OPERATIONAL REVIEW

Maximum Results at Efficient Costs

THIRD EDITION

Rob Reider

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New York • Chichester • Weinheim • Brisbane • Toronto • Singapore

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This book is printed on acid-free paper. ∞

Published by John Wiley & Sons, Inc., Hoboken, New Jersey

Published simultaneously in Canada

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Library of Congress Cataloging-in-Publication Data:

Reider, Harry R., 1940–
Operational review : maximum results at efficient costs / Rob Reider.—3rd. ed.
p. cm.
Includes index.
ISBN 0-471-22810-9 (cloth : acid-free paper)
1. Auditing, Internal. 2. Auditing. I. Title.

HF5668.25 .R45 2002
657′.458—dc21

2002004489

Printed in the United States of America
10 9 8 7 6 5 4 3 2 1

About the Author

Rob Reider, CPA, MBA, PhD, is the President of Reider Associates, a management and organizational consulting firm he founded in 1976, which is located in Santa Fe, New Mexico. Prior to starting Reider Associates, he was a manager in the Management Consulting Department of Peat, Marwick in Philadelphia. His area of expertise encompasses planning and budget systems, managerial and administrative systems, computer processing, financial and accounting procedures, organizational behavior and theory, management advisory services, large and small business consulting, management information and control techniques, and management training and staff development.

Rob has been a consultant to numerous large, medium, and small businesses of all types in the aforementioned areas (in both the private and public sectors). In addition, he has conducted many and varied operational reviews and benchmarking studies and has trained both internal staff and external consultants in these techniques.

He is the course author and nationally sought after discussion leader and presenter for more than 20 different seminars that are conducted nationally for various organizations and associations. He has conducted more than 1,000 such seminars throughout the country and has received the AICPA Outstanding Discussion Leader of the Year award.

Considered a national expert in the areas of operational reviews and benchmarking strategies, Rob provides specific consultation in the areas of general business management, development of internal and external consulting practices, organizational and management systems, and the development and conducting of continuing professional education (CPE) and other training programs.

Rob is the course author of nine Reider Associates self-study courses marketed nationally. He is also the author of the following books also published by John Wiley & Sons, Inc.

- *The Complete Guide to Operational Auditing*
- *Operational Review: Maximum Results at Efficient Costs*
- *Benchmarking Strategies: A Tool for Profit Improvement*
- *Improving the Economy, Efficiency, and Effectiveness of Not-for-Profits*

Rob has also been a presenter at numerous professional meetings and conferences around the country and has published numerous articles in professional journals. He has been a frequent commentator on the educational video programs produced by Primemedia Workplace Learning such as The CPA Report, The Governmental Update, and the Accounting and Financial Managers Network.

Rob has earned the degree of Bachelor of Science (BS) in Business Administration and Master of Science in Business (MBA) from Drexel University as well as Doctor Of Philosophy (Ph.D) in Organizational and Management Psychology from Southwest University. He is currently listed in *Who's Who in the East and West, Who's Who in the World, Who's Who in Finance and Industry, Personalities in America, International Biography, Who's Who of Emerging Leaders in America,* and *Who's Who in Executives and Businesses*.

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Preface

The objective of this how-to guide to performing the operational review for results is to help the reader understand the basic principles involved in planning and conducting an operational review directed toward the continual implementation of best practices in an organized program of continuous improvements. In addition, it will provide the information and fundamentals the reviewer must know to use operational review concepts to enable the organization to operate most economically, efficiently, and effectively—that is, to maximize operating results at the least cost using the most efficient methods. This book is designed to meet the needs of the reviewer, regardless of any prior experience in performing operational reviews. Both basic knowledge for those with no previous hands-on experience, and reinforcement and additional learning for those who already have some prior operational review experience are provided.

Questions that will be answered include:

- What is an operational review?
- When should an operational review be performed?
- How can an operational review be performed effectively and efficiently?
- How can positive change be effected as a result of an operational review?

- How can operational review tools and techniques be used to maintain operations in an economic, efficient, and effective manner on an ongoing basis?
- How can best practices be identified and implemented in a formalized program of continuous improvements?

One Must Know the Questions before One Can Seek the Answers

The materials presented in this book can be used by management and supervisors and other employees to perform operational reviews for their operational areas of responsibility. In addition, the tools and techniques presented can be used by others, such as internal and external consultants and auditors, to maintain operations in the most economical, efficient, and effective manner.

PURPOSE AND OBJECTIVES

In today's many-faceted and multidisciplined economic environment, organizational management has placed ever more emphasis on increasing results with fewer resources through evaluation of the economy, efficiency, and effectiveness of the organization's operations. The operational review is the tool used to perform such an evaluation, either singularly or as part of another procedure such as benchmarking, activity-based management, total quality management, reengineering, and so on. This book presents the basic principles of planning and conducting such an operational review, as well as the fundamentals the reviewer must be aware of to understand operational review concepts.

The objectives of this book are:

- To increase understanding of operational review concepts and the ability to use them effectively.
- To increase understanding of the purpose and mechanics of conducting operational reviews.

- To help identify the relationship and differences between operational reviews and other procedures such as benchmarking, activity-based costing/management, reengineering, and so on.
- To increase the skills and abilities needed to conduct operational reviews.
- To increase awareness of operational review opportunities and to help in their identification.
- To improve the reviewer's capability to perform operational reviews in his or her present situation.

Knowing the Purpose and Objectives Ensures Taking the Correct Path

ORGANIZATIONAL SYSTEMS AS HELPERS

In many organizations today, top management is seeking ways to become competitive and maintain market position—or merely to survive. Managers have sensed that many of their organizational systems are detrimental to progress and have held them back from achieving organizational, departmental, and individual goals and objectives. These are the very systems that are supposed to be helpful; for example:

- Planning systems, long- and short-term, that resulted in documented plans but not in actual results.
- Budget systems that became costly in terms of allocating resources effectively and controlling costs in relation to results.
- Organizational structures that created unwieldy hierarchies, which produced systems of unnecessary policing and control.
- Cost accounting structures that obscured true product costs and resulted in pricing that constrained competitiveness.
- Management systems that produced elaborate computer systems and reporting without enhancing the effectiveness of operations.

- Sales functions and forecasts that resulted in selling those products that maximized sales commissions but may not have been the products management desired to produce and sell.
- Operating practices that perpetuated outmoded systems ("We've always done it that way") rather than promoted best practices.

Operational reviews, together with other techniques, are tools to make these systems helpful as intended and direct the organization toward its goals. Theoretically, organizations should operate in an economic, efficient, and effective manner at all times. If such was the case, operational review techniques would be applied on an ongoing basis. However, with the passage of time, good intentions and initially helpful systems tend to deteriorate. Operational reviews are then necessary to help get the organization back on track by pinpointing operational deficiencies, developing practical recommendations, and implementing positive changes.

Helpful Systems
Need to Be Helpful

Again, theoretically, managers at all levels should be held accountable for using the scarce resources entrusted to them to achieve maximum results at the least possible costs. Although management should embrace operational review concepts and apply them as they proceed, this is rarely the case. More typically, management has to be sold on the value of operational reviews. In selling the benefits of conducting operational reviews, it is important to stress that unlike other techniques that cost time and money for uncertain results, operational reviews pay for themselves. In effect, the operational review environment becomes a profit center instead of a cost center. Although there are no guarantees, a successful operational review should result in at least three to four times its cost in annual savings. These are not one-time savings, but ongoing, that is, savings year after year. With the success of an operational review, management may quickly realize that the more operational reviews done and the more recommended economies and efficiencies implemented, the greater the savings and results. In addition, the residual capability for performing operational reviews remains in the area under review, so operations personnel can continue to apply operational review concepts on an ongoing basis.

Keep in mind that the intent of the operational review is not to be critical of present operations, but to review operations and develop a program of best practices and continuous positive operational improvements by working with management and staff personnel. This can be accomplished most effectively by working with operations personnel in areas where they recognize deficiencies and are willing to cooperate. The concept of operational reviews should be sold as an internal program of review directed toward improved economies and efficiencies that will produce increased operational results.

Best Practices
Provide Best Results

OPERATIONAL REVIEW PROCESS: STARTING AT THE TOP

The operational review process should start at the top of the organization. Top management should define and communicate its strategic plans for the company, including areas of expansion, retrenchment, and status quo. At the same time, management members should identify the businesses they want to be in, the businesses they do not want to be in, their basic business principles and belief systems, and their desires for each function within the organization.

For instance, top management may define a desire for the sales function, which has historically sold whatever it could to customers, to become a more integral part of the planning process and other functions such as manufacturing and engineering. In defining their desires, members of management may identify attributes such as:

- Sales forecasts more realistically related to actual customers and products to be sold.
- A larger percentage of the sales forecast (at least 80 percent) matched by real customer orders.
- Sales efforts driven by management's identification in the planning process of what to sell, to whom, and at what quantity.

- A sales forecast with a high percentage of real customer orders that allows the company's production to be based on customer orders and expected delivery times, at a specified quality level.
- A sales function that is geared more toward providing customer service than toward making sales that maximize sales personnel's compensation.
- A sales function that works within the company's plans together with the other functions of the company, such as manufacturing, engineering, purchasing, accounting, and marketing.

With the clear identification and communication of management's desires, each function has a clear idea as to where it is heading and the basis for its evaluation The purpose of the operational review then becomes one of a helping agent, assisting each function to achieve its stated goals and objectives as related to management's desires. The performance of the operational review is thus less a critical evaluation of what a particular function is doing and more an appraisal of what needs to be done to help the function achieve its goals and become the best it can.

As the operational review team works with each function within the organization, it assists that function to understand what it needs to do to become what it should be. As best practices and improvements are recommended and implemented, each function moves toward its proper place within the organization and the company becomes a learning organization, both by function and overall.

In today's organizational atmosphere of cost cutting, downsizing, reengineering and so on, the operational review must be sensitive in its approach so as to maintain needed services in the most economical, efficient, and effective manner. Whereas management may be focusing on reducing costs, operations may be focusing on an increase in providing quality services. The review team must be careful to maintain a proper perspective so that it directs its efforts toward overall organizational goals as well as the individual requirements of each function.

Top Management's Desires Mirror the Organizational and Employee Direction

WHO IS THE OPERATIONAL REVIEWER?

An operational review can be performed by anyone with the appropriate skills. However, internal and/or external consultants, because of their knowledge of the operations and their analytical skills, are typically requested to perform such services. In some organizations, a separate operational review unit trained in operational review concepts is established. The most effective way in which to implement such procedures is to assign overall responsibility for implementing organization-wide operational review procedures, which include the performance of operational reviews as well as training operations personnel in implementing these techniques in their areas.

The progress and ultimate success in achieving the benefits of operational reviews depend greatly on the reviewers' skills and what management and others think of them. Those assigned to an operational review engagement must possess the ability to review and analyze financial, management, and operational areas. The attributes of an effective operational reviewer include:

- Curiosity (imagination)
- Analytical ability
- Persuasiveness
- Good business judgment
- Common sense
- Objectivity
- Communication skills
- Initiative to develop techniques in such areas as work measurement, flowcharting, cost-benefit analysis, organizational analysis, information technology, and so on
- Independence
- Confidence

Beyond those previously listed, the successful operational reviewer should possess the following attributes:

- The ability to spot the trouble areas by looking at a given situation and quickly determining what is getting in the way.

- The ability to identify the critical problem areas, so as to avoid "chasing mice when one should be chasing elephants." The application of the 80/20 rule states that operational reviews require 80 percent common sense and 20 percent technical expertise; and that 80 percent of the trouble areas cause 20 percent of the problems, and 20 percent cause 80 percent of the problems.
- The ability to place oneself in management's position, to analyze the problem and ask questions from management's perspective. This is sometimes difficult, as often the reviewer has never been in an operations-related management position. Even when this is not true, the reviewer may have difficulty understanding the constraints under which the manager must work, in effect, what the manager can and cannot do.
- The skill to effectively communicate operational review results. The success of an operational review is measured by the degree to which recommendations are implemented, and implementation is a direct by-product of effective communication. A rule of thumb in operational reviews is that the reviewer has been successful if management can be persuaded to adopt more than 50 percent of the recommendations.

The Operational Review
Is Only as Good as the
Operational Reviewers

OPERATIONAL REVIEW SKILLS AND ABILITIES

The attributes described earlier would be helpful to any manager, but they are vital to an operational reviewer. Although managers should have analytical ability, they may use it primarily to perform repetitive tasks. Operational reviewers, however, use these skills and abilities to assess a user's situations and recommend positive operational improvements.

The difference between required attributes for operational personnel and operational reviewers is similar to the difference between the left brain and the right brain. The left brain, which controls thinking and calculation processes, is more important to operations personnel performing repetitive tasks; whereas the right brain, which controls creativity and perceptual skills, is more critical to the operational reviewer. Basically, the operational reviewer needs a good balance of both, yet with a greater emphasis on the creative and perceptual side. This is why the best manager or operating staff member does not always make the best operational reviewer—and why things tend to stay the same.

To render effective services, the operational reviewer must have substantial knowledge of the total environment of the organization being examined and a high degree of skill and experience with the analytical techniques and tools needed to solve problems. The operational reviewer should also have sensitivity to, and understanding of, the values and goals of all the various people that make up a going concern.

Those trained in operating systems and procedures need not spend many years learning new methods before engaging in operational reviews because the basic techniques are the same. They mainly need to sharpen the problem identification and analytical skills they already possess. Operational reviews can be viewed as 80 percent practical analysis and common sense and 20 percent technical know-how.

An operational review requires the reviewer to possess a number of varied tools and techniques which include:

- Planning and budget processes
- Cost analysis, such as direct, standard, and activity-based costing methods
- Preparation and analysis of systems flowcharts
- Development and/or analysis of computer systems and programs
- Evaluation of computerized procedures and results
- Statistical sampling procedures
- Development and understanding of forecasts and projections
- Interviewing skills
- Organizational planning development and analysis
- Creation of goals and objectives and other performance standards of measurement
- Development and analysis of organizational structures
- Identification of best practices, both internal and external, and development of a program of continuous improvements

- Verification of the accuracy of data
- Determination of compliance with laws and regulations
- Use of sophisticated analytical techniques such as matrix analysis, linear regression correlation, critical path method, and so on
- Cost versus benefit analysis
- Communication skills, both oral and written
- Knowledge of current thinking and procedures such as total quality management (TQM), benchmarking, reengineering, complexity theory, and so on

Success as an effective operational reviewer is based on what is accomplished, that is, recommendations made to management that are subsequently implemented. Operational reviews should be fascinating and rewarding to the reviewer as well as to operations personnel. The individual's stature as an operational reviewer, credibility of the entire review staff, management's and others' positive regard of the review staff—all will increase in proportion to the degree of success attained in the operational review.

Because of the number of different types and complexities of operational reviews and the varying skills required, supporting functional disciplines are often necessary to supplement the regular review staff's skills and abilities. However, it is not always practical to maintain personnel with all of the required skills on the operational review staff. Thus, consider the skills that are necessary for the successful conduct of each operational review, and either make sure that such skills are available on staff or contract for needed outside expertise.

The Success of the Operational Review Is Directly Related to the Skills of the Operational Reviewers

OPERATIONAL AREAS TO BE ADDRESSED

In this book, we will be looking at conducting operational reviews of any and all organizational functions and activities that hinder or help the effort to maintain the company in the most economical, efficient, and effective manner possible. In this regard, the operational review team must be aware of basic business principles that help to enhance the organization's success as well as those that the company should avoid. With these principles in mind, the review team should analyze operations to identify areas for improvement in which best practices can be implemented that maximize the chances of success and minimize the risk of failure.

Although the primary focus of the operational review is on the manner in which scarce resources are used by the organization, considering the sources and uses of resources and the policies and procedures used to deal with over and under operational conditions based on expected results, the following specific operational areas need to be addressed:

1. Sales of Products or Services

- Are sales made to quality customers with the right products at the right time?
- Does each sale make a contribution to profits?
- Are all costs compared to the sale such as product costs (direct material and labor), assignment of product-related activity costs (e.g., manufacturing processes, quality control, shipping, and receiving), functional costs (e.g., purchasing, accounts payable, billing, and accounts receivable), and customer costs (e.g., marketing, selling, support services, and customer service)?
- Do sales relate to an agreed-upon sales forecast? Is the company selling the right products to the right customers?
- Do sales integrate with an effective production scheduling and control system?

2. Manufacturing or Production of Services

- Are sales orders entered into an effective production control system, which ensures that all sales orders are entered into production in a timely manner to ensure on-time, quality deliveries?
- Is work-in-process kept to a minimum so that only real customer orders are being worked on rather than building up finished goods inventory?

- Are the most efficient and economical production methods used to ensure that the cost of the product is kept to its realizable minimum?
- Are direct materials and labor used most efficiently so that waste, reworks, and rejects are kept to a minimum?
- Are nondirect labor (and material) costs such as quality control, supervision and management, repairs and maintenance, material handling, and so on kept to a minimum?

3. Billing, Accounts Receivable, and Collections

- Are bills sent out in a timely manner at the time of shipment or before?
- Are accounts receivable processing procedures the most efficient and economical?
- Is the cost of billing, accounts receivable processing, and collection efforts more costly than the amount of the receivable or the net profit on the sale?
- Is the number and amount of accounts receivable continually analyzed for minimization?
- Are any customers paying directly or through electronic funds transfer at the time of shipping or delivery?
- Are bills and accounts receivable in amounts exceeding the cost of processing excluded from the system?
- Has consideration been given to reducing or eliminating these functions?

4. Inventory: Raw Materials and Finished Goods

- Are raw material and finished goods inventories kept to a minimum?
- Are raw materials delivered into production on a just-in-time basis?
- Are finished goods completed in production just in time for customer delivery?
- Is the company working toward getting out of these inventory businesses?

5. Purchasing, Accounts Payable, and Payments

- Are all items that are less than the cost of purchasing excluding from the purchasing system with an efficient system used for these items?
- Are all repetitive high volume and cost items (e.g., raw materials and manufacturing supplies) negotiated by purchasing with vendors as to price, quality, and timeliness?
- Does the production system automatically order repetitive items as an integrated part of the production control system?
- Has consideration been given to reduce these functions for low and high ticket items leading toward the possible elimination of these functions?
- Does the company consider paying any vendors on a shipment or delivery basis as part of its vendor negotiation procedures?

6. Other Costs and Expenses: General, Administrative, and Selling

- Are all other costs and expenses kept to a minimum? Remember, an unnecessary dollar not spent is a dollar directly to the bottom line.
- Are selling costs directed toward customer service and strategic plans rather than maximizing salespeople's compensation?
- Is there a system in effect which recognizes and rewards the reduction of expenses rather than the rewarding of budget increases?
- Are all non–value-added functions (e.g., management and supervision, office processing, paperwork, and so on) evaluated as to reduction and elimination?

The Operational Reviewer Needs Direction to Know What to Look For

Many other operational areas and concerns could be listed. Those listed above are only meant as examples of areas that should be considered in the operational review. In effect, the operational review may result in reviewing many of the company's major operations as most functions selected for review affect many other functions and activities. The operational review team needs to set their guidelines as to the extent of their study. Often the area selected (e.g., cash management) invades every activity of the company. To ensure that the company operates with effective operating procedures, the operational review team must understand that every dollar expended and every dollar collected by the company must be evaluated as to its appropriateness to the company's plans and operations.

Every Dollar Expended
and Every Dollar Collected
Must Be Evaluated

CHAPTER ONE

Overview of Operational Reviews

This chapter provides an overview of operational review concepts and principles and terminology. In an ever-changing economic and competitive environment, management is looking for more than historical financial data. Managers need and request information about the internal operations of their organization, and seek recommendations as to how they can manage and operate more economically, efficiently, and effectively. The operational review process is most helpful and beneficial in the following instances:

- Identifying operational areas in need of positive improvement—looking for best practices as part of a program for continuous improvements.
- Pinpointing the cause (not the symptom) of the problem—avoiding quick fix short-term solutions in favor of longer term elegant solutions.
- Quantifying the effect of the present situation on operations—identifying the cost of present practices and the benefits to be derived through implementation of best practices.
- Developing recommendations as to alternative courses of action to correct the situation—identifying best practices in a program of continuous improvements.

This chapter will:

- Introduce operational review concepts and principles.
- Provide an update of the current status of operational reviews.
- Familiarize the reader with commonly used operational review definitions and terms.
- Identify the purposes and components of operational reviews.
- Increase understanding of the benefits of operational reviews.
- Introduce the phases in which a typical operational review is conducted.

Pinpoint the Cause, Not the Symptom, of the Problem to Identify the Best Practice

OPERATIONAL REVIEW CONCEPTS

Organizations have been in existence for thousands of years, some successful and long-lasting, others short-lived. Through the years there have been no clear cut criteria or formula for success. Many business organizations have been successful through such intangible attributes as luck, falling into a market niche, being the first, consumer acceptance, and so on. Other companies, even some using the best available business acumen and methods, have failed miserably.

Identifying, implementing, and maintaining the secrets of success is an elusive target. Banking on what has worked in the past and one's own internal Ouija board are ineffective substitutes for objective internal appraisal and external comparison and analysis—what is called an operational review. Operational reviews are becoming the tool of choice for gathering data related to programs of continuous improvement and to gain competitive advantage.

Operational review can be defined as a process for analyzing internal operations and activities to identify areas for positive improvement in a program of continuous improvement. The process begins with an analysis of existing operations and activities, identifies areas for positive improvement, and then establishes a performance standard upon which the activity can be measured. The goal is to improve each identified activity so that it can be the best possible, and stay that way. The best practice is not always measured in terms of least costs, but more often may be what stakeholders value and expected levels of performance.

The Goal Is to Make Each Activity the Best Possible— And Keep It That Way

Operational review processes are directed toward the continuous pursuit of positive improvements, excellence in all activities, and the effective use of best practices. The focal point in achieving these goals is the customer or stakeholder (both internal and external) who establishes performance expectations and is the ultimate judge of resultant quality. A company customer is defined as anyone who has a stake or interest in the ongoing operations of the organization and anyone who is affected by its results (type, quality, and timeliness). Stakeholders include all those who are dependent on the survival of the organization, such as:

- Suppliers/vendors: external
- Owners/shareholders: internal/external
- Management/supervision: internal
- Employees/subcontractors: internal/external
- Customers/end users: external

Operational review results provide the company—owners, management, and employees—with data necessary for effective resource allocation and the strategic focus for the organization. The operational review process provides for those objective measures to determine the success of the company's internal goals, objectives, and detail plans, as well as external and competitive performance measures. Evaluating a company's performance against stakeholder expectations enables the company to pursue its program of continuous improvement on the road to excellence. Effective operational review procedures encompass both internal and external needs.

Stakeholder Expectations Are the Key to Evaluating the Company's Performance

Managers or supervisors who are responsible for an operational area have traditionally maintained the operation as they found it; that is they primarily accepted the organization, personnel, and functions they inherited. They were not allowed or did not understand how to make their assigned area of responsibility more efficient. And many times, there were systems in effect (such as overcontrolling bosses) that prevented such positive changes. The purpose of the operational review is to assist managers and operations personnel in looking at their areas of responsibility from an operational viewpoint. This means that operations are viewed with an eye toward whether they can be improved so as to be performed more efficiently, effectively, or economically.

Given today's increasingly varied and competitive economic environment, management places more and more emphasis on the evaluation of the economy, efficiency, and effectiveness of the organization's operations. Managers and employees of an operational area are often too close to operations, too resistant to change, too enmeshed in daily operations, and so on, to review their own operations objectively. Because both internal and external consultants have the fact-finding and diagnostic skills needed to perform such operational reviews, they are frequently asked to do so. In some organizations, a separate unit is formed strictly to perform operational reviews.

Operational reviewing got its start when management stopped being concerned solely with reviewing the reporting of information and started wondering why a transaction was made in the first place and whether there was a better way to do it. Operational review is the process whereby the reviewer determines whether members of management are using the resources entrusted to them in the most economical and efficient manner, to achieve the most effective results of operations.

Why Was the Transaction Made in the First Place and Is There a Better Way?

What are some of the reasons an operational review should be performed? The focus and scope of operations in both the public and private sectors have changed in recent years. Management has increased demands for more relevant information on the conduct of its operations and related results than can be found in strictly financial data. Both business and government management seek more information with which to judge the quality of operations and make operational improvements. That is why operational review techniques are needed to evaluate the effectiveness and efficiency of operations.

WHY BUSINESSES ARE IN EXISTENCE

Before even thinking about performing an operational review of an organization, it is necessary to determine why the organization is in existence. When clients are asked this question, invariably the answer is to make money. Although this is partly true, there are really only two reasons for a business entity to exist:

1. ***The customer service business.*** To provide goods and services to satisfy desired customers, so that they will continue to use the business's goods and services and refer it to others. An organizational philosophy that correlates with this goal that has been found to be successful is "to provide the highest quality products and service at the least possible cost."
2. ***The cash conversion business.*** To create desired goods and services so that the investment in the business is as quickly converted to cash as possible, with the resultant cash-in exceeding the cash-out (net profits or positive return on investment). The correlating philosophy to this goal can be stated as follows: "To achieve desired business results using the most efficient methods so that the organization can optimize the use of limited resources."

This means staying in business for the long term to serve customers and grow and prosper. A starting point for establishing operational review measurement criteria is to decide which businesses the organization is really in (such as the two above) so that operational efficiencies and effectiveness can be compared to such overall organizational criteria.

Being in the Customer Service and Cash Conversion Businesses Enables the Company to Make Money and to Survive

BUSINESSES A COMPANY IS NOT IN

Once short-term thinking is eliminated, managers realize they are not in the following businesses and decision making becomes simpler:

- ***Sales business.*** Making sales that cannot be collected profitably (sales are not profits until the cash is received and all the costs of the sale are less than the amount collected) creates only numerical growth.
- ***Customer order backlog business.*** Logging customer orders is a paperwork process to impress internal management and outside shareholders. Unless this backlog can be converted into a timely sale and collection, there is only a future promise, which may never materialize.
- ***Accounts receivable business***. Get the cash as quickly as possible, not the promise to pay. But remember, customers are the company's business; keeping them in business is keeping the company in business. Normally the company has already put out its cash to vendors and/or into inventory. It may even be desirable to get out of the accounts receivable business altogether. This is particularly true for small sales where the amount of the sale is less than the cost of billing and collections or where major customers (e.g., 20 percent of all customers equal 80 percent of total sales) are willing to pay at the time of shipping or receipt as part of price negotiations.
- ***Inventory business.*** Inventory does not equal sales. Keep inventories to a minimum (zero if possible). Procure raw materials from vendors only as needed, produce for real customer orders based on agreed-upon delivery dates, maximize work-in-process throughput, and ship directly from production when the customer needs the product. To accomplish these inventory goals, it is necessary to develop an effective organizational life stream that includes the company's vendors, employees, and customers.