ENTERPRISE PERFORMANCE MANAGEMENT: Tools and Techniques

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(E Content meant for MBA IV Semester, Enterprise Performance Management)

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Overview of Management Control

RESPONSIBILITY CENTERS

ENGINEERED EXPENSE CENTER

DISCRETIONARY EXPENSE CENTER

REVENUE CENTER

PROFIT CENTER

INVESTMENT CENTER

Responsibility Center

- A Responsibility center is an organization unit that is headed by a manager who is responsible for its activities
- Responsibility center is entrusted with control over costs, revenues and investment funds
- It is the lowest organizational level where funds control functions are carried out
- Each Responsibility center consumes certain (monetary) resources as inputs and its activities result in specific outputs (monetary as well as non monetary)
- Performance of a Responsibility depends on the relationship between inputs consumed and outputs produced

RESPONSIBILITY CENTERS AND THEIR CHARACTERISTICS

ENGINEERED EXPENSE CENTER

OPTIMAL RELATIONSHIP CAN BE ESTABLISHED BETWEEN INPUTS (DOLLAR) AND OUTPUTS (PHYSICAL UNITS)

NO CONTROL OVER REVENUE OR INVESTMENT LEVELS

RIGHT TO DECIDE INPUT MIX

PERFORMANCE ASSESSED THROUGH COST BUDGETS

MANUFACTURING FUNCTIONS

DISCRETIONARY EXPENSE CENTER

OPTIMAL RELATIONSHIP CAN NOT BE ESTABLISHED BETWEEN INPUTS (DOLLAR) AND OUTPUTS (PHYSICAL UNITS)

NO CONTRL OVER OUTPUTS

DIFFICULT TO ASSESS THE PERFORMANCE

INCREMENTAL AND ZERO BASE BUDGETING

RESEARCH AND DEVELOPMENT FUNCTIONS, STAFF FUNCTIONS

REVENUE CENTERS

INPUTS (COSTS DIRECTLY INCURRED) NOT RELATED TO OUTPUTS (REVENUE)

NO AUTHORITY TO DECIDE PRICE

CONTROL EXECUTED THROUGH REVENUE BUDGETS

MARKETING FUNCTIONS

RESPONSIBILITY CENTERS AND THEIR CHARACTERISTICS

PROFIT CENTER

INPUTS (DOLLARS) ARE REALTED TO OUTPUT (DOLLARS)

RIGHT TO CONTROL INPUT MIX, PRODUCT MIX AND PRICE

PERFORMANCE ASSESSED THROUGH ACTUAL PROFIT AGAINST BUDGETED PROFITS

THESE CENTERS ENJOY THE MAXIMUM AUTONOMY

BUSINESS UNITS AND DIVISIONS

INVESTMENT CENTERS

PROFITS ARE RELATED TO CAPITAL EMPLOYED

RIGHT TO CONTROL INPUTS (LABOUR, MATERIAL,SUPPLIES,TECHNOLOGY)

RIGHT TO CONTROL SELLING PRICE,PRODUCT MIX AND CAPITAL INVESTMENT

PERFORMANCE ASSESSED THROUGH BUDGETED ROI, BUDGETED ECONOMIC VALUE ADDED (EVA),ROCA, ROE, DUPONT ANALYSIS

BUSINESS UNITS AND DIVISIONS

MEASURING PERFORMANCE OF ASSETS EMPLOYED

ROI

= (NET RETURN ON INVESTMENT /COST OF INVESTMENT) X 100 %

ECONOMIC VALUE ADDED (EVA)

= NOPAT ADJUSTED FOR CAPITAL CHARGE

= NOPAT – (TOTAL ASSETS –CURRENT LIABILITIES) X WACC

THIS IS THE RESIDUAL INCOME THAT ADDS VALUE TO THE FIRM

ECONOMIC VALUE ADDED (EVA) vs ROI

WHY EVA IS OPERATIONALLY SUPERIOR TO ROI?

- ALL BUSINESS UNITS HAVE THE SAME PROFIT OBJECTIVE FOR COMPARABLE INVESTMENTS
- DECISIONS THAT *INCREASE* A CENTER’S ROI MAY *DECREASE* ITS OVERALL PROFITS
- DIFFERENT INTEREST RATES (CAPITAL CHARGE) MAY BE APPLIED ON DIFFERENT TYPES OF ASSETS

DU PONT ANALYSIS

RETURN ON EQUITY)ROE

= NET PROFIT/EQUITY

= (NET PROFIT/SALES)

X (SALES/ASSETS)

X (ASSETS/EQUITY)

ROE

= NET PROFIT MARGIN (=EBIT - I {1-T})

X RETURN ON ASSETS

X FINANCIAL LEVERAGE

AN ILLUSTRATION (DU PONT ANALYSIS)

	ABC CORP		XYZ CORP	(INR ,000)
	YEAR 1	YEAR2	YEAR1	YEAR2
NET INCOME	1000	1200	2100	2100
REVENUE	10,000	10,000	17,500	17,500
PROFIT MARGIN	0.1	0.12	0.12	0.12
REVENUE	10,000	10,000	17,500	17,500
AVERAGE ASSETS	5,000	4,800	8,750	8,750
ASSET TURNOVER	2.0	2.08	2.0	2.0
AVERAGE ASSETS	5,000	4,800	8,750	8,750
AVERAGE EQUITY	2,000	2,000	5,000	3,500
FINANCIAL	2.5	2.4	1.75	2.5

Du Pont Analysis Continued

Return on Equity (ROE) ,when decomposed , gives various ratios useful for fundamental analysis of companies:

ROE = Net Profit/Equity

= Net Profit/Pretax Profit

x Pretax Profit/ EBIT

x EBIT/ Sales

x Sales/ Assets

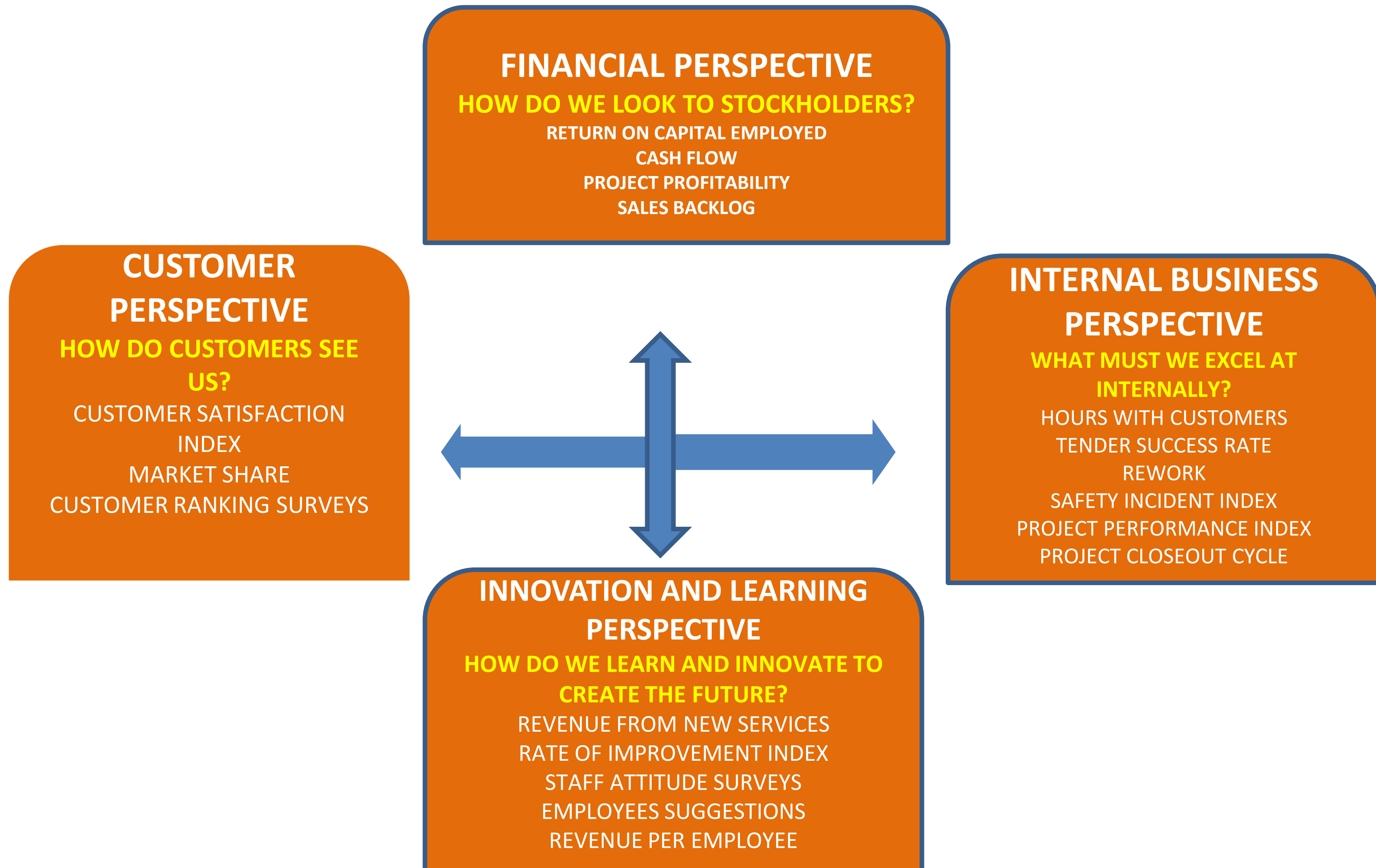
x Assets/ Equity

BALANCED SCORECARD

(**Robert S Kaplan and David P Norton, 1992**)

- It is a Performance Measurement System
- It is a tool to augment goal congruence
- Helps in setting organizational objectives
- Provides feed back on Strategy formulation and on its Implementation
- Indicates how non financial measures affect long term financial results of the company
- Tries to blend diverse strategic measures:
  - **Outcome and Driver Measures**
  - **Financial and Non financial measures**
  - **Internal and External Measures**

BALANCED SCORECARD



IMPLEMENTING BALANCED SCORECARD

- DEFINE STRATEGY
- DEFINE MEASURES OF STRATEGY
- INTEGRATE MEASURES INTO THE MANAGEMENT SYSTEM
- REVIEW MEASURES AND RESULTS FREQUENTLY

Balanced Scorecard: Pitfalls and Limitations

- Poor correlation between nonfinancial measures and their consequences
- Measures are not updated and reviewed
- Sometimes difficult to figure out proper trade offs
- Measurement Overload
- BS poorly tied to Incentive Programmes
- ‘*Stretch Goals*’ not achieved if the company has no mechanism for improvement