

PERFORMANCE LEADERSHIP SERIES

# WHAT IS THE BEST METHODOLOGY? GETTING TO DOUBLE-LOOP LEARNING

**FROM BEST PRACTICES TO NEXT PRACTICES:  
SECOND IN A FOUR PART SERIES**

by Frank Buytendijk, Beingfrank Research  
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## ABOUT THE SERIES

In a series of papers, author and industry expert Frank Buytendijk examines the people side of business performance and business intelligence. How does measurement affect human behavior? How does organizational culture contribute to business intelligence? What does a rational decision making process look like? Which number games do we recognize in business? What is the best methodology to manage business performance? In this second article of a series on how measurement drives behavior, Frank discusses how to determine what measurement methodology fits your requirements best .

## ABOUT THE AUTHOR

Frank Buytendijk (Beingfrank Research) is a well-known industry expert specialized in strategy, performance management and organizational behavior. He is an exceptional speaker at conferences all over the world, known for his out-of-the-box, entertaining and slightly provocative style. Frank is also a TDWI fellow, a visiting fellow at Cranfield University School of Management, and author of various books, including "Performance Leadership" (McGraw-Hill, September 2008), "Dealing with Dilemmas" (Wiley & Sons, August 2010) and "Socrates Reloaded: The Case of Ethics in Business and Technology" (Beingfrank Publications, September 2012). Follow Frank on Twitter at @FrankBuytendijk or visit [www.frankbuytendijk.com](http://www.frankbuytendijk.com).

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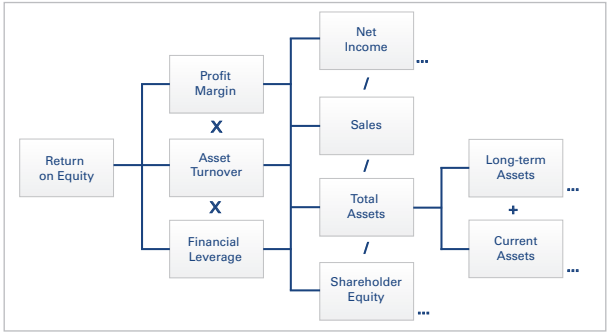
<sup>1</sup>The content of this paper is based on Buytendijk, F.A., 2010, "Performance Leadership," McGraw-Hill, United States

There are many measurement methodologies. Some have a background in finance and control, like DuPont ratio analysis, value-based management and budgeting. Others are rooted in operations, like activity-based management and six-sigma. CSF (critical success factors), the Balanced Scorecard and Performance Prism come from the field of strategy. Most methodologies are related, they have been developed over time as a reaction to each other, and to complement each other.

All performance management methodologies have one thing in common. They are based on the concept of “double loop learning.” In single-loop learning, people and organizations take action according to the difference between expected and obtained outcomes; in other words, it is a simple variance analysis. In double-loop learning, you question the values, assumptions, and policies that led to your actions in the first place. If you are able to view and modify those, then double-loop learning is taking place. In more compact terms, double-loop learning is learning how you learn.

DUPONT RATIO ANALYSIS AND ECONOMIC VALUE ADDED

Key performance indicators have their roots in DuPont ratio analysis. In 1919, one of the financial executives at DuPont, founded in 1802 as a gun powder mill and now one of the largest science companies in the world, came up with the DuPont ratio analysis. This analysis uses a financial performance indicator called return on equity.



Return on equity tells a story of success today (profitability) and success tomorrow (potential growth).

It describes, through a tree of calculations, the drivers for return on equity. The profit margin is of course the element that drives profitability. Asset turnover describes how effectively a company converts its assets into sales; this has an impact on the potential growth of the company (how fast the engine is running).

However, ROE doesn't tell you what decision to take. This is where the economic value added (EVA) formula comes in, a more modern view. This measure aims to capture the economic profit of an enterprise and to describe creation of shareholder wealth over time. EVA explains to business managers on all levels that capital is not for free and should be applied to activities that at least provide a higher return than the cost of capital, forcing focus on creating value. Business unit plans, investment proposals, and even some projects can be evaluated based on their contribution to the net operating profit and their expected return. But EVA doesn't give guidance on how to create the highest return. You would need a more operationally focused methodology to help you figure out how to get there.

ACTIVITY-BASED MANAGEMENT

Activity-based management (ABM) aligns activities, resources, and financial results. Financial results are achieved by selling products and services that are produced through certain activities. Activities, in turn, are fueled by resources. The principles of ABC can be applied to areas broader than cost accounting. For instance, most organizations today are concerned with customer, product or channel profitability. And increasingly there is an interest in dynamic pricing, as pioneered by hotels and airlines. ABC helps to set a profitable price for each and every individual transaction. As valuable as this is, ABM doesn't you anything about your strategy however..

CRITICAL SUCCESS FACTORS AND BALANCED SCORECARD

A huge step forward in turning strategy into performance came from the concept of critical success factors9 (CSFs), originating in the 1960s.

CSFs are the few key areas where “things must go right” for the business to flourish and for its goals to be attained. As a rule of thumb, an organization (or part of an organization) should have three to five critical success factors, each perhaps with three to five key performance indicators. They allow managers to discuss how to deploy the limited amount of resources an organization has, and allocate them to the activities that really make the difference between success and failure. But how do we know where to look for those CSFs and KPIs?

The balanced scorecard, developed by Kaplan and Norton, is a framework to describe an organization’s strategy and to provide feedback as to its effectiveness.

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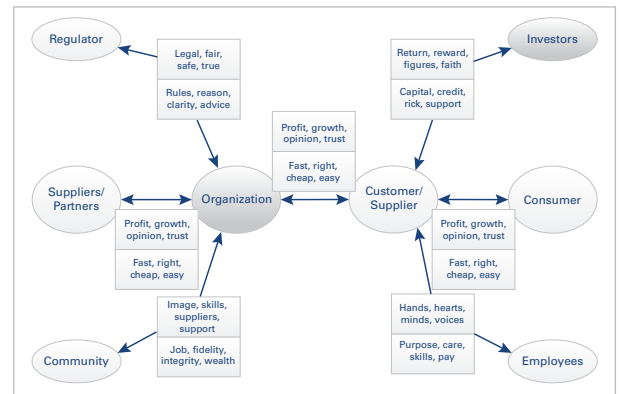
The key message of the balanced scorecard is that the performance of an organization should be structurally viewed from four perspectives:

- Financial perspective: How are we perceived by our shareholders?
- Customerperspective: How do our customers look at us?
- Process perspective: How effective and efficient are our business processes?
- Learning/growth perspective: How able are we to learn and adapt?

One of the reasons why the balanced scorecard is such a recognizable tool is that it describes something fundamental, regardless of the industry or geographic location in which you are situated. In order to be successful and have a healthy bottom line, you need to have your shop in order and keep your customers happy. And to make sure it stays that way, you need to adapt to changes in your environment.

## THE PERFORMANCE PRISM

The balanced scorecard is often criticized for only recognizing customers and shareholders as vital stakeholders. The Performance Prism is a lesser-known methodology that sets out to solve that. This methodology describes in great detail what stakeholders expect from each other. With this in mind, it triggers the right strategic discussion. By understanding different stakeholder objectives, we can find a solution to reconcile these differences, which probably will lead to much smarter strategies than optimizing a single set of objectives.



## BEYOND BUDGETING

SSo far I didn't mention budgeting, the most commonly used (and most hated) performance management instrument of all.

The beyond-budgeting model offers the most radical alternative. Its proponents argue convincingly that the practice of budgeting may have worked in the industrial era where business was predictable, but that a modern business is much more decentralized and networked than the traditional hierarchical organization. Instead of an annual budget, beyond budgeting proposes a process of continuous updates, a so-called rolling forecast. If an initiative has a clear business case that realistically predicts a profitable outcome, a lack of budget may never be the reason for not doing it. “Blowing the budget,” (a bad thing) is replaced by “blowing the forecast” (a good thing). The targets are set in aspirational terms, building a sense of urgency

and a “can do” mentality.

Of course, a benchmark for performance is needed. There is no fixed budget with which to compare performance, but rather a dynamic ranking of regions, offices, sales people, projects, and so on. Also, a company peer group comparison is important to make sure your company not only did better than previously, but also better than the market. Although adopting the beyond-budgeting model fully might be too radical an approach for many organizations, it is important to understand the basics and how they relate to your budgeting mechanism.

### SO, WHAT IS THE BEST METHODOLOGY?

For every success story for each measurement methodology, there are multiple examples of projects that have failed or did not deliver to the desired extent. The conclusion is obvious: There is no direct link between bottom-line performance and implementation of a specific methodology. It is not a specific methodology that improves performance, but people's actions and their behaviors.

Any methodology can work, as long as it is a shared methodology and as long as you stick with it. Many times I have heard remarks like: “Yes, we tried to implement the balanced scorecard, but we dropped it after three months. It didn't work.” And indeed it didn't work, nor would any other methodology. It takes time to learn how to use a framework.

The most important goal of the various methodologies is to spark a discussion:

- Once a cost price is calculated, ABC tells a story on how the costs were accumulated and provides a way to verify the assumptions that managers have when driving costs down or pricing the products and services. That insight is invaluable.
- EVA should be used to clarify assumptions and discussions among the management team and other stakeholders. Even the “objective” financial numbers are based on assumptions. Depreciation

is a guess, the weights of the cost of capital are subjective, and the various reserves on the balance sheet used to calculate the total invested capital are likewise based on subjective decision making.

- Beyond budgeting is totally structured around discussing the right investment proposals, as it is a zero-based plan approach.
- The balanced scorecard forces us to discuss how to align our business and create a strategy map with cause-and-effect relationships. Links in a strategy map are not a tool for command and control, but an instrument for communication and collaboration. It drives management toward collaborative behavior.

The best methodology for your specific organization is the one that feels the most comfortable. Choose the one that matches the scope of what you are trying to measure best, such as operations or finance. All the better if that also reflects the background of your company, or management team. Or the opposite: a methodology that helps the management team create a deep understanding of an area that is less familiar to them. And stick with it. However, once you have the feeling you master the methodology, there is nothing against fusing in elements of other methodologies that you feel complement what you have discovered to be less developed in the methodology you use. No one says that's forbidden! Performance measurement should fit the organization like a tailored suit. ♦

**READ THE WHOLE SERIES:**

*How Measurement Drives Behavior.* In this introductory paper to a four-part series, author and industry expert Frank Buytendijk examines the people side of business performance and business intelligence.

1. *Fact-based decision-making, or is it?* Take a close look at the process of decision making to ensure a rational, appropriate process is applied.
2. **What is the best methodology? Getting to double-loop learning.** Understanding the right measurement methodology is essential to achieving your requirements.
3. *Number games: making sure metrics drive the right behavior.* Why it's important to use measurements that incent actions that benefit the organization as a whole.
4. *It's the culture, stupid!* Unless measurements are linked to an organization's culture, the effect will be lost.