Performance Measurement: Understanding Critical Success Factors

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Strategic planning and performance management are of significant importance to the survival of today's businesses. From small businesses to multinational, Fortune 500 companies, these factors are critical to their operational success.

This series of articles will outline a number of best practices for the implementation of strategic planning and performance management. The best practices will cover four primary initiatives: critical success factors, key performance indicators (KPIs), dashboards, and balanced scorecards.

Unfortunately, forward progress on these initiatives is often hindered by excessive debate concerning what they entail and how they should be carried out. In an effort to clarify some of this confusion, these articles will attempt to present an in-depth analysis of each initiative, as well as clarifying their roles in the overall strategic planning and performance measurement process.

What Are Critical Success Factors?
This piece will focus on the first of these initiatives, critical success factors. Critical success factors are defined as a group of indispensible activities or elements that enable an organization to achieve its stated objectives, thereby ensuring the successful performance of both current and future operations.

While some critical success factors may be relevant to only one business perspective, others may actually apply to more than one. For example, a product recall may affect both customer satisfaction and financial performance.

In such cases, critical success factors that impact multiple perspectives are more "core" in nature than those that apply to only one perspective.

Why Are Critical Success Factors Necessary?
Critical success factors are integral to the achievement of company goals. Without such factors, businesses have no roadmap by which to navigate their operations. Lacking guidance, senior leadership will find controlling the organization more challenging as priorities change with the wind to put out the latest fire. It is therefore of crucial importance that such factors allow senior leadership to commit to the highest priority events needed to pursue strategic objectives, as well as utilize methods of accountability and metrics for gauging success so as to better apply corrective actions.

In conjunction with the other three best-practice initiatives, critical success factors can also ensure that company vision and mission statements are translated into actionable strategies. In addition, these initiatives clearly identify strategies and goals that can be delegated to successively lower levels of the organization so that personnel at all levels may focus on appropriately prioritized day-to-day activities. Such focus brings a much tighter linkage between strategic intent and the operational performance required to achieve goals and objectives.

How Do You Develop Critical Success Factors?
Critical success factors can be created through just a few simple steps. First and foremost, it is important to obtain executive sponsorship for your project. This generally also includes assembling a critical success factor team, with members from the right stakeholder groups, such as the board, executive management, middle management, staff, customers, suppliers, and partners. The critical

success factor team's mission is to identify the critical success factors that are most important to achieving the objectives identified in the strategic plan.

The identification of critical success factors should begin with an analysis of the business's strengths, weaknesses, opportunities, and threats (SWOT).Then, look for any factors that are interrelated with, or have a significant impact on, other areas of the business. From these, identify and refine just five to ten key critical success factors.

In the next stage, align these five to ten critical success factors with four to five core business areas or "perspectives." Such areas might include finance, operations, sales and marketing, or customer satisfaction, to name a few. It is also sometimes useful to generate relationship maps for each strategic critical success factor to determine which ones have the greatest number of relationships.

Finally, determine what metrics are being reported on currently and identify what additional metrics are needed for measuring your factors. Then summarize, report on, and distribute the critical success factors throughout the organization.

Examples of Critical Success Factors in Action

Here are common examples of critical success factors to demonstrate how this strategy may be developed and aligned within the four initiatives. These particular critical success factors would be relevant to a manufacturing company.

First, a manufacturing company might list maintaining ample inventory levels to ensure line fill rates remain at or above 99.5% as a critical success factor. Line fill rate measures the number of pick list items that are successfully pulled when a pick list is issued to Distribution. Thus, a 99.5% line fill rate means that 0.5% of all line items will be placed on backorder.

Another example of a common critical success factor would be, as part of a plan required to generate cash for a new product launch, improve inventory turns 10%, from 3.0 turns per year to 3.3 turns per year by fiscal year end. Inventory turns generally measure how many times inventory is replaced per year. It is calculated by dividing the total cost of goods for a year by the current inventory balance. As of the previous year end our hypothetical manufacturing company incurred $6.0 million in cost of sales and held $2.0 million in total inventory, yielding 3.0 in turns ($6.0m COS / $2.0m Inventory = 3.0 turns). In order to get to 3.3 in turns for this year, at the same cost of goods, the total inventory would have to decrease by $0.2 million, resulting in a total inventory of $1.8 million. It is also useful to note that having an inventory turn target provides a check and balance to the line fill rate in that the two goals are diametrically opposed with respect to inventory management. That is, the company needs to maintain high fill line rates while not allowing inventory to build up as a way to achieve the goal.

In Summary

Identification of critical success factors is a precursor to developing key performance indicators, the measurements that quantify objectives and support assessment. In summary, critical success factors:

- Are indispensible to the achievement of an organization's stated objectives.
- Are necessary for the development of a successful roadmap by which senior management may gauge success and apply appropriate corrective actions.
- May be achieved by identifying company goals, conducting a SWOT analysis, and applying necessary metrics.

If you feel unable to complete this process internally, it can sometimes be helpful to consult an outside service provider. Outside professionals can offer an objective, expert perspective that can often not be found within the company.

The next article in the series will focus on key performance indicators (KPIs) and the process required to create them.

About CFO Edge
CFO Edge, LLC is a leading Southern California provider of outsourced CFO services. Based in Los Angeles, we are a group of experienced chief financial officers who engage with CEOs and CFOs on demand to address strategic planning, business management, and day-to-day financial operations challenges. Our seasoned professionals deliver services as interim CFOs, part-time CFOs, project-based CFOs, recruitment-to-permanent CFOs and interim-to-permanent CFOs. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 626.683.8840.

About Resource Planning Solutions
Chase Morrison is the Managing Director for Resource Planning Solutions Corporation. As the firm's Chief Financial Consultant, he combines extensive experience as a director of financial planning and analysis with his passion and knowledge for innovative IT solutions. While much of his career has been working with Fortune 500 companies, Mr. Morrison is now focused on using those same performance management tools to help small-to-mid-sized companies, mostly in the manufacturing and distribution industries. For more information, visit www.rpscgi.com or call 818.436.0781.