



**Performance  
Management  
Institute, Inc.**

**Business Leadership  
Team Alignment**

.... most businesses have two information systems. One is organized around the data stream; the other, far older one, around the accounting system. The accounting system, though, is a five-hundred-year-old information system that is in terrible shape.

The changes we will see in information technologies over the next twenty years are nothing compared to the changes we will see in accounting.

– Peter F. Drucker, *Managing in the Next Society. The Information Society*

**The Performance Management Institute (PMI) Pivotal Fact:**

Standard Financial Statements are designed to provide outsiders with a standardized summary view of a company’s historical financial performance. They are not designed to provide the details necessary to manage an enterprise. Frank Hammit, a ‘Lean Manufacturing’ practitioner for over two decades, since building the early Honda plants, says it this way:

**“Traditional financial accounting drives you away from world class solutions to your problems.”**

Because:

- It rewards keeping people and capital assets busy even in the absence of demand (sales)
- It values inventory as an asset when any inventory above a minimum is a liability
- Information reporting is:
  - Always after the fact
  - Too late to predict corrective action
  - Allows for argument of the data (analysis paralysis)
  - The process can be manipulated to skew the data
  - Data can be inaccurate, manipulated and misrepresented
  - Few people “really understand the financial reports and how they contribute to their slice of the pie
  - As the process lead time collapses the cost of data collection and entry increases and the usefulness of the date diminishes it does not measure the flow of product through a facility (value adding ratio)

Financial Statements are primarily designed and intended as a summary of financial results of a company that allow observers to compare management’s performance, and for tax compliance. The original purpose that drove the creation of the CPA profession out of the SEC Acts of 1933 & 34 was to protect the public and the government from dishonest businesspeople.

As pointed out by Lou Mobley, the very structure of accounting requires one group of people (client companies) to pay another group of people (financial services professionals) to do work on behalf of third parties (bankers, IRS, shareholders and the

public). This sets up a series of here-to-fore un-resolvable double-binds that subtly detract from every level of peer and direct-report relationships, if that same data is attempted to be used for management purposes. (see more on the reasons and costs of this problem on page 4). Lou Mobley is the person who gave the concept of Operating Cashflow to the marketplace, although most its power is still latent, waiting to bear its fruit.

PMI has as its foundation the work of Mr. Mobley, begun over 50 years ago, with his creation of the ROA Chart. His ROA visualization tool was the basis for arguing with DuPont's Treasurer, who made the formula public at the AMA in 1952. He used the chart to demonstrate that presenting ROA as a single percentage hid its most crucial value, as had been used by GM since the '20's, but without the ability to visualize it (see Lou's Chart below, on the next page). Lou went on to found and run the Sands Point Executive School for IBM's Tom Watson Jr. in 1955. He supported his students in the implementation of his argument with DuPont's Treasurer as the Profit Planning initiative in 1957, which began IBM's ascendancy over the next 20 years to become one of the most successful and best managed businesses in the world.

It took several years of failure of the week on Finance at Sand's Point to motivate Lou in the direction that led him to discover the mathematical matrix that graphically and numerically explains how and why the balance sheet changes, which he did in 1959. It was only in the years after he left IBM that Lou realized just how devastating the lack of usable information about cash was to the entrepreneurs of America. This led him, in 1980, to begin writing letters to the SEC, ABA, FASB and anyone else he could think of.

His persistence led, with the help of his partner, Robert Block of 3-D Business Tools and others, seven years later to the enacting of FASB rule 95 in November of 1987. At the eleventh hour, when everything was in place and Lou was not present, the regulation was effectively gutted by making the direct format statement 'highly encouraged', but voluntary, allowing the indirect option to become by far the version of choice ever since. So far this had led to almost two more decades of cash being the least understood and most confusing element of financial information, especially in regards to projecting the future of the bank account both accurately and understandably to the non-financial business person.

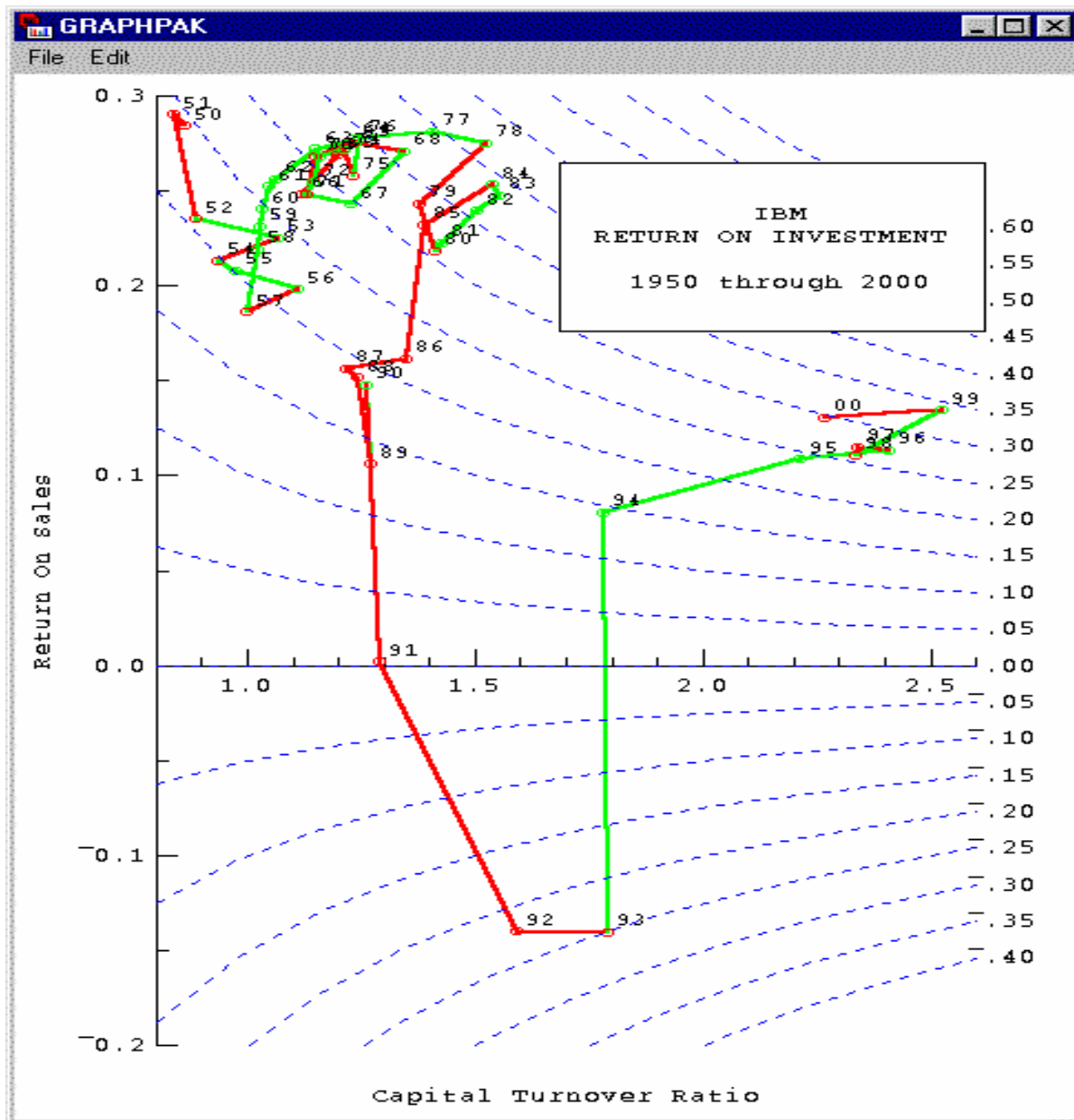
"I have grappled with the issue of cash flow...I have an MBA in finance, and I have always found it, from every angle, very difficult, to reconcile the various financial statements, and more importantly, how to budget cash flow moving forward . . . this book and software helped me and my clients understand where they are, what their cash flow position is, and how they can actually control it moving forward,"

Sean Taylor, Financial Scoreboard/Mobley Matrix User

"It has been a few years since we had cash flow on a monthly basis, and even when we had it, it was the Indirect Method. It was always so confusing. The description off to the left was Accounts Receivable, then increase was bracketed, and decrease was open, People wouldn't be able to make any sense out of it. Even I got confused sometimes, wondering "what's that mean?" where plugging it into the Scoreboard, right off the bat you can see Collections, and you can look across and see, we had Sales of X, but we only collected Y. What's going on?" -

Ken Thengval, CFO, PMI Pilot #4

## IBM's Financial Performance 1951 – 2000 shown on Lou Mobley's ROI (actually ROA) graph



- Green lines and points signal years of positive (or zero) Return on Investment;
- red signals negative.
- Blue dashed lines are lines of constant ROI. (Movement toward the upper-right is good.) This plot was produced by APL GRAPHPAK.
- Variables: The Return on Sales ordinate and Capital Turnover Ratio are derived from four pieces of data found in annual reports.
- Return on Sales = Net Earnings Before Taxes / Gross Revenue
- Capital Turnover Ratio = Gross Revenue / Average Assets
- Return on Assets is defined here as the product of Return on Sales and Capital Turnover



## **The PMI Star**

Five different bodies of expertise and experience link into a central hub made of two key pieces: one is the core capital and intellectual property of the enterprise, its objective resources; the other is vision and mission – the purposes for which it exists and the culture that inhabits it, its more ephemeral (invisible) resources.

Each of the five wings of the star have its own language and worldview, often using the same words for different things and different words for the same things. The puzzle is made complete and coherent when there is an objective shared language of results that gives every part of the system access to knowing the score for itself, the other parts and the whole simultaneously.

When each wing can only see the star from its own worldview, then all the other wings are spotty to them. In other words, their picture is incomplete at best and invisible at worst. Only when each wing is transparently available to each other wing, is the star filled in, or fully visible as a whole to each wing.

The double-binds, in which everyone is a victim to un-reconcilable contradictions set up by the very nature of the financial organizing system, generate conflicts in several subtle and costly ways. The basis for how we get set against one another, and for the solution, can be found if we examine our language.

Three worldviews and the 5 roles make up the language landscape of an organization. The roles and the confusion set up by their separate disciplines' use of words are described above under the PMI Star. In the seminal book, *Managing by the Numbers*, Kremer, Rizzuto and Case put forth Kremer's notion that every organization has a 'Sacred Glossary' that is tacit and fragmented. There is no written set of definitions and no thesaurus for those not in the loop at the inner circle, and even some members in that in-group only have fragments.

The reason for that is that in addition to the 5 roles in the star, there are three worldviews that have very different views of 'the elephant'. They are distinct from each other and the 5 roles in ways that are extremely subtle and not well understood, and have negative consequences in many ways, not the least of which is to make sustained and true leadership alignment almost impossible to achieve for any length of time. This fundamental dis-connect is generated from the three separate epistemologies underlying the executive, financial and operational worldviews.

This is the actual 'turf' that gives rise to the endemic fiefdoms and siloing that pervade most organizations of any significant size. There is a leverage point that Lou Mobley discovered which can overcome this pernicious and pervasive situation. If a meeting of minds around the development of a shared 'sacred glossary' can be created by the 'captain of the ship' and 'steward of the treasure' in service of, and with meaningful input from the 'crew'(those that actually do the work), a rapid, positive and profound cultural shift is predictable from the 'Mobley Effect'. The Effect of Lou's approach was considered such a powerful competitive advantage by Tom Watson Jr. that he disallowed an article Lou had written for the Harvard Business Review when he was nearing retirement after 15 years at Sands Pt. In addition to lowering losses of operating cash (25 – 33+% in many companies) and margin that turf competition creates, this building of an explicit and evolving collaborative 'sacred glossary' will have a hugely positive impact on the market-wide difficulty experienced in many enterprise software systems conversions and cultural integrations required by mergers and acquisitions.

PMI's dozen SME pilots are a small beginning in the challenge to replicate the Mobley Effect. What will be required is a much more extensive version of the multiple series of collective conversations it took to enact FASB 95 from 1980 through 1987. PMI asserts that this hidden issue, and the generally unrecognized opportunity for exercising a new kind of leadership on the part of the CEO and CFO, will, when addressed, have a significant, positive and long-lasting impact on the nature of work and leadership in the larger institutions of US economy and society. The implications of creating a GAAP for Operations Accounting and Integral Operations Finance are far-reaching, especially for the CFO and finance functions in the future. It can only be positive and uplifting for all involved who have a genuine desire to serve the good of the whole.

### *Solving the Bottom Lines Puzzle: Knowing the Score*

708 Gravenstein Hwy. N. #135 • Sebastopol • CA 95472 • 707• 829•3976

[www.financialscoreboard.com/welcome.html](http://www.financialscoreboard.com/welcome.html)

[jballard@financialdashboard.com](mailto:jballard@financialdashboard.com)