

Understanding Your Company's Performance Architecture

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Responsible Management Practice

We all want to be able to say with some degree of confidence that a given action will produce a given result. Conversely, we also want to be able to say that a given result requires a certain action. Our success depends on being able to identify and make use of the connections between the results we seek and the resources at our disposal. These connections are to be found in what is called an organization's "performance architecture." This post defines and briefly explains the three domains of performance making up a company's performance architecture.

Performance Architecture

The three domains of performance are listed below (see Figure 1):

- Financial
- Operational
- Behavioral

The numbered tabs in Figure 1 represent linkages between the domains.

Each domain of performance has a different structure.

Mapping an organization's performance architecture creates a roadmap for realizing results. A brief discussion of these three domains follows.

Financial Domain

The structure of the financial domain is mathematical in nature; it is concerned with counted and calculated values (e.g., profit).

The financial domain of a company is defined by its chart of accounts, its accounting systems and the measures of financial performance that are used. The high-level structure of one measure of for-profit business performance – ROE or Return on Equity – is shown in Figure 2.

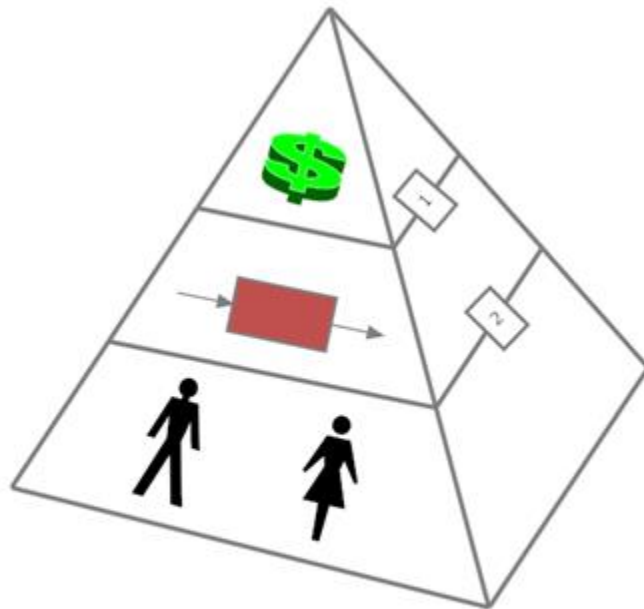


Figure 1 - The Performance Pyramid



Figure 2 - High-Level Structure of ROE

The financial measures used vary from organization to organization. In one company, Profit as a percent of Sales might be an important measure; in another, that measure doesn't get much attention but Return on Assets Managed does. A capital-intensive manufacturing organization might be very interested in Return on Invested Capital (ROIC). But professional services firms (e.g., lawyers and consultants) are more likely to be interested in measures of income as well as the profitability of clients and engagements. Publicly traded stock companies might pay attention to earnings per

share but that measure is meaningless with respect to a non-profit company. In non-profit organizations retained earnings takes the place of profit and, in turn, contributes to the non-profit's invested reserves. All organizations use financial measures as gauges of their financial performance.

Tab 1 in the Performance Pyramid (Figure 1) refers to the linkages between the organization's financial performance and its operational performance. The organization's chart of accounts, revenue booking, cost allocation mechanisms and financial reports are the best starting points for identifying the linkages between financial and operational performance. The basic task is a matter of selecting a measure and then analyzing its mathematical structure. Carry this analysis deep enough and, sooner or later, financial measures tie to operational variables. Figure 3 shows several levels of detail in the structure of Return on Equity. A sweeping new ad campaign could drive up selling expense and operating expense.

The linkages between financial and operational performance are found in the low-level details of the structure of key financial measures. In Figure 3, arrows point to Cost of Sales and Operating Expense. Further decomposition of these variables would lead through the organization's chart of accounts and cost accounting system into its operational structures and processes. Cost of Sales ties to Manufacturing Labor Cost and that in turn might well tie to overtime hours which in turn



Figure 3 - Detailed View of Return on Equity

could tie to a poorly designed process (or poorly trained people).

Operational Domain

The structure of the operational domain is physical in nature; it is concerned with stocks and flows, with systems of production, distribution and the like. The operational domain takes the form of processes.

The operational domain consists of two basic kinds of processes: *transformation* and *transaction* processes. Transformation processes convert organizational inputs into outputs (e.g., raw materials into finished products). Transaction processes focus on exchanging organizational outputs for new inputs (e.g., selling finished products or services to customers and using the monies received from customers to

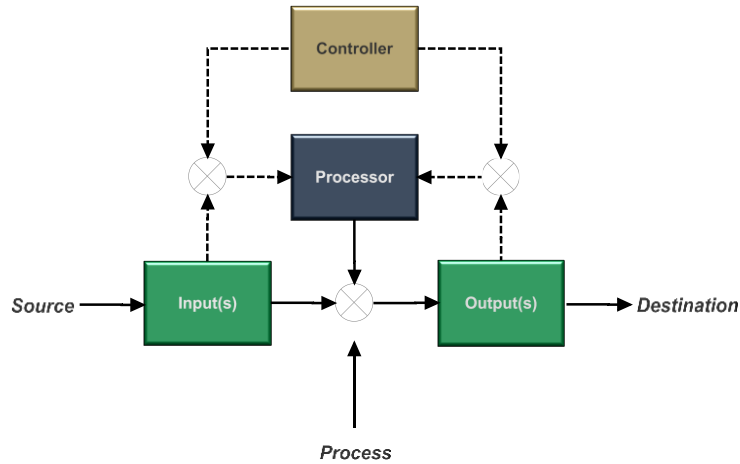
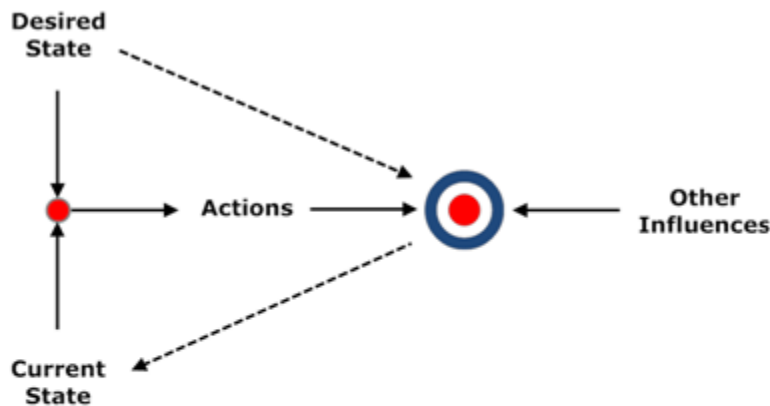


Figure 4 - Work and Work Control System

purchase more materials from suppliers.). Both categories can be viewed as work systems that accomplish the output production and the input acquisition work of the organization. The basic structure of a work system is depicted in Figure 4. It shows that inputs are transformed into outputs as a consequence of interactions between those inputs and the system’s processor (which might be a machine or a human being). Control is exercised over outputs and inputs via feedback loops.



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Figure 5 – The Target Model

Behavioral Domain

The structure of the behavioral domain is concerned with the factors that determine human behavior and performance.

This is the domain of human behavior and performance. Because people in organizations are there to accomplish the work of the organization, be it output production or input acquisition, two models are useful here. First, the work system model (Figure 4) can be used to examine work processes in which the “processor” is a person. Second, a

model that depicts people as purposeful, goal-oriented actors also proves useful when the behavior and performance of people are of central interest. The Target model in Figure 5 is a closed-loop, feedback-controlled model. (A special post will be devoted to examining this model in more detail.)

Tab 2 in the Performance Pyramid (Figure 1) refers to the links between the operational and behavioral domains. People in organizations are process participants; they do work and thus their work products and actions feed directly into the organization's processes. In many cases, people *are* the processors.

Conclusion

In organizations, the ends we seek and the means at our disposal are linked through at least three different yet related domains of performance: financial, operational and behavioral. Being able to map and trace our way through the various structures comprising this architecture makes the probability of identifying effective actions much higher than would otherwise be the case.

***About the Author:** My name is Fred Nickols. I am a writer, an independent consultant and a former executive. Visual aids of one kind or another have played a central role in my work for many years. My goals in writing for SmartDraw's Working Smarter blog are to: (1) provide you with some first-rate content you can't get anywhere else, (2) illustrate how important good visuals can be in communicating such content and (3) illustrate also the critical role visuals can play in solving the kinds of problems we encounter in the workplace. I encourage you to comment on my posts and to contact me directly if you want to pursue a more in-depth discussion. I can be reached via email at fred@nickols.us.*

