
Corporate Performance and Activity-Based Management: How the Best Companies Make Their Systems Work

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EXECUTIVE SUMMARY

- Many companies have begun using *activity-based costing* (ABC) and *activity-based management* (ABM) to improve their cost management systems.
- Studies about performance measurement systems and ABM can suggest methods the best companies used to reach their business goals. In particular, studies facilitated by the International Benchmarking Clearinghouse have identified best practices in both corporate performance measurement systems and ABM.
- Best practices identified include performance measurement systems with *fewer financial measures* and the *horizontal alignment of processes* through a balanced system of measures.
- Another best practice had to do with *participative* and *evolutionary* approaches to selecting performance measures.
- Leading-edge companies use their corporate performance measurement systems to track operations accurately and to balance their requirements for attaining continued profitability.

A few years ago, the International Benchmarking Clearinghouse, a service of the American Productivity & Quality Center (APQC), and the Consortium for Advanced Manufacturing-International (CAM-I) conducted a study of best practices in both *activity-based costing* (ABC) and *activity-based management* (ABM). Soon afterward, APQC also kicked off a *corporate perfor-*

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mance measures (CPM) study in conjunction with Carl Thor of Jarrett Thor International and 21 sponsoring organizations.

The ABM study represented the most comprehensive work undertaken in this emerging area; it had 60 sponsors, 15 best-practice companies, and 167 survey respondents. The goal of the study was to identify best practices in the installation, application, and use of ABM information systems.

OBJECTIVE OF THE CPM STUDY

A CPM system uses measures that top management chooses to help guide the company toward its goals. Because (as experience shows) what gets measured gets done, performance measures are essential to keeping a company financially healthy and strategically focused.

The objective of the CPM Benchmarking Consortium Study was to identify innovative and proven practices for developing, implementing, and evaluating performance measurement systems. This required investigating the following:

- Types of performance measures.
- Organizational alignment through performance measures.
- Management and use of performance measurements.

Participants identified ten "best-practice" companies worth studying because of their outstanding performance measurement practices.

FINDINGS OF THE CPM STUDY

Participants in the CPM study identified both long- and short-term benefits of effective CPM systems, including:

- Balancing the various needs of stakeholders.
- Aiding problem solving and decision making.
- Serving as an early indicator of long-term issues.
- Providing leading indicators of financial health and survival.

The following sections describe some of the other key findings from the CPM study.

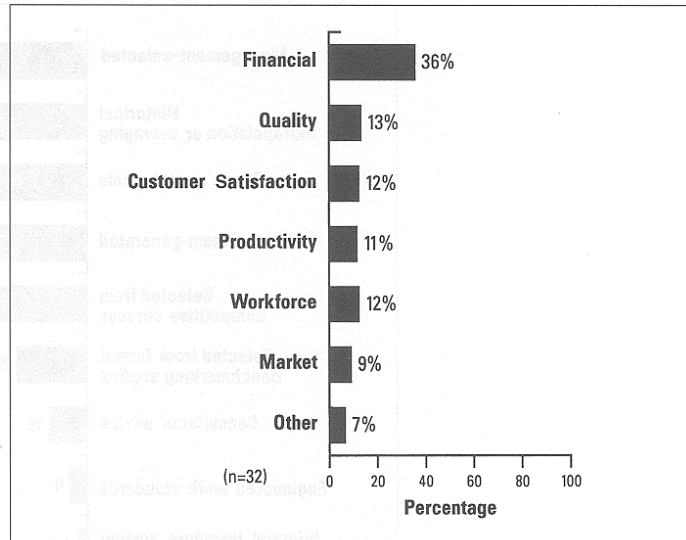
Types of Measures

The top five or six performance measures that CEOs use vary widely according to the type of organization. Although financial measures are used most often, CEOs also rely on measures of quality, customer satisfaction, and productivity (see Exhibit 1). Increasingly, however, companies are moving toward performance measurement systems that use fewer financial measures.

Alignment of Organizations Through Performance Measures

Leading companies align processes *horizontally* through a balanced system of measures. They also use more participative and evolutionary approaches in the selection of measures.

Exhibit 1. Measures Used by CEOs



Both sponsors of the study and best-practice companies also provided evidence of vertical alignment between their strategic plans and their performance measurement systems.

Management and Use of Measurement

Best-practice companies set goals for most of the CEOs' performance measures. As Exhibit 2 shows, the companies use a number of methods for setting goals.

Most top corporate performance measures are reviewed monthly. Best-practice companies select goals and performance measures for their systems in the knowledge that the goals and measures will both change and continuously improve as conditions change. People in a wide range of positions assume the roles of initiating, designing, leading, and administering the measurement system.

Communication

Communication at all levels is critical. Results of the studies suggest that relatively formal methods of communication are more effective than casual methods.

FINDINGS OF THE ABM STUDY

An ABC system traces costs to the products or services delivered to customers by tracking the activities performed (or consumed) to deliver those products or services. ABM, in turn, refers to the use of

Exhibit 2. Methods for Setting Goals



ABC to improve the business. The goals of ABM are to improve profits by providing value to customers efficiently and effectively.

The ABM best practices study produced deeper findings than the CPM study because of its narrower focus. These findings include several business models that best-practice companies use successfully.

ABM Best-Practices Model

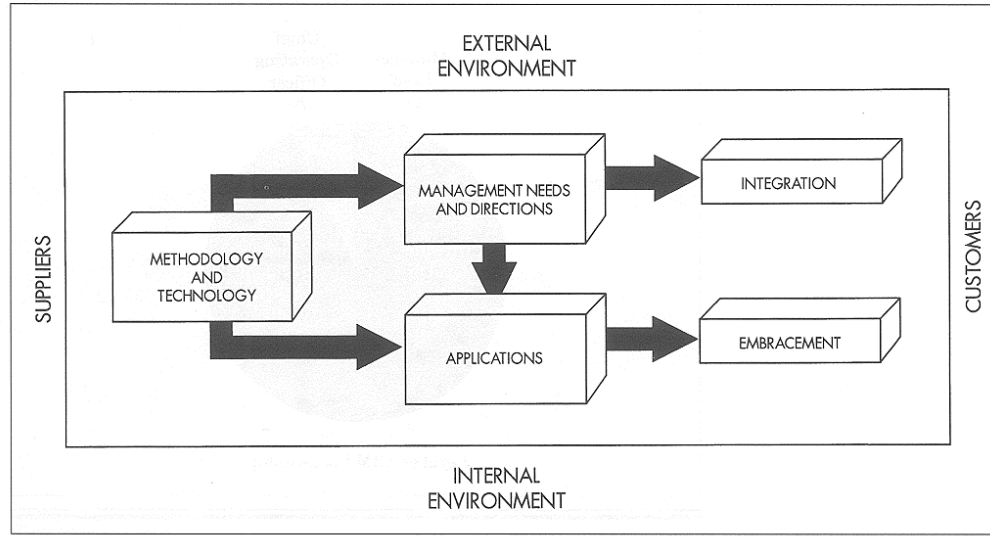
Development of a best-practices model for ABM (see Exhibit 3) is perhaps the most significant contribution of the ABM study. Widely used and frequently quoted, this model provides a structural framework for understanding best practices in the development, application, and use of ABM.

The model groups best practices around the following themes:

- Methodology and technology.
- Management needs and direction.
- Applications.
- Integration.
- Embracement.

The model makes an important distinction between best practices for *integration* and best practices for *embracement*.

Exhibit 3. ABM Best-Practice Model



The term “embracement” goes beyond integration and occurs when people who use the information take ownership. Best practices in this area include acceptance, accountability, and use of the information for self-monitoring.

The term “integration” refers to how well information is integrated with an existing financial and operating system, and also the ease of updating and maintaining the system. Integration also involves the issue of integrating the information system with the business itself—its strategies, goals, initiatives, and plans.

The term “embracement” goes beyond integration and occurs when people who use the information take ownership. Best practices in this area include acceptance, accountability, and use of the information for self-monitoring.

Since the release of the ABM Best-Practices Model, it has become an industry standard and has been cited frequently in articles, publications, and presentations.

ABM Value Cycle

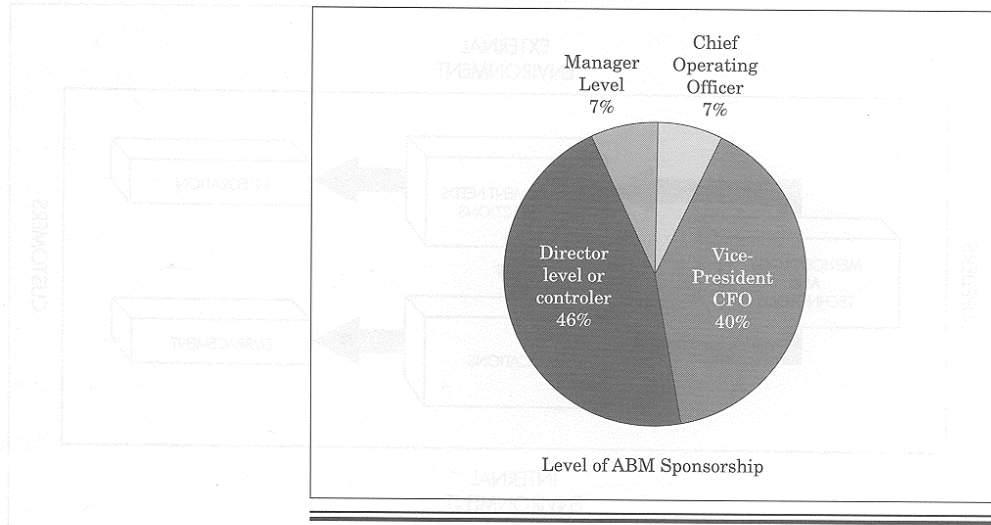
Another significant contribution of the ABM best-practice study was development of the ABM value cycle, which specifies 16 frequently used applications of ABM information.

The study consolidates the benefits and value of these applications into three areas:

- Process-related applications.
- Decision-making applications.
- Performance measurement applications.

Best-practice companies have learned that single and limited use of ABM information fails to capture the full value and potential of the

Exhibit 4. Level of ABM Sponsorship



information. Therefore, they consistently seek new applications for (or ways to use) ABM information.

Consistent Application of ABM Methodology

Best-practice companies consistently apply generally accepted ABM methods, procedures, terms, techniques, and practices. Usually the methods and techniques are adapted to the specific requirements of the best-practice companies.

Each organization studied insists on having a common "language" about ABM that everyone throughout the organization can understand. For example, the two-stage methodology for tracing costs in ABC is both well-known and well-understood. People must also clearly understand the distinction between ABC and ABM.

Management Commitment and Priority

The commitment and support of an organization's top leaders were critical success factors for ABM implementations at the best-practice companies. As Exhibit 4 shows, ABM projects are commonly sponsored at top management levels.

Out of 15 best-practice companies, 13 identify the commitment to ABM of senior management as either a high or a top priority. The ABM initiatives at each of these companies have high visibility and are important to the success of the organization.

At best-practice companies, management demonstrates its commitment to ABM not only by words but also by committing the resources needed. Indicators of management's commitment include

willingness to sponsor training, involvement by operational and other top managers, and the percentage of employees involved in an ABM implementation.

Cost-Efficient, Reliable, and User-Friendly Systems

Best-practice companies place significant emphasis on installing the systems, procedures, and methods necessary to collect and report activity-based information regularly. The frequency of ABM reporting ranges from continuous and real-time reporting to periodic reporting (quarterly or yearly). Usually, however, the reporting period is monthly.

Organizations that use ABM information for process improvement, cost control, operational performance, and day-to-day operational decision making tend to report ABM information more frequently and in more detail. Best-practice companies that use ABM information in more strategic applications (for example, for product costing and customer profitability analyses) report ABM information less frequently. Either way, the systems, procedures, and methods chosen must be responsive to the needs of the users, easy to update and maintain, reliable, and cost-efficient.

Cultures That Support Change

Best-practice companies manage their internal environments by nurturing a culture that supports change. Teamwork, trust, and a common vision were evident at each of the best-practice companies. While the best-practice companies acknowledge that external factors were often what caused them to implement ABM, each was willing to embrace change and meet the challenge posed by the external environment.

For example, best-practice companies position ABM as a business analysis tool that serves as an enabler for decision making and process improvement. These companies use ABM to address the entire value chain for their products and services. They work with suppliers to support product development and reductions in total costs of parts. They work with customers to support product development and reductions in customer support costs.

ABM AS AN EMERGING MANAGEMENT TOOL

Each best-practice company indicated that it had not fully implemented ABM—and had a long way to go. The important lesson is that organizations must continue to experiment and improve their understanding and use of ABM and similar management tools.

Methodology

Primary and secondary research were both used to select the ten best-practice companies for the CPM study. Additional information came from the study's subject-matter expert and from the sponsor companies. The study team for both the CPM and ABM studies collected data by using questionnaires and interviews during site visits.

As part of the study on ABM, participants in the study attempted to identify all known ABM implementations undertaken in North America. The consortium invited more than 750 of the more than 3,000 organizations identified to participate in a detailed survey designed to identify best practices in ABM. Only organizations that had achieved positive results from ABM efforts were asked to complete the survey. Overall, 167 companies returned qualified responses.

Based on survey responses, ABM study participants identified 40 companies as best-practice sites in ABM, 15 of which participated and hosted site visits. Criteria for selection of best-practice organizations included maturity of installation, scale of coverage, scope of application, results attained, and anticipated learning opportunities.

SUMMARY

The CPM study sought to identify innovative practices in the development and deployment of performance measurements, which is critical for running a quality organization. When the ABM best-practice study began, the goal was to create a pioneering work that would pave the way for organizations that choose to implement ABM. Participants in both studies were generally satisfied that they had met their goals.

Although some of the results and findings from the studies are proprietary, 11 of the best-practice companies identified in the ABM Best-Practice study agreed to release profiles of their ABM efforts, which are available in the final report from the study. These companies are:

- Axiom Corp.
- Deere & Co.
- Delco Electronics.
- Electronic Data Systems (EDS) Strategic Support Unit.
- First Tennessee Bank.
- GM-Service Parts Operations.
- IBM Corp.
- Parker Hannifin Compumotor Division.
- PCS Health Systems, Inc.
- United Technologies Corporation–Carrier.
- Valvoline Company.

The report on the CPM study also includes profiles of the best-practice companies, including:

- Corning.
- Gates Rubber Co.
- Harford Systems–Duracool Division.
- Honeywell MICRO SWITCH Division.
- McDonald's.
- Sara Lee Knit Products.

- Tenneco Gas.
- Texas Instruments, DSEG.
- United Parcel Service.
- USAA.

Final reports from these consortium benchmarking studies can be purchased from APQC. The *ABM Final Report* is available for \$195 for members of the International Benchmarking Clearinghouse and \$295 for nonmembers. The *CPM Final Report* is available for \$195 for Clearinghouse members and \$295 for nonmembers. For a complete listing of benchmarking final reports or to view executive summaries from these studies, visit the APQC Web site at www.apqc.org. To purchase either of these reports, call APQC at either (800) 776-9676 or (713) 681-4020, or email them at apqcinfo@apqc.org. ♦