

THE MEASURE NETWORK

VALUE-LINKED MEASUREMENT AT DELL

Gregory Reilly and Christopher M. DeRose

The adage "You get what you pay for" is one that business people across the globe readily concede is true. After all, countless studies have demonstrated that reward systems are directly linked to how employees behave and the quality of the work they do. Most business people are also savvy enough to know that dollars, euros, or yen alone do not drive behavior.

GREGORY P. REILLY is a founding partner of Measure.net—The Business Performance Measurement Company. Measure.net works with business organizations to help them to better understand and further enhance their performance measurement capabilities. Mr. Reilly is coauthor of an upcoming book on performance measurement called Value Measurement (Jossey-Bass). He can be reached at greilly@measure.net.

CHRISTOPHER M. DEROSE is an associate of the University of Michigan's Global Business Partnership and of Action Learning Associates, a consulting organization focused on organizational transformation.

THE VALUE DEFINITION CHALLENGE

Human beings expect to derive some level of intrinsic satisfaction from their work by knowing that their efforts contribute to accomplishment of a meaningful purpose. Given the prevalence of this conventional wisdom, therefore, it is surprising that so few organizations can tell their employees how to create value, much less tie reward systems to value creation.

It is common sense that business leaders strive to reward value creation, because the role of business people is to focus individual and collective efforts so that their organizations become more valuable. The inability to succeed in rewarding value usually stems from either a lack of an effective process for identifying how the company creates value or insufficient discipline to create an operating-level measurement system. Companies that create a process for successful value definition and drive to institutionalize a measurement system around it, however, experience tremendous ben-

efits not only in bottom-line results but also in employee performance, morale, and capability.

In past issues, this column has discussed how to create and use a value-linked Measure Network in an organization. This time, it will explore how one company applies value-linked measurement principles to create and implement an effective measurement system.

THE DELL STORY

Dell offers an outstanding benchmark of a company that has used a value-linked measurement system to drive value creation. Today, Dell is the world's largest computer systems company and has consistently led its industry in liquidity, profitability, operational effectiveness, and growth. In 1995, however, Dell's future looked anything but bright. The stock performed flatly for three years, company assets were underperforming the industry, inventories were high, and accounts receivables were outpacing revenue growth rates.¹ Dell's remarkable transformation is directly related to its ability to

create a measurement system that clearly identifies how value is created for key stakeholders and then to show thousands of its workers at all levels how their own activities can impact specific aspects of value creation.

In late 1995, shortly after the arrival of new CFO, Tom Meredith, Dell overhauled its financial system. It started this process by revisiting the fundamental needs of its two primary stakeholders, customers and shareholders. In the fast-cycle technology markets, Dell's customers wanted the latest technology at the lowest price. Shareholders expected double-digit returns that were typical of the technology sector in the mid-to late-1990s without contributing new capital to grow the business. Dell concluded that the best way to maximize value for both stakeholders would be to stop focusing exclusively on revenue growth and to shift its focus toward converting orders into cash as quickly as possible.

This change led Dell to analyze nearly every aspect of how it operated, and to better understand the linkages between its business processes and the value that each process delivered. Armed with a clearer understanding of the cause-and-effect dynamics in the business, Dell's asset management team and treasury operations led the way by defining financial measures of both value creation for investors and the key operational activities that support them. Using these metrics, Dell could quickly assess how its liquidity and cash-conversion cycle were affecting overall value creation. In addition to the new emphasis on measures, such as days sales outstanding, days sales in inventory, and days payables outstanding, challenging

new stretch targets were set for each measure. In little more than a year, Dell had taken its cash conversion cycle from 40 days to less than five days.² Days sales in inventory went from more than 30 days in 1995 to just four in 2001.³ Although these financial and operational results are impressive, it should be noted that these changes laid the foundation for Dell to create an internet-based direct sales model that was far more efficient than its competitors. In short, the process and infrastructure changes that were inspired by these performance measures have turned the computer industry upside down and fueled Dell's ascent from upstart to Fortune-50 industry leader.

CREATING A SYSTEM

Dell accomplished this massive change through the creation and disciplined execution of an enterprise-wide, value-linked measurement system. Although internal financial analysts had identified a set of key, cross-functional financial measures, Dell's management challenge lay in linking these indicators to the day-to-day tasks and concerns of managers, operators, and service specialists throughout the company. As one Dell manager noted, "most people believed, erroneously, that they didn't have much effect on the asset management metrics."⁴ The company dispelled this by helping employees create metrics at their level that were tied

to its measure of investor value creation, return on invested capital (ROIC), and other asset management measures. In 1996, Dell's asset management team launched a series of more than 100 presentations to employees worldwide. Simple examples, such as reducing errors in sales processing clearly demonstrated how profoundly employees could drive value creation. The employee newsletter contained diagrams outlining the link between individual activities and ROIC.⁵ People from shop floor to board room not only became familiar with the key concepts of ROIC and cash conversion, they shared a common language, value creation framework, and a direct, measurable link between their individual actions and achievement of the company's strategic objectives.

MEASUREMENT IN ACTION

A company that has clearly defined value creation and institutionalized its pursuit into the corporate culture isn't hard to spot—just talk to the company's frontline workers. When recently asked about how he knows he is doing a good job, a Dell technical support specialist described one key measure related to the percentage of calls that are kept "within boundaries."⁶ This indicator describes the extent to which specialists stay within the parameters of their own expertise and their own calling queue when helping customers resolve technical issues. The measure encourages technical support staff to transfer customers to different queues when a set of predefined criteria calls for it. One of the things that makes this measure useful and effective is the technical support staff's clear under-

standing of how their local behavior is critical to maximizing value for customers by ensuring that customers get the right support from the best possible source. Furthermore, the Dell technical support specialist was also quick to point out his understanding of the linkage between the "within boundaries" measure and ROIC, the high-level measure of value creation for investors. He recognized that having the most knowledgeable person answer a question could help minimize overall support costs. He also explained that different customers pay for different levels of technical support and that proper boundary management clearly contributes to the maximization of tech support revenues for Dell—everyone should "get what they pay for" and no more.

LEARNING FROM DELL

Dell's creation of a value-linked measurement system, using ROIC as the aggregate measure of financial value creation, is one of the primary reasons that the company's price-earnings ratio is more than double that of the average S&P company. During the past few years, Dell's share price has almost mirrored its ROIC performance. Dell's case offers some insights for creating and implementing a value-linked measurement system. Three major lessons follow.

Lesson 1: Teach and Involve Everyone

Leaders at Dell made the time to teach the principles behind its strategy and measurement system to employees at all levels. This is a difficult effort in any company. It requires the teachers to make the measurement system easily understandable while simultaneously

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avoiding the oversimplification that would make it useless for implementation.

Lesson 2: Use a Process to Make it Personal

Through the treasury presentations and other efforts, individuals were encouraged to take the lead in redesigning processes, activities, measures, and jobs so that work was done most efficiently. Michael Dell cites an example in which he asked a European team to stretch for inventory reductions that the team initially thought were impossible. The team ultimately came back with results that were more than three-fold what Dell had expected. Personal involvement by hands-on operators leads not only to better results but also more ownership and creativity from workers. As Dell wrote in his book, "people all across the company who would not otherwise be engaged in discussions about P&Ls or balance sheets, talk and think about the company's ROIC and make decisions accordingly. Rather than think 'me,' they're thinking 'we'."⁷

Lesson 3: Identify Value-Creation Line of Sight For All Employees

Nobody wants to be a cog. Many jobs, particularly high-repetition tasks or manual line positions, fail to provide employees with the sense that their efforts are meaningful. Some jobs are too distant from the end product, others may

never involve customer contact, and most are perceived as incidental to achievement of the organization's strategy. By providing employees with line of sight between their individual efforts and value creation, however, a value-linked measurement system offers people direct insight into their personal impact. The worker in the mailroom can see the importance of getting checks to the right people at the right time to ensure cash is available and interest earned. The sales processor can tie his or her errors to the cost of merchandise returns and customer complaint calls. Such insight not only motivates employees to provide their best effort; it also inspires them to provide their best ideas. Soon, as Dell experienced, employees are not resisting change; they are inciting it with ideas for improvement.

PERFORMANCE MEASUREMENT ROI

No measurement system will entirely eliminate subjectivity or inspire every employee to offer his or her best effort. As demonstrated at Dell, however, those willing to invest the effort to create a good measure network see tremendous return on their investment. The bottom line improves because people are more engaged in the business, more excited about their personal impact, and more open to contributing new ideas. ■

Notes

1. Dell Computer Corporation Web site, www.dell.com.
2. Russ Banham, "Upgrading Cash Flow at Dell," CFO (December 1997, Vol. 13), p. 47.
3. Dell Computer Corporation Web site.
4. Banham, p. 47.
5. Michael Dell, *Direct From Dell* (New York: HarperCollins, 1999), p. 135.
6. Telephone interview conducted by Gregory Reilly, January 29, 2002.
7. Dell, p. 136.