

STRATEGY

# Measuring Financial and Operational Benefits

When taking Six Sigma into functional areas, companies should ensure that the investment yields the desired results

BY BRYAN CAREY

**F**or transactional businesses, such as financial institutions, applying Six Sigma in the operations areas has been relatively painless. Based on early good results, many companies have decided to expand the implementation to business and functional units, such as legal and marketing.

This migration, however, has not been nearly as smooth or painless. Operations areas deal with a large number of repeatable transactions that are easily measured, similar to those in a manufacturing plant. Not so with business and functional units.

For many people, seeing sales or marketing as a process is a challenge; seeing them as having measurable transactions that directly correlate to process improvement and financial gain is an even greater leap. Although there are many metrics used to indicate the success of these units (such as sales revenue and sales closed per call), measuring the impact of an improvement project on the sales process itself is a different animal.

In many instances, companies fail to consistently measure the financial and operational performance of the Six Sigma work being done, and thus do not know if the investment is yielding the desired results. This can be corrected by using: 1) standard financial metrics that are integrated into the overall business planning process, not just a stand-alone process improvement initiative, and 2) key performance indicators that are based on actual process transactions and linked to the business strategy.

## Standard Financial Metrics

One of the most important things a Six Sigma deployment Champion can do is to integrate a finance role into the deployment team. The role of the finance participant is to create tools and guidelines for what constitutes the financial benefits of a Six Sigma project, consistent with

that company's culture. In order to do this, the finance representative must:

- Establish outcome measures for the projects.
- Determine current performance and identify immediate actions that need to be taken.
- Establish a measurement and oversight process to ensure that Six Sigma projects maximize the return on investment.

A large majority of project financial benefits will fall into one of several categories. The categories that a company uses should align with its overall project approval and financial tracking philosophies. Some suggested categories to consider are:

- **Cost reduction** – If resources or other costs are eliminated as a result of the Six Sigma project, the project receives credit for the cost reduction. These reductions fall directly to the bottom line and should be measured by the amount of annualized

## Give Six Sigma the Same Treatment

As much as possible, Six Sigma benefits should be dealt with in the same way any change initiative is approved, budgeted and tracked. Doing so emphasizes that Six Sigma is part of the way business is conducted and not an additional to-do.



cost eliminated from the business.

- **Increased capacity** – If the productivity of a process is improved (i.e., more is processed with the same resources), then the overall unit cost will be reduced. This benefit is measured by calculating the amount of expense retained in order to mitigate the impact of future cost increases. As an example, a process whose expense is \$100 per unit of work has a unit cost of \$100. If capacity is doubled through process improvement and cost of the overall process stays the same, then the unit cost decreases to \$50.
- **Cost avoidance** – A response to competitive pressures and changing environment (such as new legislation), this benefit is measured as the realistic cost avoided as a result of the implementation of the new process. For example, a company may use process improvement to avoid fines related to legal and compliance issues.
- **Revenue growth** – This benefit comes from an increase in revenue from new business. It is measured by calculating the number of new customers and the associated revenue gained because of the new process over a predefined period.
- **Retained revenue (profit)** – Revenue retained from existing customers at risk (people who remain customers under the new process because their VOC needs are being met) is measured by calculating the value of that business over a predefined period. For example, if the value of an existing customer is \$1,000 and if on average the new process keeps 10 customers that would have left under the old process, then the retained revenue profit should be \$10,000.
- **Improved investment income** – The additional investment income earned due to an acceleration of the receipt of monies is calculated by determining the net present value of the accelerated cash flow over a predetermined period.
- **Risk management** – Projects that enable more effective management of the company's risk in functional areas such as audit and insurance can result in benefits that are measured by improvements in either reduced economic capital or a lower cost of capital.

Many times if the finance representative determines that a project does not fall into one of the common categories, then a team consisting of the process owner, Black Belt, Master Black Belt and the finance representative will

create their best calculation of value. This calculated value might be reviewed by a designee of the chief financial officer who is assigned either to the company-wide finance governance process or to an established steering committee. The most important thing is that the value is reviewed and approved using a predefined governance or review process, and that standards and guidelines are maintained.

### Key Performance Indicators

Another set of benefits that needs to be measured is the *key performance indicators* (KPIs) for a company. KPIs are critical measurements of behavior or performance that directly correlate with specific business goals and, in turn, operational performance.

Whatever KPIs are selected, they must reflect the organization's goals, they must be key to the success of the organization and they must be quantifiable. KPIs usually are long-term considerations. While the definition of what they are and how they are measured does not change often, the goals for a particular KPI may shift as the organization's goals change or as it gets closer to achieving a goal.

If a KPI is going to be of any value, there must be a way to accurately define and measure it. "Create more cross sales" is useless as a KPI without some way to distinguish between one product offering and the next. "Being the friendliest process" will not work as a KPI because there is no way to measure the subjective quality of friendliness or to compare it to others.

### Get SMART on KPIs

To help ensure that KPIs effectively serve their purpose, when setting them practitioners can use the SMART test:

**Specific** – Clear and focused to avoid being misinterpreted

**Measurable** – Can be quantified and compared to other data

**Attainable** – Achievable, reasonable and credible under expected conditions

**Realistic** – Fit into the organization's constraints and are cost effective

**Timely** – Doable within the time frame



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It is important to define the KPIs consistently from project to project. For a KPI of “increased sales,” such considerations as whether to measure by units sold or by dollar value of sales must be addressed. Will returns be deducted from sales in the month of the sale or the month of the return? Will sales be recorded for the KPI at list price or at the actual sales price?

Also, targets must be set for each KPI. A company goal to be the employer of choice might include a low “turnover rate.” After the KPI has been defined as “the number of voluntary resignations and terminations for performance, divided by the total number of employees at the beginning of the period” and a way to measure it has been set up by collecting the information in a human resources information system, the target has to be established. “Reduce turnover by 5 percent per year” is a clear target that everyone will understand and be able to take specific action to accomplish.

### Stages and Examples of KPIs

As with many management issues, building a solution in stages is often best. Suggested stages for KPIs:

- Define the links between corporate goals and major operational perspectives
- Map these strategic links to required processes in each operational area
- Define a set of near-term and medium-term metrics that drive the new outcomes in each area
- Define the gaps and dependencies across the organization that will need to be bridged to result in corporate success
- Implement the metrics as individual and group scorecards and monitor to secure the strategic results

Some examples of good KPIs for sales and marketing processes might include:

- **Productivity** – Number of sales calls and cycle time of a typical sales call

- **Effectiveness** – Sales conversion rate
- **Quality** – Accuracy of quotes and percentage of add-on products accepted
- **Customer satisfaction** – Customer attrition and turnover
- **Revenue** – Number of new accounts, account profitability and revenue per sale

### Smoothing the Transition

If Six Sigma is to be successful in transactional organizations, the deployment team and the business need to be able to measure the benefits of the projects – both financial and operational performance. By knowing the benefits, companies can determine whether the investment is yielding the desired results.

Standard financial metrics and key performance indicators, properly applied, can help smooth the transition of Six Sigma from the obvious transaction-oriented operations functions to the not-so-obvious sales and marketing areas. ♦

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