts of the business.
- Avoid obsessing too much about categorising risks – rather than ensuring that the key risks have been identified and mitigation plans developed.
- Never assume that the risk register is complete – there will always be 'unknown unknowns' and the biggest enemy of effective ERM is complacency.

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## ENTERPRISE RISK MANAGEMENT IN PRACTICE

### Gemini Motor Sports, a hypothetical illustration from a CGMA case study: how to evaluate enterprise risk management maturity

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Gemini Motor Sports (GMS), a public company headquartered in Brazil, manufactures on-road and off-road recreational vehicles for sale through a dealer network in Brazil and Canada. GMS Chief Financial Officer (CFO) David Cruz was charged with overseeing the development of the initial ERM framework for the company.

In the first year of implementation, the ERM team met with senior management, and identified and prioritised a number of crucial risks that had been disruptive to GMS. Their initial presentation to the audit committee was criticised for being a rehash of past problems, and not useful to the board as they discussed the strategic direction of GMS.

In the second year of the programme, after seeking ERM training for the team, Cruz focused more attention on potential events that managers thought might affect the business. He asked them to assess the likelihood and potential impact of the identified risks.

The resulting report was well received. However, the audit committee chair suggested that the next step be an evaluation of the risk management process and the degree of its integration with the strategic management process of the organisation, leading to the use of the *CGMA Risk Management Maturity* tool.

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Lessons learned:

- Broad involvement on the part of board members and employees is essential in determining the risk appetite of a company, and in identifying and prioritising risks.
- Speed of onset and persistence of risks, in addition to impact and likelihood, are important considerations in the prioritisation of risks.
- Ongoing monitoring and concise reporting on key risk exposures are essential for effective risk management.

## Further resources

**[cgma.org/essentialtools](https://cgma.org/essentialtools)**

# RISK HEAT MAPS

## What are they?

## FRAMEWORK

A risk heat map is a tool used to present the results of a risk assessment process visually and in a meaningful and concise way.

Whether conducted as part of a broad-based enterprise risk management process or more narrowly focused internal control process, risk assessment is a critical step in risk management. It involves evaluating the likelihood and potential impact of identified risks. Heat maps are a way of representing the resulting qualitative and quantitative evaluations of the probability of risk occurrence and the impact on the organisation in the event that a particular risk is experienced.

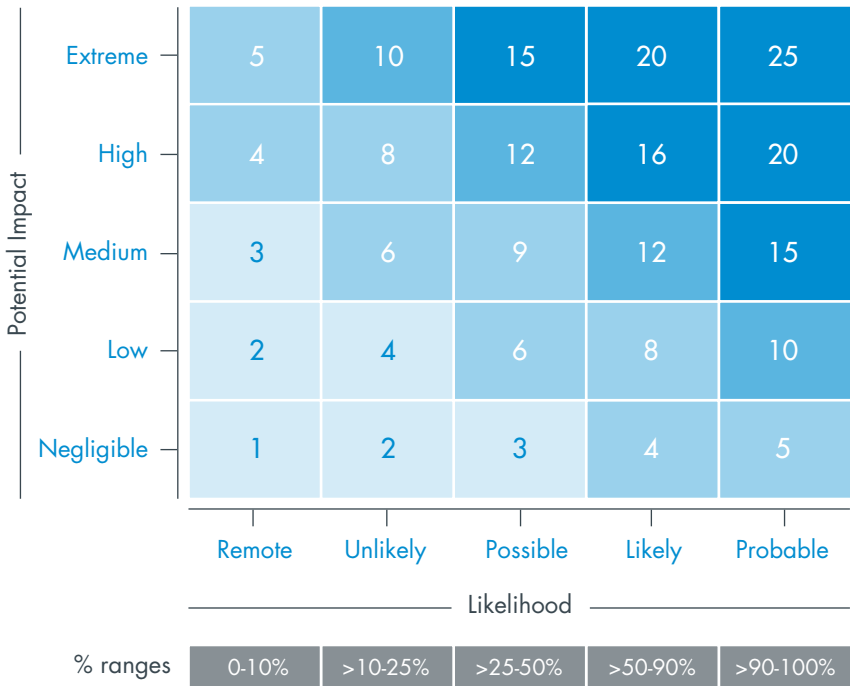
The development of an effective heat map has several critical elements – a common understanding of the risk appetite of the company, the level of impact that would be material to the company, and a common language for assigning probabilities and potential impacts.

The 5x5 heat map diagram on the right provides an illustration of how organisations can map probability ranges to common qualitative characterisations of risk event likelihood, and a ranking scheme for potential impacts. They can also rank impacts on the basis of what is material in financial terms, or in relation to the achievement of strategic objectives. In this example, risks are prioritised using a simple multiplication formula.

Organisations generally map risks on a heat map using a ‘residual risk’ basis that considers the extent to which risks are mitigated or reduced by internal controls or other risk response strategies.



## Heat risk map



Source: Scott McKay, *Risk assessment for mid-sized companies: tools for developing a tailored approach to risk management*. AICPA, 2011

“Helping managers quantify the potential impact of risk events is one of the most important exercises in the risk management process. Operational managers often struggle with the concept of materiality and how to define it in both qualitative and quantitative terms.”

– Scott McKay. *Risk assessment for mid-sized companies*, 2011

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## What benefits do Risk Heat Maps provide?

Risk heat maps provide a visual, big picture, holistic view to share while making strategic decisions. They can improve the management of risks and governance of the risk management process with increased focus on risk appetite and risk tolerance of the company. Risk heat maps can allow for more precision in the risk assessment process with the identification of gaps in the risk management and control process. They can also support greater integration of risk management across the enterprise and embedding of risk management in operations.

## Implementing a Risk Heat Map? Questions to consider:

- How much risk are we willing to accept?
- What constitutes a material risk to our company?
- What is the range of acceptable variance from our key performance and operating metrics?
- How will we define our terms to evaluate the likelihood of risk events and the impact that they might have on our business, so that we can map our potential risk events to our heat map?

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## ACTIONS TO TAKE/Dos

- Use risk self-assessment workshops to take advantage of the insights of managers.
- Prepare an initial 'straw-man' risk library to use as a starting point.
- Get consensus on risk tolerances – acceptable levels of missing targets.
- Clarify terms used to establish probability estimates.
- Establish participants' understanding of the effectiveness of controls and other risk responses used in the organisation.

## ACTIONS TO AVOID/Don'ts

- Don't rely on surveys to capture initial thoughts about risks.
- Avoid getting stuck in root cause analysis.
- Don't forget to quantify risks in terms of potential financial impact on the organisation in terms of cash, earnings etc.
- Don't forget to consider the state of controls and other risk management practices in place in the organisation.

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## RISK HEAT MAPS IN PRACTICE

### How to communicate risks using a heat map

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In the CGMA tool *How to communicate risks using a heat map*, Figure 5 shows a sample heat map for a select set of risks for a hypothetical company. The sample groups these risks together according to their interrelated nature and effect on operations. See the link in 'Further resources' to access the full case study.

The company used its earnings per share sensitivity to establish a range of impacts from trivial (<\$25k in earnings) to very material (>\$75m in earnings). Risks that were evaluated and grouped for presentation in the example include the following:

- Obsolescence risk
- Customer concentration or distribution risk
- Manufacturing risk
- New product introduction risk
- Supply chain risk
- Safety risk
- Physical asset risk

By mapping these risks, it was clear that the likelihood and the impact of physical asset risk were relatively low in relation to the risks associated with new product introduction, customer concentration and supply chain. Each of those was considered to be both more likely and to have greater impact.

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Lessons learned:

- A more accurate sales forecasting function was a recurring theme thought to be a key risk indicator associated with several of these interrelated risks.
- The perception of supply chain risk increased with the vertical supply chain as viewed by downstream business units.
- The likelihood and the potential impact of risk events appeared highest with the new product introduction (NPI) process, indicating that opportunities may exist in how the company is structured and manages NPI.

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

# CGMA ETHICAL MANAGEMENT REFLECTION CHECKLIST

## What is it?

## CHECKLIST/BEST PRACTICE

This is a checklist of reflective questions relating to the management of ethics. It is designed to provide organisations and individuals with an overview of how well ethical management practices are embedded in their organisations.

The questions cover areas such as: ethical statements and codes of conduct; training; collection of ethical data; reporting of ethical issues; and support when faced with ethical dilemmas.

The checklist can be downloaded from [cgma.org/essentialtools](https://www.cgma.org/essentialtools)

## What benefits does the Ethical Management Reflection Checklist provide?

With the importance of ethics and non-financial reporting rising on the global agenda, organisations need to be managing their business responsibly. Increasingly, they are also being required to demonstrate and verify what they are doing to ensure this.

The ethical management reflection checklist helps to reinforce your professional code of ethics in the workplace by highlighting strengths and weaknesses within your organisation.

## Using the checklist? Questions to consider:

- Where will you get the information from?
- Who will you involve? Is this part of a larger assessment?
- Who will you share the information with afterwards and how will it best be used?

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## ACTIONS TO TAKE/Do's

- Reflect on your professional obligations from your code and how your company's policies reflect this, for example, on the issue of integrity.
- Try to engage others in the process over answers you aren't sure about. There is often valuable information elsewhere in the business.
- Once you have your findings, use market information to compare your position with others to understand strengths and weaknesses.

## ACTIONS TO AVOID/Don'ts

- Don't compromise your professional obligations in undertaking your work.
- Never assume answers without involving others (for example, HR, risk and procurement). Processes may not be communicated well, which is also a critical gap.
- Don't ignore red flags. For example, if you find your organisation has no anti-bribery policy, or if it states commitments that it doesn't undertake, take action and escalate.

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## CGMA ETHICAL MANAGEMENT REFLECTION CHECKLIST IN PRACTICE

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CGMA designation holders are dedicated to upholding the highest standards of ethics and integrity. They are governed by the professional code of conduct of their issuing body, which is the AICPA or CIMA.

The principles underlying both professional codes are similar and are built on the following core principles:

- Integrity and objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour and conduct.

A case study has been developed using the fictitious Megatron Corporation, a large public company, to illustrate the navigation of ethical dilemmas, highlighting issues relating to non-disclosure at the corporate level that come to the attention of non-executive financial managers and controllers.

Taking the viewpoint of the corporate controller, the case focuses on the discovery, reporting and resolution of disclosure issues created by the actions of other employees, executive officers or directors.

The facts of the case cover issues of integrity, objectivity, confidentiality, internal accounting controls, and the procedures for investigating and reporting irregularities. As the corporate controller, you must consider these facts and formulate an appropriate response.

See the link in 'Further resources' to access the full case study.



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## Further resources

[cgma.org/essentialtools](https://cgma.org/essentialtools)

[cgma.org/ethics](https://cgma.org/ethics)

# STRATEGIC PLANNING TOOLS

## What are they?

## FRAMEWORKS

Strategic planning is the process of developing the strategy or direction and action plan to achieve the goals of an organisation. Key elements of any strategic planning process are: 1. developing an understanding of vision, mission and values, 2. a current-state assessment of the most salient internal and external factors affecting the organisation that will contribute to an informed selection from strategic alternatives.

The vision, mission and values of the organisation are foundational elements of the strategic planning process. Well-defined vision and mission statements provide direction and focus for the organisation. The values of an organisation provide the context for decisions.

- **Values** are the shared set of beliefs that determine the culture of an organisation.
- **Vision statements** are future oriented and describe the desired or ideal state of the organisation or enterprise. They answer the question – where do we want to be?
- **Mission statements** describe the fundamental purpose of the organisation, why it exists and what it is trying to do to achieve its vision. Mission statements answer the question – what do we do?

Common tools for performing an assessment of the internal and external factors impacting on strategic decisions are SWOT, and PEST or PESTEL analysis.

**SWOT (strengths, weaknesses, opportunities, threats)** analysis is a method for analysing the internal strengths and weaknesses, and the external opportunities and threats facing the enterprise. Strengths include a company's capabilities and resources that enable it to provide value and generate competitive advantage. Weaknesses are issues that limit a company's ability to exploit its strengths. Opportunities provide

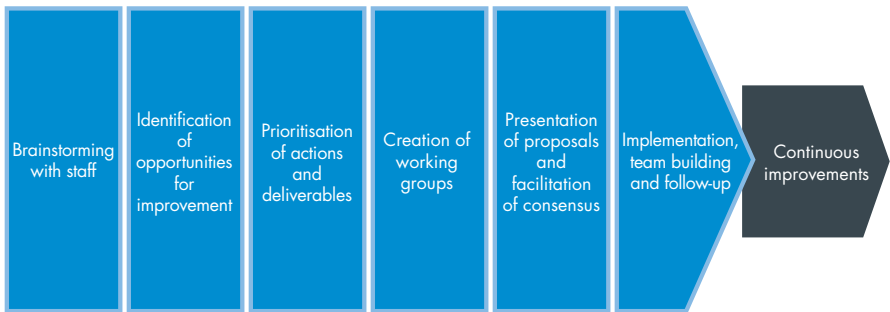
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an organisation with the chance to improve its competitive position. Threats may come from competitors, individuals, organisations, regulatory bodies or other factors in the wider business environment.

**PEST (political, economic, social, technological)** analysis is a macro framework for expanding a SWOT analysis to include political and regulatory issues, economic factors, social norms and attitudes as well as demographics, and technological developments. Some organisations expand the PEST analysis to include legal and environmental concerns (PESTEL).

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### SWOT analysis process



Source: *How to improve your finance organisation's efficiency and effectiveness: How to use SWOT analysis for finance organisation transformation*, CGMA

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“Strategy is about the basic value you’re trying to deliver to customers, and about which customers you’re trying to serve.”

– Michael Porter. *Fast Company*, February 2001

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## What benefits do strategic planning tools provide?

Strategic planning enables an organisation to set priorities, allocate resources and align employees with its mission and vision. Effective mission and vision statements reduce ambiguity and provide clarity and direction. Comprehensive SWOT and PEST analyses help an organisation to understand how to exploit its strengths, neutralise its weaknesses and take advantage of its opportunities.

## Implementing strategic planning tools?

### Questions to consider:

- What are we doing today? How are we doing it? Who are we doing it for?
- Where do we want to go? What do we want to do going forward? How are we going to do it?
- What is our competitive advantage? How do we capitalise on it?

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## ACTIONS TO TAKE/Dos

- Engage a broad-based group in the strategic planning process – make strategy everyone’s job.
- Take the time to understand your values and develop clear vision and mission statements.
- Address all four elements of the SWOT analysis – weaknesses and threats as well as strengths and opportunities.
- Evaluate internal strengths and weaknesses against external opportunities and threats to determine strategic priorities.
- Use the SWOT analysis to set priorities, objectives, goals, action plans and performance measures.

## ACTIONS TO AVOID/Don'ts

- Don't take a solely top-down approach to strategic planning.
- Avoid overlooking intangibles such as company culture or quality of management when assessing strengths.
- Don't forget to address internal weaknesses.
- Don't forget to look outside of the organisation for threats.
- Never fill the strategic plan with theory and abstraction – strategy must be translated into daily actionable goals and plans.

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## STRATEGIC PLANNING TOOLS IN PRACTICE

### Effective performance management with the Balanced Scorecard

(CIMA Technical Report, 2005)

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A case study focusing on the Customer Solutions and Support business unit of BAE Systems (formerly British Aerospace Engineering) included in the referenced Balanced Scorecard (BSC) Report illustrates the role of vision, mission, values and SWOT/PEST analysis in the strategic planning process.

**Step 1** involved a review of the competitive position of the company, technological trends and financial performance by the CEO.

**Step 2** was a comprehensive SWOT analysis undertaken by a broader group of managers and employees.

**Step 3** took the form of a vision statement based on BAE's five fundamental values. This was created to clarify the direction the company needed to move and create consensus.

Strengths and weaknesses identified in the SWOT analysis were used to focus growth in three main areas in order to regain market dominance. Long-term targets were translated into short-term performance goals for individuals and project goals that linked to strategic objectives. Scorecard performance measures were tracked with a modified 'traffic light' system and shared with employees to reinforce their shared commitment.

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Lessons learned:

- The involvement of a broad-based line management group in the SWOT analysis and creation of the values-based vision statement were essential in overcoming resistance to change.
- Linking financial performance to strategic objectives and individual performance allowed employees to see how their own work contributed to the performance of their business unit.

## Related and similar practices to consider

- Balanced Scorecard
- Strategy mapping
- Finance function effectiveness
- Scenario planning

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

# THE BALANCED SCORECARD

## What is it?

## SCORECARD

The Balanced Scorecard concept, popularised by Robert S Kaplan and David P Norton, is a performance management tool that encompasses the financial measures of an organisation and key non-financial measures relating to customers or clients, internal processes, and organisational learning and growth needs. It places these into a concise ‘scorecard’ that can be used to monitor performance.

Early implementations of the Balanced Scorecard tended to focus on including a balance of measures in the four domains or perspectives rather than on execution of strategy, but over time it has become a widely used strategic management tool. The Balanced Scorecard process attempts to identify important links between financial performance and the underlying customer, internal processes and organisational metrics. This creates a mechanism for translating the strategic vision into concrete actions necessary to achieve success.

This characteristic of the Balanced Scorecard places strategy at the core of management. When implemented properly, it can be used to align measures, actions and rewards to create a proper focus on the execution of strategic initiatives and achievement of strategic objectives, rather than a sole focus on the annual budget.

The widespread adoption of the Balanced Scorecard is due in part to its flexibility. Many companies have implemented their own variations to suit their strategic purposes. The Tesco ‘Steering Wheel’, for example, includes five perspectives, capturing their commitment to the community in addition to their financial, customer, operations and people aspects.

The Balanced Scorecard has also been successfully adapted for use by not-for-profit and public sector organisations. While the top line financial objectives of for-profit organisations are replaced by mission-related

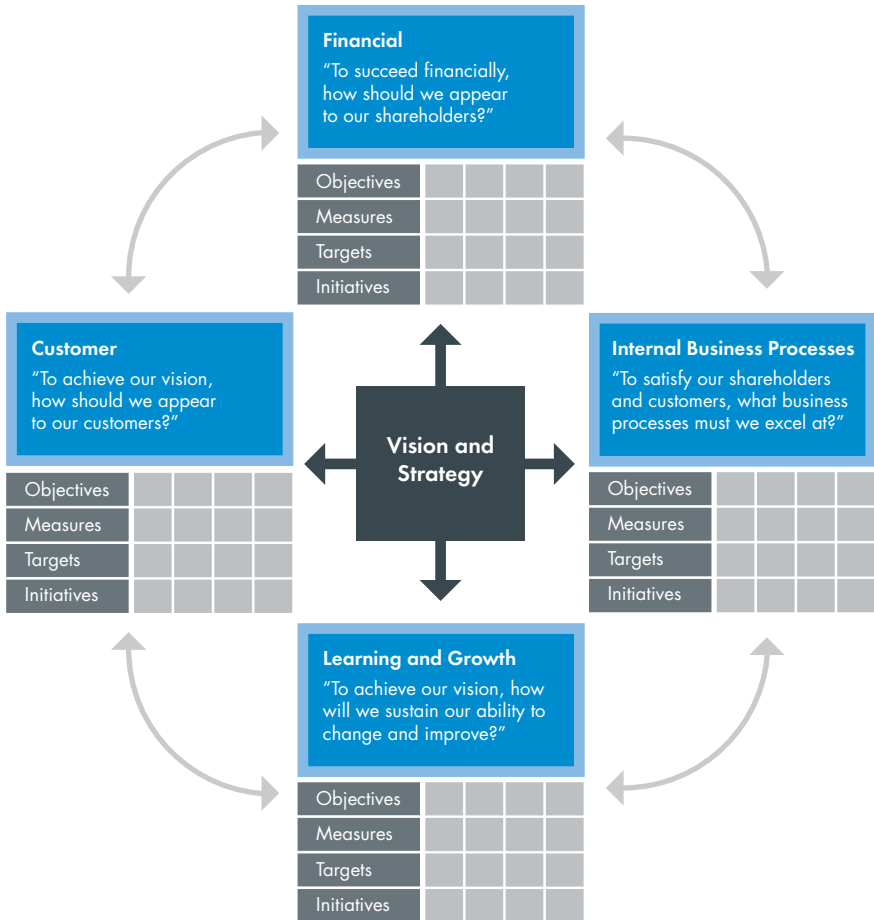


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objectives, the process of identifying relevant stakeholder, internal process and resource measures serves much the same purpose.

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## The Balanced Scorecard



Adapted from Robert S Kaplan and David P Norton, *Using the Balanced Scorecard as a strategic management system*, Harvard Business Review, January-February 1996

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“We learned early that the BSC was much more than just a better performance measurement system; it can become the basis for a new strategy management system.”

– *Strategy execution and the Balanced Scorecard*. Harvard Business School (HBS), Aug 2008

## What benefits does the Balanced Scorecard provide?

The Balance Scorecard provides a means to clarify, articulate and communicate strategy. It is a shorthand way of putting all key measures into a ‘dashboard’ that can be used to monitor results. By including non-financial measures, it can be used to show how the non-financial aspects of performance, such as customer satisfaction, drive financial performance. The Balanced Scorecard is a useful tool for motivating employees and focusing their attention on factors that are deemed to be critical to long-term performance rather than simply short-term financial results.

## Implementing a Balanced Scorecard?

### Questions to consider:

- Do we have sufficient buy-in from top management?
- Are we willing to engage in a more participatory strategy and performance management process?
- Are we committed to the organisational change effort necessary for successful implementation?
- To what extent will our current management information systems be able to support implementation? What are the costs and benefits of making these changes?
- What are we already doing that we can incorporate into our scorecard? What do we need to modify or stop doing?
- Are we prepared to focus our reporting around the scorecard?

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## ACTIONS TO TAKE/Dos

- Involve a broad senior management team.
- Engage everyone in the scorecard process.
- Use the scorecard to set ambitious goals.
- Use the scorecard to make strategy a continual process.
- Start with objectives, follow with measures, then initiatives – for example, increase sales by x%, introduce y new products in next 12 months, launch new product development and marketing initiative.
- Create measures that link to strategic success and long-term performance.
- Use the scorecard to find the best KPIs.
- Keep it to four to five KPIs for each perspective.
- Create a mix of leading, lagging, input and output measures – customer satisfaction is a leading indicator of sales; the number and quality of customer calls handled are output measures of the customer service process.
- Cascade the scorecard to business unit and functional teams.
- Each business unit's scorecard should be informed by corporate goals but not dictated by them.
- Use the scorecard to drive action plans.
- Link to compensation.
- Use the scorecard to empower teams and make strategy everyone's job.

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## ACTIONS TO AVOID/Don'ts

- Do not use the scorecard as another tool of command and control, or annual target setting process.
- Don't withdraw support for the scorecard at the first sign of missed financial targets.
- Too many measures can spoil the scorecard – don't go 'KPI crazy'.
- Failing to identify and validate causal links undermines the credibility of measures.
- Failing to cascade the scorecard and create links to compensation undermines success.
- Avoid attempting to create business unit or functional scorecards that can be aggregated upwards.

## THE BALANCED SCORECARD IN PRACTICE

### *Implementation of the Balanced Scorecard and an alternative costing system at the Royal Botanic Garden Edinburgh*

(CIMA case study, 2010)

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The Royal Botanic Garden Edinburgh (RBGE) first adopted the Balanced Scorecard (BSC) in 2004. The Senior Management Group (SMG), which was responsible for strategy development, used the BSC to answer the 'who, what, why, where, when' questions prompted by the four perspectives as they related to the services that the RBGE provides to external stakeholders.

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The original BSC created by the RBGE was employed as the basis of strategy and performance reviews. However, the prospect of a strategic review by an international peer group, along with an imperative to demonstrate alignment to the Scottish Government's National Outcomes, prompted a deeper look at the organisation's strategic objectives and underlying perspectives.

The ensuing revisions included improved alignment between the RBGE's 'impact' perspective and its 'activity' perspective. This review also led to the development of an objective costing system linked to an existing performance management system that improved monitoring of performance against strategic objectives.

Lessons learned:

- The Balanced Scorecard can be adapted to suit an individual organisation.
- The effort and commitment required from senior management to transform strategic management processes should not be underestimated.
- Resistance to change may result as individuals become more accountable for their actions.
- Management accountants are well-placed in the organisation to become very involved in the development of the Balanced Scorecard and implementation process, thereby becoming an important strategic partner in the business.

## Further resources

[cgma.org/essentialtools](https://cgma.org/essentialtools)

# STRATEGY MAPPING

## What is it?

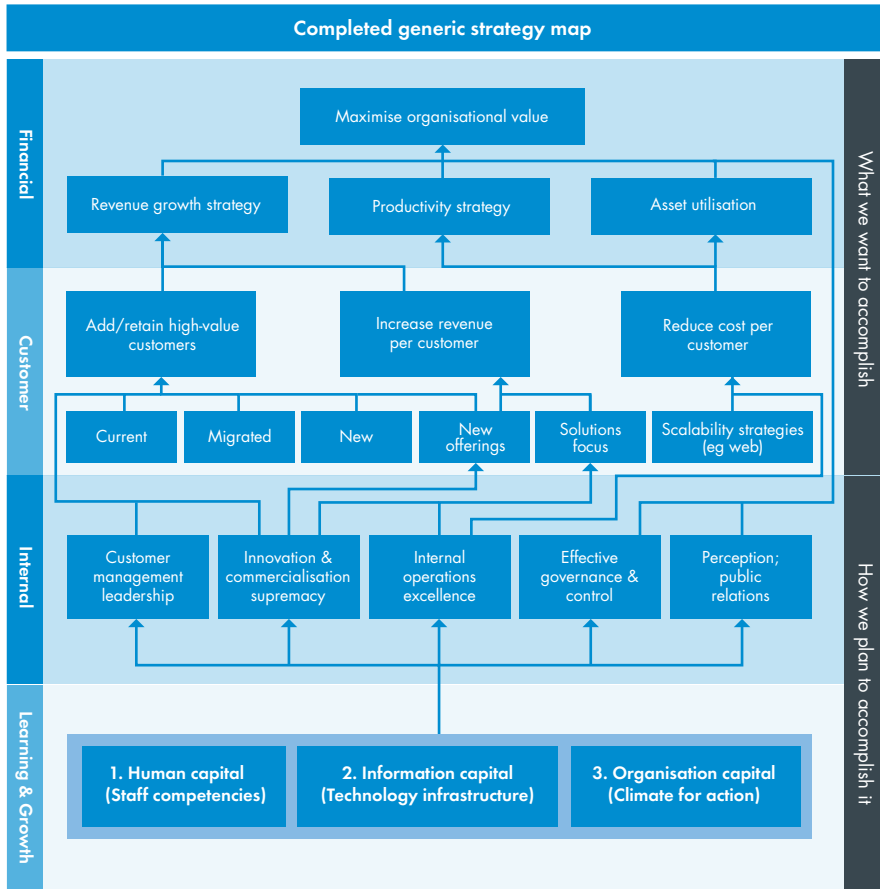
## FRAMEWORK

Strategy mapping is a tool created by Balanced Scorecard (BSC) pioneers Robert S Kaplan and David P Norton. It allows organisations to describe and communicate their strategies. Strategy maps also serve as an appropriate basis for the development of financial and non-financial Balanced Scorecard measures that can be used to monitor strategy execution and performance.

Strategy maps can be used as a standalone tool to depict an organisation's strategy. However, their real value is when they are used as part of a systematic strategic management process that aligns organisational and individual targets and initiatives with a defined mission and desired strategic outcomes. Strategy maps can be created for not-for-profit and public service entities, as well as for-profit enterprises.

The original formulation of the strategy map is based on the 'four perspectives' of the BSC – financial, customer, internal and learning and growth. The financial and customer perspectives – the outcome perspectives – are developed in response to the basic question "What do we want to accomplish?" The internal and learning and growth perspectives – the input perspectives – depict "How do we plan to accomplish it?"

## Example of strategy mapping



Source: CGMA Strategy Mapping Tool

“A strategy map provides a visual representation of the organisation’s strategy. This is truly an example of how one picture is more powerful than 1,000 words (or even twenty-five ad hoc performance measures).”

– Robert S Kaplan. *Mapping your corporate strategy*. HBS, February 2004

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## What benefits does strategy mapping provide?

Strategy maps describe how organisations create value by building on strategic themes such as ‘growth’ or ‘productivity’. They provide a way for companies to ‘tell the story’ of their strategy to employees and other corporate stakeholders, thereby increasing engagement in the strategic process. Strategy maps force organisations to place the onus first on the strategy, then on measuring implementation, thus removing the problem of numerous, unfocused measures. They form the appropriate basis for balanced scorecard performance measures, links to appropriate management and validation techniques, and allocating resources to initiatives and strategies that support an organisation’s value propositions and overriding objectives.

## Implementing a strategy map?

### Questions to consider:

- Do we need a more effective way to articulate and communicate our strategy?
- Do we need better alignment of our mission, vision, and strategy with our organisational initiatives and actions?
- Are we willing to commit to a process of clarifying the objectives, value proposition and key financial and non-financial measures necessary for strategic success?
- Do we have enough top-management buy-in to lead and implement?



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## ACTIONS TO TAKE/Dos

- Treat the strategy map as an integral part of the strategy management process.
- Engage a broad range of stakeholders – many include external stakeholders as well as internal.
- Connect the strategy map to vision and mission.
- Clarify your overriding value proposition.
- Cascade the strategy map to business units and functional departments.
- Develop business unit and functional strategy maps separately to reflect the appropriate drivers of success that will contribute to overall performance.
- Link the strategy map to initiatives and actions – for example, new customer service goals might require changes in the customer service process and additional training to improve response times or quality.
- Tie the strategy map to budget and performance processes.
- Include the operating costs and strategic investments necessary to drive success of learning and growth, and internal process initiatives.

## ACTIONS TO AVOID/Don'ts

- Do not treat strategy mapping as a one-off, or 'me-too' exercise.
- Do not forget to incorporate strategy mapping into the overall strategy management process.
- Never limit involvement to top management.
- Don't forget to validate the links and measures derived from the strategy mapping process.
- Do not ignore the resource requirements of the learning and growth, and internal process initiatives.
- Do not adopt an inflexible approach. Organisations are complex and dynamic, and strategy maps should reflect the realities of the business.

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## STRATEGY MAPPING IN PRACTICE

### *An examination of a homebuilder's performance measurement and incentive systems*

*(CIMA, Research Executive Summaries Vol. 5, Issue 6)*

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A major US homebuilder, referred to as 'Modern Classic Homes', designed a performance incentive system around its strategy map, which included customer and employee satisfaction measures as drivers of financial performance. The operating assumption underlying the strategy map was that positive employee satisfaction would contribute to positive customer satisfaction, thereby increasing referrals and decreasing warranty costs. This would result in increased revenues and profits.

While these links are intuitively appealing, especially the assumption that customer satisfaction should be a leading indicator of future success and profitability, the research is mixed. The study conducted to validate Modern Classic Homes' strategy map yielded similarly mixed findings.

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Lessons learned:

- Customer and employee satisfaction measures are complex – multiple measures may be necessary, and managers need to be more sophisticated in their understanding of how, when and where to measure them.
- There may be diminishing returns in improving customer satisfaction – managers need to assess both the costs and the benefits of improvements in satisfaction.
- Validating strategy maps is essential to ensure that the underlying assumptions hold true in practice and in driving the appropriate behaviours.

## Related and similar practices to consider

- Balanced Scorecard
- Developing non-financial key performance indicators

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

# PORTER'S FIVE FORCES OF COMPETITIVE POSITION ANALYSIS

## What is it?

## FRAMEWORK/THEORY

Porter's five forces of competitive position analysis were developed in 1979 by Michael E Porter of Harvard Business School as a simple framework for assessing and evaluating the competitive strength and position of a business organisation.

This theory is based on the concept that there are five forces that determine the competitive intensity and attractiveness of a market. Porter's five forces help to identify where power lies in a business situation. This is useful both in understanding the strength of an organisation's current competitive position, and the strength of a position that an organisation may look to move into.

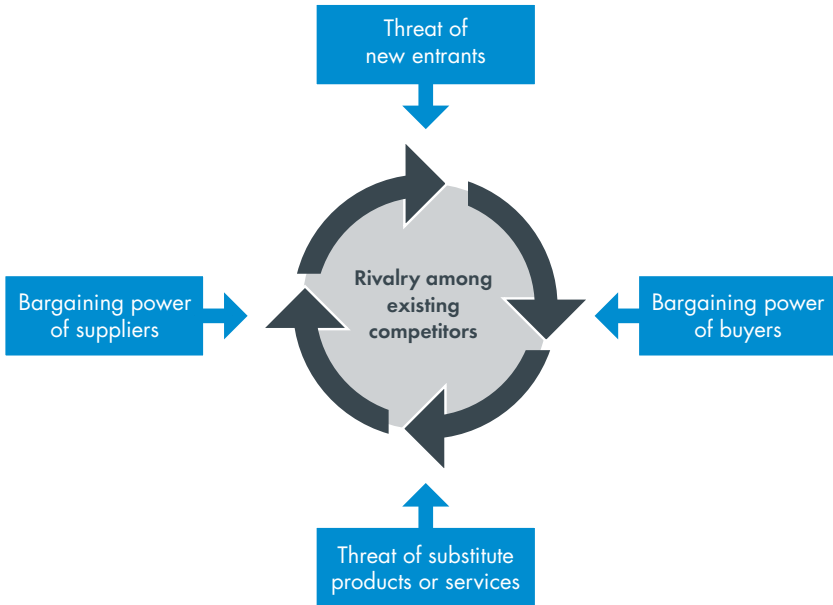
Strategic analysts often use Porter's five forces to understand whether new products or services are potentially profitable. By understanding where power lies, the theory can also be used to identify areas of strength, to improve weaknesses and to avoid mistakes.

The five forces are:

- 1. Supplier power.** An assessment of how easy it is for suppliers to drive up prices. This is driven by the: number of suppliers of each essential input; uniqueness of their product or service; relative size and strength of the supplier; and cost of switching from one supplier to another.
- 2. Buyer power.** An assessment of how easy it is for buyers to drive prices down. This is driven by the: number of buyers in the market; importance of each individual buyer to the organisation; and cost to the buyer of switching from one supplier to another. If a business has just a few powerful buyers, they are often able to dictate terms.

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## Porter's five forces of competitive position analysis



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- 3. Competitive rivalry.** The main driver is the number and capability of competitors in the market. Many competitors, offering undifferentiated products and services, will reduce market attractiveness.
  - 4. Threat of substitution.** Where close substitute products exist in a market, it increases the likelihood of customers switching to alternatives in response to price increases. This reduces both the power of suppliers and the attractiveness of the market.
  - 5. Threat of new entry.** Profitable markets attract new entrants, which erodes profitability. Unless incumbents have strong and durable barriers to entry, for example, patents, economies of scale, capital requirements or government policies, then profitability will decline to a competitive rate.

Arguably, regulation, taxation and trade policies make government a sixth force for many industries.

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## What benefits does Porter's Five Forces analysis provide?

Five forces analysis helps organisations to understand the factors affecting profitability in a specific industry, and can help to inform decisions relating to: whether to enter a specific industry; whether to increase capacity in a specific industry; and developing competitive strategies.

## Implementing Porter's Five Forces analysis? Questions to consider:

- Can we define our industry? Boundaries are not always clear in more dynamic situations.
- Do we understand which lifecycle stage the industry is in?
- Do we understand how volatile our industry is? Some industries will change faster than others.

### ACTIONS TO TAKE/Dos

- Use this model where there are at least three competitors in the market.
- Consider the impact that government has or may have on the industry.
- Consider the industry lifecycle stage – earlier stages will be more turbulent.
- Consider the dynamic/changing characteristics of the industry.

### ACTIONS TO AVOID/Don'ts

- Avoid using the model for an individual firm; it is designed for use on an industry basis.

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## PORTER'S FIVE FORCES IN PRACTICE

### Analysis of the Indian business environment

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In the June 2010 issue of *Financial Management* magazine, the five forces model was applied to the emerging Indian business environment in comparison with more developed markets. The analysis found that factors such as state protectionism and a lack of infrastructure are greater barriers to entry in India than they are in more developed nations, where market forces are more powerful.

The analysis highlighted many issues affecting competition in emerging economies and compared them to those that are more prevalent in more developed markets.

One factor that could play a crucial role in India is public opinion, which exerts a considerable influence on the government. A good example of this is a campaign against Walmart by local retailers who feel that the arrival of the US retail giant could put them out of business. Walmart has made huge investments in India, but is having to find ways around stringent regulations that prevent it from doing things as basic as putting its brand name on stores.

## Related and similar practices to consider

- PEST analysis
- Porter's Diamond
- Mendelow's stakeholder mapping matrix

## Further resources

[cgma.org/essentialtools](http://cgma.org/essentialtools)

# KEY PERFORMANCE INDICATORS (KPIs)

## What are they?

## MEASURES

A key performance indicator (KPI) is a measure used to reflect organisational success or progress in relation to a specified goal. The purpose of KPIs is to monitor progress towards accomplishing the strategic objectives that are typically communicated in a strategy map. KPIs are typically included in a reporting scorecard or dashboard that enables top management, the board or other stakeholders to focus on the metrics deemed most critical to the success of an organisation.

Financial KPIs are generally based on income statement or balance sheet components, and may also report changes in sales growth (by product families, channel, customer segments) or in expense categories. Non-financial KPIs are other measures used to assess the activities that an organisation sees as important to the achievement of its strategic objectives. Typical non-financial KPIs include measures that relate to customer relationships, employees, operations, quality, cycle-time, and the organisation's supply chain or its pipeline. Some prefer to use the term 'extra-financial' rather than non-financial, suggesting that all measures that contribute to organisational success are ultimately financial. In addition to financial and non-financial, other common categorisations of performance indicators are quantitative versus qualitative; leading or lagging; near-term or long-term; input, output or process indicators etc.

The critical element in developing KPIs is determining what is important or 'key' to the organisation. Operational measures are also important – they can be termed as just 'performance indicators', or 'PIs', to distinguish them from KPIs.

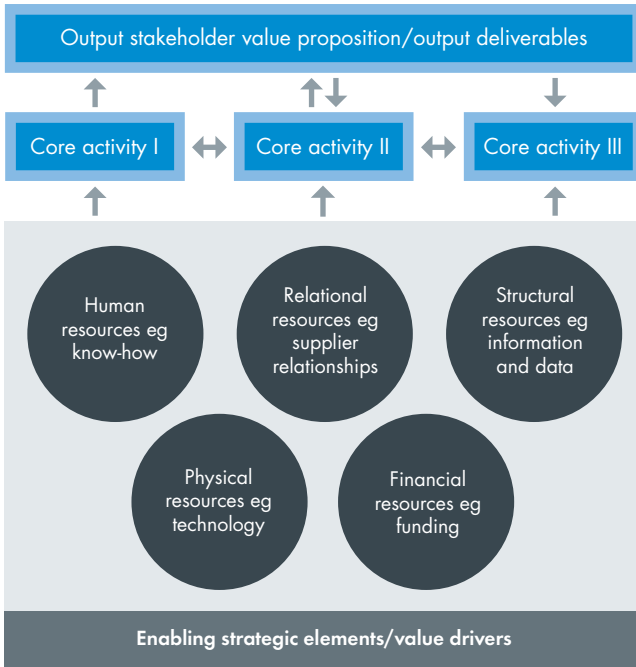


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Developing KPIs should be part of an overall strategic management process that connects the overall mission, vision and strategy of an organisation, and its short- and long-term goals, to specific strategic business objectives and their supporting projects or initiatives. Understanding the organisation's value drivers and the core activities and competencies that underpin its value proposition is an important first step in this process.

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### Value creation map template



Source: B Marr, *Managing and delivering performance*, Elsevier Ltd, 2008

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“There is lack of consensus as to what a balanced scorecard is. Many organisations develop a balanced scorecard without first developing a strategy map, from which key performance indicators (KPIs) for the balanced scorecard should be derived. In addition, many organisations confuse strategic KPIs, which belong in a balanced scorecard, with operational performance indicators (PIs), which belong in a dashboard.”

– Gary Cokins. *The promise and perils of the balanced scorecard*.  
John Wiley & Sons, Inc. 2010

## What benefits do Key Performance Indicators provide?

KPIs can improve strategy execution by aligning business activities and individual actions with strategic objectives. Well-designed KPIs can provide a means for management and the board to monitor core activities of the business rather than simply outcome measures of financial success. Integration of financial and non-financial KPIs can contribute to a greater focus on long-term success rather than short-term financial performance.

## Implementing Key Performance Indicators? Questions to consider:

- Do we understand our value drivers and core activities?
- What KPIs do we need? What performance questions do we need to answer?
- What mix of financial and non-financial measures do we need?
- What customer, human capital, operating, supply chain or pipeline measures do we need to monitor?
- Are there other key measures that are important drivers of our business, such as R&D, patents developed?

- 
- Are there leading indicators that we can develop from available data?
  - Can we collect meaningful data in a cost-effective manner for each of the desired measures?
  - Are our existing management information systems adequate to support the collection, analysis and reporting process?

### ACTIONS TO TAKE/Dos

- Base KPIs on strategic value drivers.
- Make sure KPIs are based on valid data and are easy to understand.
- Cascade the KPIs through the organisation.
- Make sure KPIs lead to positive action.
- Create a culture of continuous learning and performance improvement.
- Include a mix of both financial and non-financial KPIs.

### ACTIONS TO AVOID/Don'ts

- Do not collect data and measure too many things – too many KPIs lead to confusion rather than clarity. Five to ten 'critical' KPIs, and 20-30 overall, is a good rule of thumb.
- Avoid focusing solely on quantitative measures – qualitative assessments also provide valuable information.
- Don't forget about the importance of feedback and learning.

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## KEY PERFORMANCE INDICATORS IN PRACTICE

### *Unlocking Performance*

(CGMA Magazine, February 2012)

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This article, based on interviews with finance executives from Maersk Energy and International Flavors & Fragrances (IFF), discusses the importance of developing relevant KPIs and the role of the finance function in delivering more insightful information to manage performance.

Albert Birck, the head of performance management for Danish energy company Maersk Oil, describes the organisation's thought process for developing KPIs as follows: "Every time we discuss or design something for performance management, we assess the options to see whether they create value, are transparent, actionable (relevant, meaningful, able to influence), timely (which is more important than 'perfect') and forward-looking."

Taking this approach and making good use of their performance management technology solution has enabled the finance function to take Maersk from managing by 'gut feeling' to having high-quality analytical insights.

Roger Blanken, CPA, vice president of finance – supply chain for IFF, talks about his company's use of 'economic profit' and weighted-average-cost of capital (WACC) in planning strategy. He also explains how IFF looks at high-level indicators such as GDP, consumer prices and exchange rates – factors that impact on their commodity-based business.

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Making economic profit the primary measure of profitability has raised the quality of discussions within the company when making investment decisions.

## Related and similar practices to consider

- Balanced Scorecard
- Strategy mapping
- Developing non-financial key performance indicators

## Further resources

**[cgma.org/essentialtools](https://cgma.org/essentialtools)**

# BENCHMARKING

## What is it?

## PRACTICE

CIMA Official Terminology defines benchmarking as the “establishment, through data gathering, of targets and comparators that permit relative levels of performance (and particularly areas of underperformance) to be identified. Adoption of identified best practices should improve performance.”

Benchmarking exercises may involve either the whole organisation, or a part of it, but always require the involvement of more than one party or partner. They may be classified as either **results-based**, which compares performance metrics, or **process-based**, which looks behind the metrics to analyse the processes that generate them.

Several different types of benchmarking can be used:

- **Internal benchmarking** compares one operating unit or function with another within the same industry.
- **Functional benchmarking** (also known as operational or generic benchmarking) compares internal functions with those of the best external practitioners, regardless of their industry.
- **Competitive benchmarking** gathers information about direct competitors through techniques such as reverse engineering.
- **Strategic benchmarking** is a type of competitive benchmarking aimed specifically at strategic action and organisational change.

The development of benchmarking is most closely associated with Xerox, which introduced the practice in 1983.

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Benchmarking programmes comprise four steps:

1. Identification and/or calibration of performance gap
2. Clarification of the strategic impact of the benchmarked process
3. Identification and implementation of process improvements or strategic changes
4. Maintaining stimulus for continuous improvement.

## What benefits does benchmarking provide?

Benchmarking can help organisations to: show that performance targets can be achieved; accelerate and manage change; and enable process improvement. It can also help them to maintain focus on the external environment and generate an understanding of world-class performance.

## Implementing benchmarking?

### Questions to consider:

- Which activities or processes will we benchmark?
- Can we identify a suitable ‘best in class’ benchmarking partner?
- How will we overcome confidentiality issues?

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## ACTIONS TO TAKE/Dos

- Appoint a knowledgeable and enthusiastic 'champion', allowing sufficient authority and resources.
- Select the 'right' people – for example, staff and managers directly involved with the results/processes being benchmarked.
- Ensure effective co-ordination and communication of information provided by benchmarking partners, including the provision of reciprocal information.
- Concentrate on observing, describing and interpreting others' processes.

## ACTIONS TO AVOID/Don'ts

- Do not focus too heavily on what is currently being done; benchmarking offers the opportunity to identify potential future practices and innovative breakthroughs.
- Don't ignore organisational differences and their impact on comparative performance; non-transferable elements, such as employee skills and knowledge and organisational structure, must be recognised and allowed for.
- Avoid being defensive about any negative issues revealed by the process. The purpose of benchmarking is to reinforce improvement rather than to lay blame.



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## BENCHMARKING IN PRACTICE

### Xerox Corporation leads the way

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The Xerox Corporation is often cited as the pioneer in benchmarking practice. When the company wanted to improve performance in its warehousing and distribution operation, it didn't go down the then conventional road of process redesign. Instead, it identified the business that was acknowledged as the very best practitioner of warehousing and distribution: catalogue retailer LL Bean.

LL Bean agreed to conduct a co-operative benchmarking project, and so the two firms exchanged information on various aspects of their inventory handling and processing of orders. As a result, Xerox identified those areas in its own operation that were performing at below LL Bean's standards and implemented improvements.

One critical point to note is that Xerox adopted a business operating in a different sector altogether, instead of using another office equipment company as its model. There are many other similar high-profile cases reported in management literature. For example, when IT services company ICL wanted to improve its distribution system, it benchmarked with Marks & Spencer. And, when Motorola was trying to improve the process of delivering its mobile phones to customers, it benchmarked with both Domino's Pizza and Federal Express.

## Related and similar practices to consider

- Continuous improvement

## Further resources

[cgma.org/essentialtools](http://cgma.org/essentialtools)

# THE PERFORMANCE PRISM

## What is it?

## SCORECARD/Framework

The Performance Prism (PP) is referred to by its Cranfield University developers as a ‘second generation’ scorecard and management framework. The distinguishing characteristic of the PP is that it uses as its starting point all of an organisation’s stakeholders, including investors, customers and intermediaries, employees, suppliers, regulators and communities, rather than strategy. According to PP proponents, strategy should follow from stakeholder analysis. The PP framework also focuses on the reciprocal relationship between the organisation and its stakeholders, as opposed to just stakeholder needs.

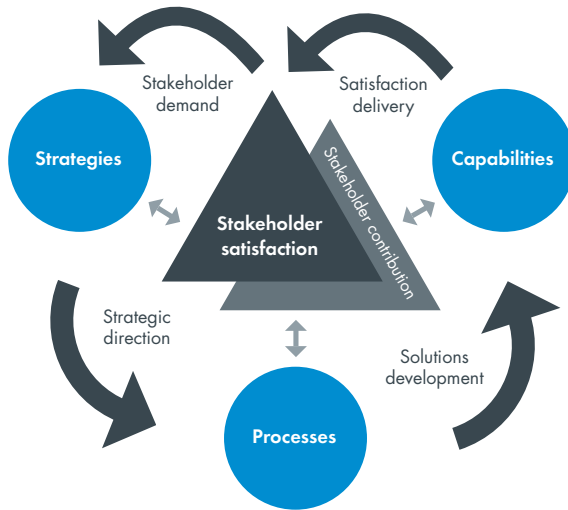
There are five ‘facets’ to the Performance Prism which lead to key questions for strategy formulation and measurement design:

1. **Stakeholder satisfaction:** Who are our stakeholders and what do they want and need?
2. **Strategies:** What strategies do we need to satisfy these wants and needs?
3. **Processes:** What processes do we need to execute these strategies?
4. **Capabilities:** What capabilities do we need to operate our processes more effectively and efficiently?
5. **Stakeholder contribution:** What do we want and need from our stakeholders if we are to develop and maintain these capabilities?

The Performance Prism is a management framework that reflects the complexities of organisations and the multiplicity and reciprocity of stakeholder relationships. The comprehensive nature and flexibility of the PP contribute to its applicability in a wide range of organisations.

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## The Performance Prism



Source: Cranfield School of Management

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“The key message here is that all organisations require certain things of their stakeholders and all organisations are responsible for delivering certain things to all of their stakeholders.”

– Andy Neely and Chris Adams, Cranfield School of Management, 2002

## What benefits does the Performance Prism provide?

The PP allows organisations to develop strategies, business processes and measures geared to the specific needs of all important stakeholder groups. By taking a broad stakeholder perspective that includes regulators and business communities, the PP enables an organisation to more directly address the risks and opportunities in its business environment. Using the PP to develop measures for each relevant stakeholder facilitates the communication and implementation of strategy.

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## Implementing the Performance Prism?

### Questions to consider:

- Does the complexity of our organisation and our stakeholder groups warrant the use of the PP?
- Which important stakeholders do we need to consider that might be overlooked by another performance management system, such as the Balanced Scorecard?
- How well do we understand our business model and our relationship with our important stakeholder groups?

### ACTIONS TO TAKE/Dos

- Start with stakeholders, not with strategies.
- Understand not only what stakeholders want from you, but what their contribution is to the organisation – such as financing from investors, and talent, energy and commitment from employees.
- Develop measures specific to the processes and capabilities necessary to meet the needs of each stakeholder.

### ACTIONS TO AVOID/Don'ts

- Don't forget about the interests of regulators and communities.
- Do not ignore the reciprocal relationship between the organisation and its stakeholders.
- Never underestimate the importance of capabilities – the people, practices, technology and infrastructure necessary to support key processes.
- Don't use the Performance Prism in small or very simple organisations.

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## THE PERFORMANCE PRISM IN PRACTICE

### Stakeholder needs at DHL

*(Measuring Business Excellence, 2001)*

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One of the first applications of the Performance Prism took place at DHL International in the UK. Implementation of the PP at DHL was precipitated by board-level frustration at the amount of time spent reviewing operational data without having any real impact on the business or the issues that continued to present themselves.

Development of a 'success map' and populating a PP revealed the needs of various stakeholders, in particular the set of customers that had a desire to have a more strategic relationship with DHL, so-called advantage customers. This led to conversations about the processes and capabilities that DHL needed in order to meet the needs of these important customers.

Once the Prism was constructed, the board was able to step back and ask important questions about how to oversee the business from a more strategic perspective and identify the relevant performance measures for the organisation.

Lessons learned:

- Implementation of the Performance Prism created a shift in the board review process from scrutinising lots of numbers to having a meaningful conversation about strategic issues and the direction of the company.
- The more strategic discussions stimulated by the PP created an emphasis on working together on issues rather than on individual functional responsibilities.

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## Related and similar practices to consider

- Balanced Scorecard
- Strategy mapping
- Developing non-financial key performance indicators

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

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# ROLLING PLANS AND FORECASTS

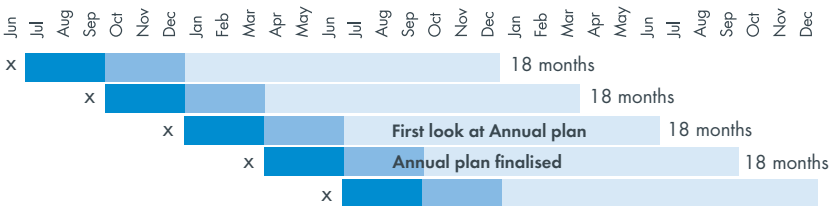
## What are they?

## PRACTICE

CIMA Official Terminology defines these as plans or budgets that are continuously updated by adding a further accounting period when the earliest accounting period has expired. A rolling forecast is continually updated, whereby each time actual results are reported, a further forecast period is added and intermediate period forecasts are updated.

Budgeting and forecasting can be viewed as part of the planning process, which looks into the future beyond the immediate timeframe. Planning is an attempt to shape the organisation’s future, while forecasting and budgeting aim to predict the value created and resources used in a specific period. Adopting a rolling approach helps to inform a more realistic and timely planning process.

### Example of rolling forecast process



- x Quarterly update of rolling forecast (during second week)
- Forecast monthly in detail (50% of forecast time spent getting it right)
- Forecast monthly
- Forecast in quarterly splits, although some budget holders may want to do it monthly

Source: *Quarterly rolling planning – get it right first time*, CIMA Insight, August 2011



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## What benefits does a rolling approach provide?

This approach reduces uncertainty in planning and forecasting. It allows flexibility where long-term costs and/or activities cannot be forecast accurately. The rolling approach encourages a regular reassessment of plans at all levels within the organisation. It also allows the business to respond quickly to current events.

## Implementing a rolling approach? Questions to consider:

- Do we have the time and resources to prepare plans on a more frequent basis?
- How can we get buy-in from the rest of the organisation?

### ACTIONS TO TAKE/Dos

- Involve budget holders in changes to the planning process.
- Base your forecasting on the key drivers of the business. Should there be a major change with any of these drivers, management can be quickly informed of the impact and react accordingly.

### ACTIONS TO AVOID/Don'ts

- Don't take a top-top approach – understand and work with the business at all levels.
- Avoid wasting time preparing detailed plans for the full year – focus mainly on the earliest period and make outline plans for subsequent periods.

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## ROLLING PLANS AND FORECASTS IN PRACTICE

### *Driving success at Southwest Airlines* (Beyond Budgeting Roundtable, 2013)

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Southwest is an icon of Corporate America. It has been consistently profitable for over 30 years and is regularly top of independent customer satisfaction ratings. It is also the most cost efficient airline and has the highest shareholder returns of its peer group. It has been voted one of the best 'corporate citizens' in America. Its focus is on continuously improving performance and meeting customers' needs. Service is a 'way of life' rather than a technique.

Targets are set by each team within broad-based parameters and expectations. This enables innovative thinking and builds ownership and commitment at the local level. Benchmarks (such as cost per available seat mile) and other key indicators are widely shared.

Planning takes place at the front line. It is a continuous process based on 12-month rolling forecasts and quarterly plans within a clear strategic framework. Managers have fast, relevant information within one unified reporting and open information system. Resources are made available monthly and quarterly based on rolling forecasts. Action plans can be approved at any time through the year and implemented immediately.

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## Related and similar practices to consider

- Beyond budgeting

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

# ACTIVITY-BASED BUDGETING (ABB)

## What is it?

## PRACTICE

CIMA Official Terminology describes activity-based budgeting (ABB) as a method of budgeting based on an activity framework, using cost driver data in the budget setting and variance feedback processes.

The most basic form of ABB uses cost drivers (identified through activity-based costing, ABC) to help derive budgets. As its name suggests, ABB focuses on activities rather than functions.

In simple terms, ABB follows three stages:

1. Identify activities and their cost drivers
2. Forecast the number of units of cost driver for the required activity level
3. Calculate the cost driver rate (cost per unit of activity).

The following simple example uses a sales office scenario, where the cost driver is number of sales orders.

- Calculate the forecast cost of processing a single sales order using ABC, adjusting for inflation if necessary (\$5).
- Forecast the number of sales orders for the budget period (40,000).
- Finally, calculate the total sales office budget ( $40,000 \times \$5 = \$200,000$ ).

This example assumes that costs incurred by the sales office are mostly variable – in practice, they would also include elements of fixed and semi-fixed costs, such as accommodation, heating and salaries. Further analysis would be required to determine how much staff time is spent processing sales orders.

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## What benefits does ABB provide?

Like activity-based costing, activity-based budgeting draws attention to overhead activities and their associated costs. It emphasises that activity costs may be controllable if activity volume is controlled. Where traditional budgeting tends to focus on input costs, ABB takes an outputs-based approach, recognising that activities drive costs. ABB views the business as a collection of activities, a perspective that links well with organisational strategy.

## Implementing ABB? Questions to consider:

- Like ABC, ABB requires significant time to implement. Do we have the required support and time?
- Do we have the required resources and software?
- Like ABC, ABB is expensive to implement. Will the costs of implementation outweigh the benefits?
- Can we easily identify all of our activities and costs?
- Can we get buy-in from operational managers?

### ACTIONS TO TAKE/Do's

- Consider using ABB if overhead costs are a significant proportion of total operating costs.
- ABB is particularly useful in a Total Quality Management (TQM) environment, to help identify the cost-effectiveness of activities.

### ACTIONS TO AVOID/Don'ts

- Don't try and implement ABB unless you are using activity-based costing (ABC) as it is only suited to organisations that are also using ABC.
- Do not ignore the need to engage with operational managers, or they may struggle with the concept of ABB, making the process more time-consuming.

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## ACTIVITY-BASED BUDGETING IN PRACTICE

### Calculating the purchases budget at GS

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GS has budgeted sales for the next two years of 24,000 units a year spread evenly throughout both years. The estimated opening inventory of finished goods at the start of the next year is 500 units but GS now wants to maintain inventory of finished goods equivalent to one month's sales.

Each unit uses 2 kg of material. The estimated opening raw material inventory at the start of the next year is 300 kg but GS now wants to hold sufficient raw material inventory at the end of each month to cover the following month's production.

The change in the policy for inventory holding for both raw materials and finished goods will take effect in the first month of next year and will apply for the next two years. The budgeted material cost is \$12 per kg.

GS uses the following approach to calculate the material purchases budget:

Budgeted sales	24,000 units	
Plus closing inventory	2,000 units	
Less opening inventory	(500) units	
Budgeted production	25,500 units	
Raw material required	25,500 units x 2 kg	= 51,000 kg
Plus closing inventory	2,000 units x 2 kg	= 4,000 kg
Less opening inventory		(300) kg
Raw material purchases		= 54,700 kg
Raw material purchases budget	54,700 kg x \$12	= \$656,400

## Related and similar practices to consider

- Activity-based costing (ABC)
- Activity-based management (ABM)

## Further resources

[cgma.org/essentialtools](https://www.cgma.org/essentialtools)

# SCENARIO AND CONTINGENCY PLANNING

## What is it?

## PRACTICE

Scenario planning provides a structured method for managers to evaluate alternative views of what may happen in the future as an aid to strategic, operational, and financial planning. Scenario planning focuses largely on answering three questions:

1. What could happen?
2. What would be the impact on our strategies, plans and budgets?
3. How should we respond?

Like many planning tools, such as strategic and tactical planning, scenario planning has its origins in the military. The adoption of scenario planning in the commercial world started in the oil and gas industry, notably at Royal Dutch Shell in the 1970s when it helped them to prepare for the oil crisis. The use of scenario planning by both businesses and public sector entities has expanded widely over the ensuing 40 years.

Four broad types of scenario questions include:

1. **Political:** ‘How will the expansion of the European Union change the political power of governments within the union?’
2. **Economic:** ‘How will the rapid economic growth of China and India change global markets?’
3. **Social:** ‘What are the implications of increasing obesity?’
4. **Technological:** ‘What will be the impact of increasing adoption of smart phones on desktop and laptop computer usage?’



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Contingency planning is a risk mitigation process for developing back-up plans in anticipation of events that might disrupt 'business as usual'. Business continuity planning is an expanded version of contingency planning that typically encompasses a more comprehensive and extended response plan for getting back to 'business as usual'.

Common types of scenario planning include:

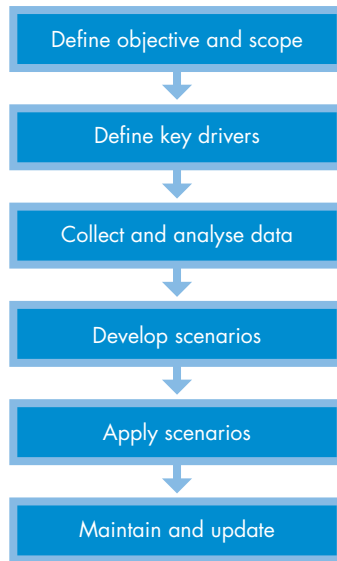
- **Single variable sensitivity analysis** – This is possibly the most common and the logical starting point for an organisation. Changing one variable at a time while holding others constant may not necessarily fully reflect complex interdependencies, but sensitivity analysis can be very valuable in understanding the potential impact of a key variable on business.
- **Multi-variable narrative-based analysis** – This form of analysis takes the form of a plausible theme that might play out in the economic, competitive, regulatory or social landscape, and considers the impact of multiple variables and uncertainties occurring jointly.
- **Initiative-based scenario planning** – Scenarios that layer various combinations of initiatives on top of a baseline enable an organisation to understand the incremental impact of growth or cost containment initiatives and set priorities within the overall strategic goals of the organisation.

Three typical approaches to defining scenarios are:

1. Along a spectrum of possible outcomes, such as a plan with upside and downside possibilities
2. A binary, either/or approach
3. A matrix of two variables with relatively high degrees of uncertainty that yield four potential outcomes when plotted in the quadrants of a matrix.

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## Scenario Plan Work Approach



Source: David AJ Axson. *Scenario planning: navigating through today's uncertain world*. *Journal of Accountancy*, March 2011

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## What benefits does Scenario Planning provide?

Scenario planning provides improved insight about the choices, opportunities and implications that uncertainty presents. It brings better quality strategic plans, budgets and forecasts, and it enables a clearer understanding of the sensitivity of the key drivers of the business and the potential impact of future events.

Scenario planning also provides a foundation for explaining performance variations by reference back to drivers incorporated into the scenarios. It can be an early warning system for potential threats and opportunities for the business.

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## Implementing Scenario Planning?

### Questions to consider:

- What is the issue that we are trying to assess? Over what time horizon?
- What are the major external factors likely to impact on our scenarios?
- What are the key internal drivers that need to be addressed?
- Do we have the right data, technology, bandwidth and skills to develop and maintain scenarios?

### ACTIONS TO TAKE/Dos

- Secure senior management commitment and participation.
- Organise scenarios around key issues to be addressed.
- Define assumptions and preconditions clearly.
- Limit the number of scenarios created.
- Make sure each scenario presents a plausible and logical alternative view of the future.
- Focus on material differences between scenarios.
- Use a balance of quantitative and qualitative data.
- Establish leading indicators or 'trip' points for signalling key scenario assumptions.
- Refresh scenarios and update assumptions on a periodic basis.

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## ACTIONS TO AVOID/Don'ts

- Avoid developing scenarios without defining the issues first.
- Don't develop too many scenarios.
- Do not attempt to develop the perfect scenario – more detail does not mean more accuracy.
- Avoid becoming fixated on any one scenario.
- Try not to hold on to a scenario after it has ceased to become relevant.

## SCENARIO PLANNING IN PRACTICE

### *Navigating through today's uncertain world*

(David AJ Axson, *Journal of Accountancy*, March 2011)

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The case of ElectricIQ, a software company that develops software for smart energy use, illustrates the application of scenario planning in practice (the name and details have been changed to maintain client confidentiality).

The company embarked on a scenario planning project to help understand the alternatives as an input to R&D, marketing and product development plans in anticipation of its expansion into the smart grid market for environmental energy management systems.

The team identified primary and secondary drivers of demand for renewable energy sources; analysed relevant underlying data; and developed four likely scenarios across the two axes of public policy and public opinion.

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Using the scenarios as a baseline, ElectricIQ's finance team recast the company's five-year plan and annual budget under each scenario to assess the financial implications and identify key performance metrics that could provide the organisation with an early warning as to which scenario is actually playing out.

Lessons learned:

- Scenario plans provide the context for review of actual and forecasted results and better understanding of variations in performance.
- Scenario plans allow a company to make fast, confident decisions by providing a sound basis for evaluating the impact of changing market conditions.

## Related and similar practices to consider

- Strategy mapping
- Developing non-financial key performance indicators
- Strategic planning tools

## Further resources

**[cgma.org/essentialtools](https://cgma.org/essentialtools)**

# CASH FLOW MODELLING

## What is it?

## PRACTICE

Cash is king. Most businesses fail not because they don't make a profit but because they run out of cash. Cash is the lifeblood of any business. Cash flow modelling is the practice of planning and forecasting the sources and uses of cash. Its ultimate objective is to provide a framework that enables the most effective, efficient and economic use of available cash and the maximisation of free cash flow (the cash generated by operating cash flow less capital expenditure), which is important as it enables a business to invest in growth-generating options.

## What benefits does Cash Flow Modelling provide?

Cash flow modelling enables companies to manage solvency more proactively. It improves the sustainability of the organisation and it improves the understanding of the impact of drivers on cash flow, leading to better decisions. Modelling facilitates cash driver target setting, and it provides a basis for enhanced analysis and reporting of cash flow performance against targets as well as earlier indicators of expected future cash flows. Cash flow modelling also improves understanding of the cash impact of investment decisions, and it improves access to capital, as capital providers have more confidence.

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## Implementing Cash Flow Modelling?

### Questions to consider:

- Do we plan scenarios to cater for a range of risks?
- Does liquidity at times constrain strategy execution?
- Do we have a cash flow or liquid reserves policy?
- How well does my organisation's cash generation compare to others in the sector?
- Does management have a clear understanding of the organisation's working capital structure?
- Does the quantity of data from the ERP system overwhelm our ability to structure it in a way that could support a model?
- What are the key drivers of cash flow in the business; where can we source the required data to support the forecast?
- Do we have the expertise and capacity to create and maintain a cash flow model?

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## ACTIONS TO TAKE/Dos

- Develop a model that facilitates analysis and reporting.
- Develop a driver-based model and assign accountability for driver targets, to encourage the right behaviours across the organisation.
- Create policies, processes and procedures that support sound cash awareness, stewardship and targets.
- Reconcile long- and short-term cash flows.
- Communicate regularly with the treasury function, to ensure cash availability.
- Keep a history of driver actuals to ensure patterns and trends are understood.
- Maintain a rolling forecast, updating period opening positions with actuals to improve short-term forecasting accuracy.
- Regularly share cash forecasts and performance information with lenders, to encourage their support in lean times.
- Report, in management information, on the security of, and risks associated with, sources of funding. Monitor the creditworthiness of key (or new) customers, taking action if credit risk increases.
- If the organisation is planning a fundamental change, eg a restructure, merger or acquisition, get involved from the start, focusing on cash model impact.



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## ACTIONS TO AVOID/Don'ts

- Avoid blind faith and optimism – don't rely on modelling only one scenario.
- Don't rule out the effect of environmental factors such as inflation and currency exchange rates.
- Avoid developing a cash flow model in isolation of the balance sheet and P&L. The rigour of balancing the balance sheet increases assurance that the cash forecast is realistic.
- Don't make cash flow management a purely financial function. Communicate with wider management to avoid a culture focused on the top and bottom lines of the P&L.
- Avoid regularly exceeding creditor settlement terms – credit ratings will reflect this to the possible detriment of the organisation's cost of capital and ability to attract new capital. If necessary, formally agree longer settlement terms with creditors.
- Avoid taking an optimistic view when forecasting drivers; instead, form an independent view and ensure expenditure is aligned to this.
- Don't assume that the credit rating of your organisation or group is accurate – proactively manage your organisation's ratings with the ratings agencies.

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## CASH FLOW MODELLING IN PRACTICE

### Helping Marks & Spencer deliver £185m in cash flow between 2007 and 2010

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Working with other parts of the business, the business service centre helped to deliver incremental cash flows of £185m over this critical period. Gary Critchley, head of business services and information, says; "It is really a team game in terms of how we partner with our colleagues in finance and other parts of the business. That could be sourcing, treasury, logistics, or on projects, so that, when we are implementing business changes, we are always cognisant of how we can make this work for us both practically and financial."

One of the ways that cash flow was delivered was through improved cash management. Managing net debt over the period helped Marks & Spencer to sustain its credit rating, cost of borrowing and – ultimately – its profits. "We were able to sustain the debt during the credit crunch when credit markets tightened significantly. If we had needed to renegotiate any of our facilities, then that would have been difficult and potentially expensive. You needed to conserve as much cash as you could during that time. We have to make sure that we create commercial value – value in understanding the connection between the business behaviour, the commercial driver, the business project and the financial ledger."

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## Related and similar practices to consider

- Internal rate of return (IRR)
- Discounted cash flow (DCF)
- Net present value (NPV)
- Capital ratios
- Investor ratios
- Weighted average cost of capital (WACC)
- Capital asset pricing model (CAPM)
- Cash flow return on investment (CFROI)

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

# ACTIVITY-BASED COSTING (ABC)

## What is it?

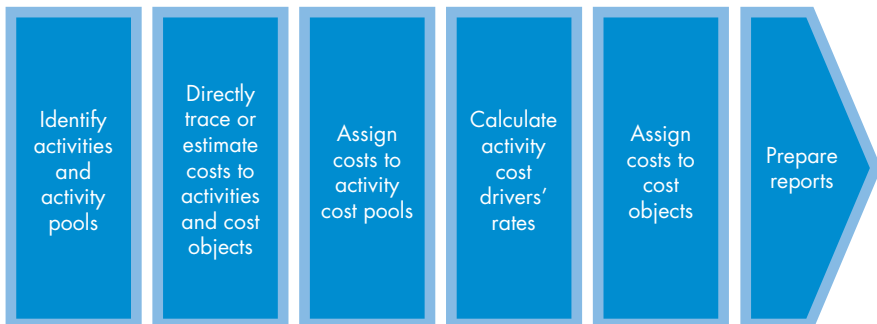
## PRACTICE

CIMA Official Terminology describes activity-based costing as an approach to the costing and monitoring of activities, which involves tracing resource consumption and costing final outputs. Resources are assigned to activities and activities to cost objects. The latter use cost drivers to attach activity costs to outputs.

ABC was first defined in the late 1980s by Kaplan and Burns. It can be considered as the modern alternative to absorption costing, allowing managers to better understand product and customer net profitability. This provides the business with better information to make value-based and therefore more effective decisions.

ABC focuses attention on cost drivers, the activities that cause costs to increase. Traditional absorption costing tends to focus on volume-related drivers, such as labour hours, while activity-based costing also uses transaction-based drivers, such as number of orders received. In this way, long-term variable overheads, traditionally considered fixed costs, can be traced to products.

### The activity-based costing process



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“Over the past 15 years, ABC has enabled managers to see that not all revenue is good and not all customers are profitable customers.”

– Kaplan and Anderson. *Time-driven activity-based costing*. Harvard Business Review, November 2004

## What benefits does ABC provide?

Activity-based costing provides a more accurate method of product/service costing, leading to more accurate pricing decisions. It increases understanding of overheads and cost drivers; and makes costly and non-value-adding activities more visible, allowing managers to reduce or eliminate them. ABC enables effective challenge of operating costs to find better ways of allocating and eliminating overheads. It also enables improved product and customer profitability analysis. It supports performance management techniques such as continuous improvement and scorecards.

## Implementing ABC? Questions to consider:

- Do we fully understand the resource implications of implementing, running and managing ABC?
- Do we have the resources to implement ABC?
- Will the costs outweigh the benefits?
- Can we easily identify all of our activities and costs?
- Do we have sufficient stakeholder buy-in? What will it take to achieve this?
- Will the additional information ABC provides result in action that will increase overall profitability?

## ACTIONS TO TAKE/Dos

- Get buy-in from the rest of the business. ABC provides business managers, as well as the finance function, with the information needed to make value-based decisions.
- Use ABC for pricing and product prioritisation decisions.
- ABC should be implemented by management accountants as they are best placed to manage the process and to ensure benefits realisation.

## ACTIONS TO AVOID/Don'ts

- Do not get caught up in too much attention to detail and control. It can obscure the bigger picture or make the firm lose sight of strategic objectives in a quest for small savings.
- It is important not to fall into the trap of thinking ABC costs are relevant for all decisions. Not all costs will disappear if a product is discontinued, an example being building occupancy costs.

## ACTIVITY-BASED COSTING IN PRACTICE

### *How Xu Ji achieved standardisation in working practices and processes*

(CIMA case study, 2011)

The Chinese electricity company Xu Ji used ABC to capture direct costs and variable overheads, which were lacking in the state-owned enterprise's (SOE) traditional costing systems.

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The ABC experience has successfully induced standardisation in their working practices and processes. Standardisation was not a common notion in Chinese culture or in place in many Chinese companies. ABC also acts as a catalyst to Xu Ji's IT developments – first accounting and office computerisation, then ERP implementation.

Prior to the ABC introduction in 2001, Xu Ji operated a traditional Chinese state-enterprise accounting system. A large amount of manual bookkeeping work was involved. Accounting was driven predominantly by external financial reporting purposes, and inaccuracy of product costs became inevitable. At this time, Xu Ji underwent a series of flotations following China's introduction of free market competition.

The inaccuracy of the traditional costing information seriously impeded Xu Ji's ability to compete on pricing. The two main tasks for the ABC system were to: trace direct labour costs directly to product and client contracts; and allocate manufacturing overheads on the basis of up-to-date direct labour hours to contracts.

Lessons learned:

The common 'top-down' management style and organisational culture among SOEs worked well when instigating innovative ideas and inducing corporate-wide learning. Top management's commitment to trying out new management ideas and investing in new technology has been the unique feature.

## Related and similar practices to consider

- Time-driven activity-based costing
- Activity-based budgeting (ABB)
- Activity-based management (ABM)

## Further resources

[cgma.org/essentialtools](http://cgma.org/essentialtools)

# LEAN

## What is it?

## PRACTICE

Lean management is a system derived from Toyota's lean manufacturing methodology, which systematically aims to reduce waste, improve workflows and eliminate non-value-adding activities. This ultimately creates more value for customers, with fewer resources.

"Lean... provides a way to do more and more with less and less – less human effort, less equipment, less time, and less space – while coming closer and closer to providing customers with exactly what they want."

– Womack and Jones, *Lean Thinking*, second edition, 2003

## What benefits does Lean provide?

The benefits of lean management techniques are very similar to those of lean production. Any activity that fails to add value can be considered waste, including wasted effort. Lean can result in significant cost savings for the labour-intensive service industry, by reducing staffing levels and eliminating errors. However, organisations must avoid compromising on quality.

The concept of doing more with less has significant appeal to the not-for-profit sector. The UK's National Health Service has used lean management successfully to improve bottlenecks in accident and emergency departments.



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## Implementing Lean? Questions to consider:

- What will we gain? Will the cost outweigh the expected benefits?
- Can we make the required cultural change?
- Will lean have a positive or a negative impact on service levels?

### ACTIONS TO TAKE/Dos

- Develop a multi-skilled workforce through training.
- Communication is vital to ensure that employees do not feel threatened by the fear of staffing cuts.

### ACTIONS TO AVOID/Don'ts

- Lean techniques should not be seen as an end in themselves – the true benefits will come from a shift in organisational mindset and culture.
- Avoid making efficiency changes at the expense of customer service.

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## LEAN IN PRACTICE

### *Lean management in the garment industry*

(CIMA Edge, 2011)

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The garment manufacturing industry in Sri Lanka faces many challenges as a result of low-cost apparel manufacturers worldwide, and must find new ways to stay competitive.

Economic growth in the country has resulted in high cost of maintenance for companies, with the management of operational costs being specifically challenging. The 'price per unit' which was once a competitive advantage in the industry in Sri Lanka, is no longer able to compete with the high volumes of countries such as China, Vietnam and Bangladesh which are offering better pricing options.

With this in mind, many large organisations in the country have looked at lean manufacturing as a valuable tool to reduce costs through the elimination of waste.

For example, there is a major contribution to an organisation's working capital from its raw material sourcing and stock holding. The lean theory helps the organisation to understand the causes of non-value-add activities such as stock holding and to develop mechanisms to reduce these.

Many companies in the industry have originated from mass manufacturing, with stock holding days averaging between 65 and 85. With lean implementation they have managed to reduce stock holding to between 20 and 40 days, creating a positive contribution towards working capital management and space saving.

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## Related and similar practices to consider

- Total Quality Management (TQM)
- Six Sigma
- European Foundation for Quality Management Model (EFQM)
- ISO 9000

## Further resources

**[cgma.org/essentialtools](https://cgma.org/essentialtools)**

# QUALITY MANAGEMENT TOOLS

## What are they?

## FRAMEWORKS

According to the UK's Chartered Quality Institute, the only true measure of acceptable quality is customer satisfaction, which takes into account both objective and subjective interpretations of the needs and expectations of customers.

Quality management involves planning and controlling activities to ensure that the product or service is fit for purpose, and meets design specifications and the needs of customers, according to a CIMA official study text.

Traditionally, quality management focused on quality control, where finished goods were inspected and tested, and substandard 'waste' product disposed of or sold at a lower price. However, contemporary thinking rejects this approach as inefficient and profit-draining. As a result, several tools and philosophies have been developed that aim to focus on and eliminate waste entirely.

### Cost of Quality (CoQ)

According to CIMA Official Terminology, CoQ is the difference between the actual cost of producing, selling and supporting products or services and the equivalent costs if there were no failures during production or usage. The cost of quality can be analysed into:

- **cost of conformance** – cost of achieving specified quality standards
- **cost of prevention** – costs incurred prior to or during production in order to prevent substandard or defective products or services from being produced
- **cost of appraisal** – costs incurred in order to ensure that outputs produced meet required quality standards
- **cost of non-conformance** – cost of failure to deliver the required standard of quality

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- **cost of internal failure** – costs arising from inadequate quality which are identified before the transfer of ownership from supplier to purchaser
  - **cost of external failure** – costs arising from inadequate quality discovered after the transfer of ownership from supplier to purchaser.

### Total Quality Management (TQM)

CIMA Official Terminology describes TQM as the integrated and comprehensive system of planning and controlling all business functions so that products or services are produced which meet or exceed customer expectations. TQM is a philosophy of business behaviour, embracing principles such as employee involvement, continuous improvement at all levels and customer focus. It is also a collection of related techniques aimed at improving quality – such as full documentation of activities, clear goal-setting and performance measures from the customer perspective.

Originally developed in Japan in the 1950s, the aim of TQM is to get things ‘right first time’, an approach that increases prevention costs, such as system design, but helps to prevent internal and external failure costs. There is an emphasis on participation throughout the value chain, and a commitment to continuous improvement through constant reassessment of processes.

### Kaizen

CIMA Official Terminology describes Kaizen as a Japanese term for continuous improvement in all aspects of an entity’s performance, at every level.

The philosophy of Kaizen seeks to involve all levels of employees, encouraging suggestions for small incremental improvements across all areas of the business which over time have a major impact. In a manufacturing context, processes are standardised, assessed and then improved, with the ultimate result being decreased waste and increased productivity.

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## Six Sigma

CIMA Official Terminology describes Six Sigma as a methodology based on TQM to achieve very low defect rates. The ‘sigma’ refers to the Greek letter used to denote standard deviation, so ‘six sigma’ means that the error rate lies beyond six standard deviations from the mean. To achieve six sigma, an organisation must therefore produce not more than 3.4 defects per million products.

In practice, businesses use techniques such as statistical process control to monitor and chart processes, identifying exceptions to the upper and lower limits and aiming to reduce the number of faults.

## EFQM Excellence Model

The EFQM model is a framework for management systems, developed by the European Foundation for Quality Management. It aims to assess performance; integrate and align existing tools, procedures and processes; introduce a way of thinking that encourages reflection and stimulates continuous improvement; and identify the key actions that are driving results.

A key feature of the model is a diagnostic framework that allows organisations to grade themselves against nine key criteria. These focus on the cause and effect relationship between how an organisation carries out its actions (enablers), and what these achieve (results).

Enablers	Results
Leadership Strategy People Partnerships and resources Processes, products and services	Customer results People results Society results Business results

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## What benefits do Quality Management Tools provide?

An effective quality management programme leads to higher quality processes and outputs. These in turn lead to greater customer satisfaction and improved profitability. Quality management encourages a culture of team working at all levels of the organisation, which in turn improves productivity. Human resources are recognised as a key organisational asset. Lower costs of failure, combined with shorter processing times, will result in cost savings.

## Implementing Quality Management Tools?

### Questions to consider:

- How do we measure quality?
- Are senior management fully committed to the quality concept?
- Can we ensure buy-in across the organisation?
- What training will staff require?

### ACTIONS TO TAKE/Dos

- Communicate the benefits of quality management across the organisation. Quality management techniques require buy-in and engagement at all levels in order to work effectively.
- Encourage a culture of teamwork, ensuring that managers work as part of their teams, rather than as overseers.
- Encourage a culture of ownership and responsibility among employees.
- Be aware that existing rewards may conflict with quality management by encouraging individualism over teamwork.

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## ACTIONS TO AVOID/Don'ts

- Don't be complacent – quality management is a long-term process seeking to make continual, small improvements over time.
- Avoid the use of too many quality measures – be selective and recognise that some may conflict with others.

## QUALITY MANAGEMENT IN PRACTICE

### Addressing quality problems at Toyota

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Toyota encountered significant quality problems in 2009–10 when it had to recall 5.3 million vehicles in the US, in relation to five separate issues relating to braking, acceleration and power steering, affecting various models. US regulators linked the problems to 51 deaths.

How could this happen in an organisation with a supposed quality-oriented philosophy and an investigative approach which advocated going to the source of any issue? How did defective parts enter the supply chain? Why were quality problems not identified or dealt with more promptly?

Toyota's own assessment of where it went wrong was "the pace at which we have grown may have been too quick... Toyota's priority has traditionally been first safety; second quality; and third volume. These priorities became confused... We pursued growth over the speed at which we were able to develop our products and our organisation."



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The company also felt it could have handled its response to the safety issues more effectively. “We must think more from a customer first perspective rather than a technical perspective when investigating complaints... we must communicate faster, better and more effectively with customers and regulators.”

Toyota’s solutions include new regional quality officers to give regions more autonomy and decision-making with regard to recalls and other safety issues. It also established a new special committee for global quality, and teams to investigate quickly reports of unintended acceleration. It reinforced its design capability by transferring one thousand engineers to focus on design of components and other quality issues.

Toyota lengthened product lifecycles by four weeks to give more time to address safety/quality issues and improved monitoring systems to better capture intelligence on quality/safety concerns from various sources, including web mentions, customer calls and government databases. It intends to equip more vehicles with the technology to diagnose problems and report faults (‘black boxes’) and has allowed external parties to review its technology.

## Related and similar practices to consider

- Quality circles
- 5-S
- ISO 9000

## Further resources

[cgma.org/essentialtools](http://cgma.org/essentialtools)

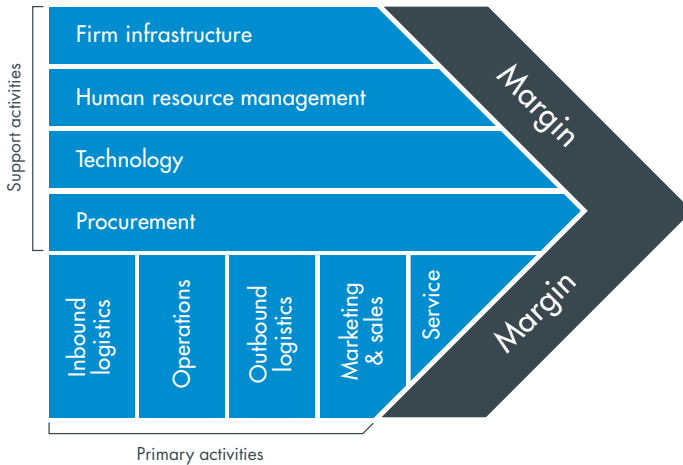
# VALUE CHAIN ANALYSIS

## What is it?

## PRACTICE

According to CIMA Official Terminology, the value chain is a sequence of business activities by which, in the perspective of the end-user, value is added to (or costs incurred by) the products or services produced by an entity.

Example of value chain analysis process



Value chain analysis is based on the principle that organisations exist to create value for their customers. In the analysis, the organisation's activities are divided into separate sets of activities that add value. The organisation can more effectively evaluate its internal capabilities by identifying and examining each of these activities. Each value-adding activity is considered to be a potential source of competitive advantage.

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The three steps for conducting a value chain analysis are:

1. **Separate the organisation's operations into primary and support activities**

Primary activities are those that physically create a product, as well as market the product, deliver the product to the customer and provide after-sales support. Support activities are those that facilitate the primary activities, for example, HR.

2. **Allocate cost to each activity**

Activity cost information provides managers with valuable insight into the internal capabilities of an organisation.

3. **Identify the activities critical to customer satisfaction and market success**

There are three important considerations in evaluating the role of each activity in the value chain:

- Company mission, influencing the choice of activities undertaken.
- Industry type, which influences the relative importance of activities. The value chain for a service industry, for example, will look very different from that of a manufacturing industry.
- Value system, including the value chains of an organisation's upstream and downstream partners in providing products to end-customers.

## **What benefits does Value Chain Analysis provide?**

Value chain analysis can help organisations to gain better understanding of key capabilities and identify areas for improvement. It can help them to understand how competitors create value; and help organisations to decide whether to extend or outsource particular activities.

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## Implementing Value Chain Analysis?

### Questions to consider:

- Can we identify our areas of activity easily?
- Can we identify the costs and benefits of each activity easily?
- How will we turn this analysis into competitive advantage?

#### ACTIONS TO TAKE/Dos

- Benchmark your activity processes against those of your competitors to identify how they create value.
- Focus on the links between each element of the value chain to better understand how value is created along the chain.

#### ACTIONS TO AVOID/Don'ts

- Value chain analysis focuses on the internal activities of the business – but don't forget the external view. What do your customers think?

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## VALUE CHAIN ANALYSIS IN PRACTICE

### The Nestlé Cocoa Plan

(Nestlé, 2013)

As part of their Creating Shared Value initiative, Nestlé carried out a value chain analysis to identify the areas of greatest potential for joint value optimisation with society. These activities (Nutrition, Water and Rural Development) are seen as core to business strategy and operations, and vital to the welfare of the people in the countries where they operate.

In October 2009 the £67m 'Cocoa Plan' was launched in the Côte d'Ivoire, with planned investment of £67m over a 10-year period. The initiative aims to help cocoa farmers to run profitable farms and improve quality of life for their families, while ensuring a sustainable and high-quality supply of cocoa in the long term. A focus on training, buying from co-operatives, eliminating child labour and working with the Fairtrade programme creates value, both for Nestlé and the farmers who supply them.

Further case studies can be found at:  
<http://www.nestle.com/csv/case-studies>

## Related and similar practices to consider

- Supply chain analysis
- Enterprise resource planning (ERP)
- Activity-based costing (ABC)
- Benchmarking

## Further resources

[cgma.org/essentialtools](http://cgma.org/essentialtools)

# CUSTOMER RELATIONSHIP MANAGEMENT (CRM)

## What is it?

## PRACTICE

CIMA Official Terminology describes customer relationship management as a culture, possibly supported by appropriate information systems, where an entity emphasises the interface between itself and its customers. Knowledge is shared, within the entity, to ensure that the customer receives a consistently high service level.

Many of the principles of customer relationship management can also be applied to supplier relationships.

## What benefits does CRM provide?

The focus on customer relationship management has become increasingly core to all organisations. Companies have increasingly recognised the significant costs related to the loss of customers and are trying to better understand, measure, manage and improve customer retention. CRM helps organisations examine how to measure and improve long-term customer lifetime value.

CRM software systems combine sales, marketing and customer service functions, with benefits including better understanding of buying habits, better identification of prospective customers, and increased customer satisfaction.

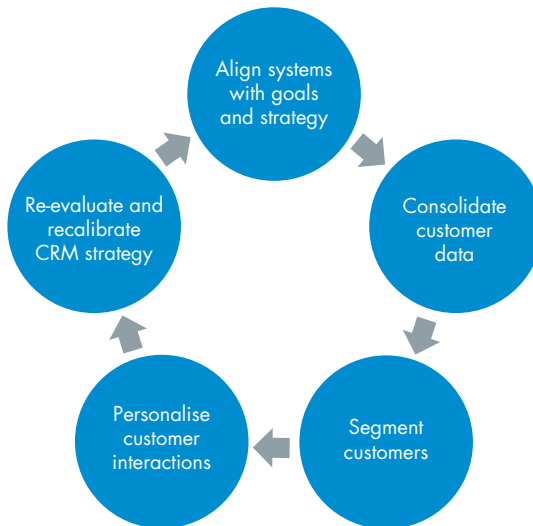
Increasingly, they are integrated with e-commerce systems, allowing businesses to build a detailed image of their customer or membership base. This leads to improvements in marketing, sales processes, customer services, analysis and reporting.

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A more recent development has seen businesses harnessing the power of social media. By monitoring what customers and target markets are saying about their products or services on their own or generic sites such as Twitter and Facebook, businesses can identify opportunities and areas for improvement. It is essential for businesses to consider the global impact of customer feedback.

The following diagram shows one approach to implementing CRM:

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Source: Adapted from the *CRM Excellence Model*, Best Practices 2001

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## Implementing CRM? Questions to consider:

- Does our business have a customer-focused culture?
  - How do/how will we measure customer satisfaction?
  - What are the long- and short-term objectives?
  - What does success look like?
  - What will we do with the information gathered?
-

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## ACTIONS TO TAKE/Dos

- Consider the impact that implementing CRM will have on staff, who may be wary of the new software.
- Plan and budget for staff training at the beginning of the process – do not allow cost over-runs in other areas to impact on this key area.

## ACTIONS TO AVOID/Don'ts

- Don't forget the importance of human contact in servicing your customers.
- Avoid placing value efficiency over customer satisfaction.
- Don't underestimate the potential of low-margin customers.

## CRM IN PRACTICE

### How Tesco and ASOS.com work with customer information

*(FM magazine, 2013)*

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Tesco processes information from two-thirds of the transactions at its tills to learn more about its customers' buying patterns in different stores and at different times of the day.

This wasn't always the case. When Sir Terry Leahy, who pioneered the use of big data in large-scale retail during his 14-year tenure as CEO of Tesco, arrived at the group, he found little in the way of sophisticated research.



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His introduction of the Clubcard – a reward card for customers – gave Tesco a high level of information on its customers and saw the group grow from being the third biggest retailer in the UK to the third biggest in the world.

“I was a little surprised, when I came into the business, how subjective it was – how people would make decisions on the basis of no information whatsoever,” says Sir Terry.

“The bar code came along in the 1980s and that revolutionised a lot of things. You were getting the beginnings of a database then on products, and then the big breakthrough was when you had enough computing power to gather customer information as well as product. It really did make a difference. The year the Clubcard was launched was the year we overtook Sainsbury’s to second place in the UK.”

Other retailers, such as online fashion house ASOS.com, which has quickly grown to a market capitalisation of £1.4bn, are reaping the rewards from using big data. “I’ve had every scrap of information about my customers since day one,” says ASOS.com chief executive Nick Robertson. “There was no bigger evidence of that than when we got caught up in the Buncefield fire at an oil depot in 2005. I had the names and addresses of every single customer who had placed orders so we were able to contact them to explain the situation. Once we were back, I emailed all the same customers again to say we had a bit of stock we needed to clear now because it’s a fire sale, come and shop. We got back on our growth trajectory as a result of having all that data.”

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## Related and similar practices to consider

- Customer profitability analysis (CPA)
- Supplier relationship management (SRM)
- CGMA customer value tool

## Further resources

**[cgma.org/essentialtools](https://www.cgma.org/essentialtools)**

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# Appendix

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