

3 Total budget for Landscape

Sales	1,000 packets	£12,000
Cost of sales		<u>£6,700</u>
Gross profit		£5,300
Fixed overheads		<u>£2,500</u>
Net profit		£2,800

price and cost is used because the other variances in the reconciliation calculate price, cost and usage fluctuations.

Sales price variance ascertains whether the selling price was higher or lower than expected. So was the selling price above or below budget? Answer: 5p above per product. What is the total variance? Answer: £48 favourable (that is, 960 x £0.05).

The fixed overhead expenditure variance determines whether actual costs were above or below budget. Did PPL spend more or less money than expected? Answer: £100 adverse (that is, £2,500 – £2,600).

Although many students consider the calculation of variances to be difficult, understanding the reasons why variances are calculated will aid this process and help students to cope with “difficult” data. ■

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4 Actual results for Landscape

Sales	960 packets	£11,568
Cost of sales		£6,432
Material price variance		£106
Material usage variance		-£60
Labour rate variance		£11
Labour efficiency variance		-£20
Variable overhead expenditure variance		-£30
Variable overhead efficiency variance		<u>£15</u>
		£22
Gross profit		£5,158
Operating expenses		<u>£2,600</u>
Net profit		£2,558

5 Reconciliation for Landscape

Budgeted net profit		£2,800
Sales volume variance	-40 packets	-£212
Sales price variance		£48
Material price variance		£106
Material usage variance		-£60
Labour rate variance		£11
Labour efficiency variance		-£20
Variable overhead expenditure variance		-£30
Variable overhead efficiency variance		£15
Fixed overhead variance		-£100
Actual net profit		£2,558

Paramount pictures

Bob Scarlett

It's a simple idea: identify who's best at an activity that your organisation needs to improve and learn from what they do. So why isn't everyone benchmarking?

“Benchmarking is the process of improving performance by continuously identifying, understanding (studying and analysing), and adapting outstanding practices and processes found inside and outside the organisation, and implementing the results”

The American Productivity and Quality Centre, 1997

Benchmarking is an approach to performance management that starts with the premise that, whatever the process – be it supply, production, sales or services – our performance can best

be measured and managed by comparing it with that of an appropriate entity which is already achieving world-class performance. The entity we use to provide the benchmark needn't operate within the same sector. The benchmark can be from another organisation (an “external” benchmark) or a different segment within the same organisation (an “internal” benchmark).

A benchmark provides a standard of excellence against which to measure and compare. Benchmarks are performance measures – for instance, “how many?” (eg, customers served per employee per hour); “how quickly?” (eg, delivery time to customer); “how high?”

(eg, the proportion of sales giving rise to repeat business); and “how low?” (eg, proportion of defective products).

To be meaningful, a benchmark should relate to a key performance indicator – ie, something within the business's process that has a major influence on its results. Establishing benchmarks is a necessary part of the exercise, but it does not in itself provide an understanding of best practice. And nor does knowledge of the benchmarks necessarily lead to improvements. Benchmarking is the learning of lessons about how best performance is achieved. Rather than merely measuring performance, it focuses

on how to improve any given business process by discovering the practices that are responsible for high performance, understanding how they work and adapting them to your operation. A benchmarking exercise may take the form of a process comparison that doesn't involve the use of metrics.

Some writers identify three distinct approaches to benchmarking:

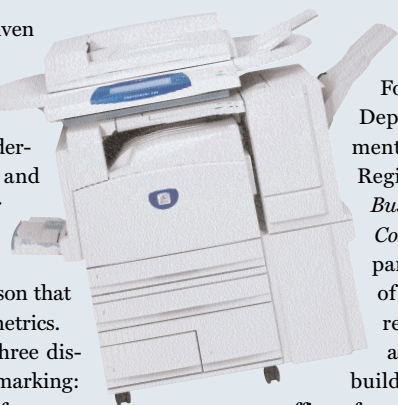
- **Metric** – the practice of comparing appropriate metrics to identify possible areas for improvement.
- **Process** – the practice of comparing processes with a partner as part of an improvement process.
- **Diagnostic** – the practice of reviewing the processes of a business to identify those that indicate a problem and offer potential for improvement.

The Xerox Corporation is often cited as the pioneer in benchmarking practice. When the company wanted to improve performance in its warehousing and distribution operation, it didn't go down the then conventional road of process redesign. Instead it identified the business that was acknowledged as the very best practitioner of warehousing and distribution: catalogue retailer LL Bean.

LL Bean agreed to conduct a co-operative benchmarking project and so the two firms exchanged information on various aspects of their inventory handling and processing of orders. As a result of this, Xerox identified those areas in its own operation that were performing at below LL Bean's standards and implemented improvements. One critical point to note is that Xerox adopted a business operating in a different sector altogether, instead of using another office equipment company as its model.

Many other high-profile cases have been reported in management literature. When IT services company ICL wanted to improve its distribution system, it benchmarked with Marks and Spencer, for example. And, when Motorola was trying to improve the process of delivering its mobile phones to customers, it benchmarked with both Domino's Pizza and Federal Express. American Express is widely regarded as a leader in payment collection. It has provided a benchmark in this area for many other businesses, most of which are not in the financial services sector.

Many benchmarking exercises have been sponsored by trade organisations, academic



groups and government departments. For example, the former Department of Environment, Transport and the Regions published the *Business Guide to Energy Costs in Buildings*, prepared with the support of CIMA. This guide reported energy usage across a wide variety of buildings, including offices, factories, shops and banks around the UK. Energy usage was reported using the metric energy consumption per square metre of floorspace for each type of building.

Two figures are given: one for "typical consumption" and one for "best-practice consumption". Every user has to multiply these metrics by an appropriate location factor (allowing for climate differences – eg, 1.1 for Scotland and 0.8 for southern England) in order to make the comparison with their own energy usage meaningful.

Energy usage in a building is very much influenced by its design, equipment and management. The installation of wall insulation, double glazing and energy-efficient light bulbs, combined with simple practices such as switching off computers outside office hours, can all achieve substantial cost savings. The potential benefits in this area may not be apparent to a business until a benchmarking exercise such as this has been conducted. The government department has reported cases where energy-saving programmes undertaken by businesses have saved up to 60 per cent of energy costs in certain buildings.

An article in *Total Quality Management* ("Collaborating to compete: benchmarking through regional partnerships", Vol 10, 1999) described the formation of a regional benchmarking network based at the Newcastle Business School. Businesses in the north-east of England subscribed to the network and formed eight special-interest groups, each with a facilitator, to conduct a variety of process benchmarking exercises.

Benchmarking in all its varied forms is becoming widespread in manufacturing, services and the public sector. In particular, it's seen to offer a more sophisticated tool in performance management than more traditional approaches such as standard costing. The general thrust behind this idea is that standard costing belongs to the era when goods were produced in continuous production runs and when a high proportion of

costs were "product specific". In the new economy, goods tend to be highly customised, contain a significant service element and are produced in short production runs on a just-in-time basis. A large proportion of product costs are determined at the design stage or are "customer specific" – ie, they relate to the way in which the goods are provided to the customer. Efficiency is therefore a function of product engineering, the flexibility of the production operation and customer relationship management.

Some people argue that the traditional budgetary control report based on standard costing simply does not address these issues. A comprehensive system of benchmarking can give a much fuller impression of how well or badly an operation is performing, and it's more likely to give an idea of those areas that can be improved.

That said, benchmarking has its critics. John Puckett, of the Boston Consulting Group, was quoted as saying: "Benchmarking relies on competitive data that isn't readily available. When the data is available, it may be neither accurate nor timely. Moreover, it allows a comparison at only one point and does not provide a way to improve performance continually."

That's a fair comment, but the discussion above shows some of the ways in which this criticism might be answered. For one thing, benchmarking need not rely on competitive data. As with most business techniques, it has to be done well if it's to yield results.

The "pursuit of best practice" concept is widely regarded as the way of the future and has become increasingly popular among practitioners of various management disciplines since the 1990s. The ever-growing body of literature on benchmarking indicates its widespread adoption. It's predicted that this momentum will grow in the future as benchmarking becomes the normal way

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