The Gartner Business Value Model: A Framework for Measuring Business Performance

Business Intelligence Summit

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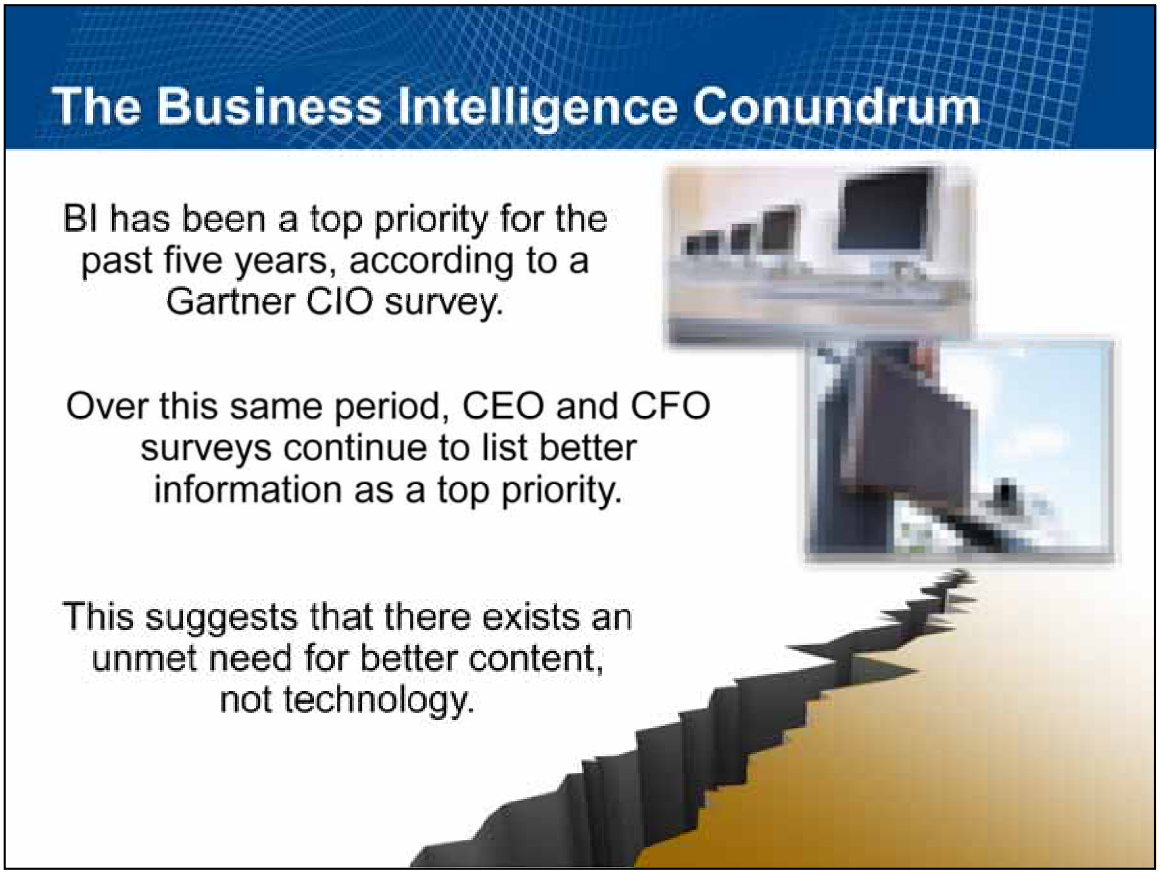
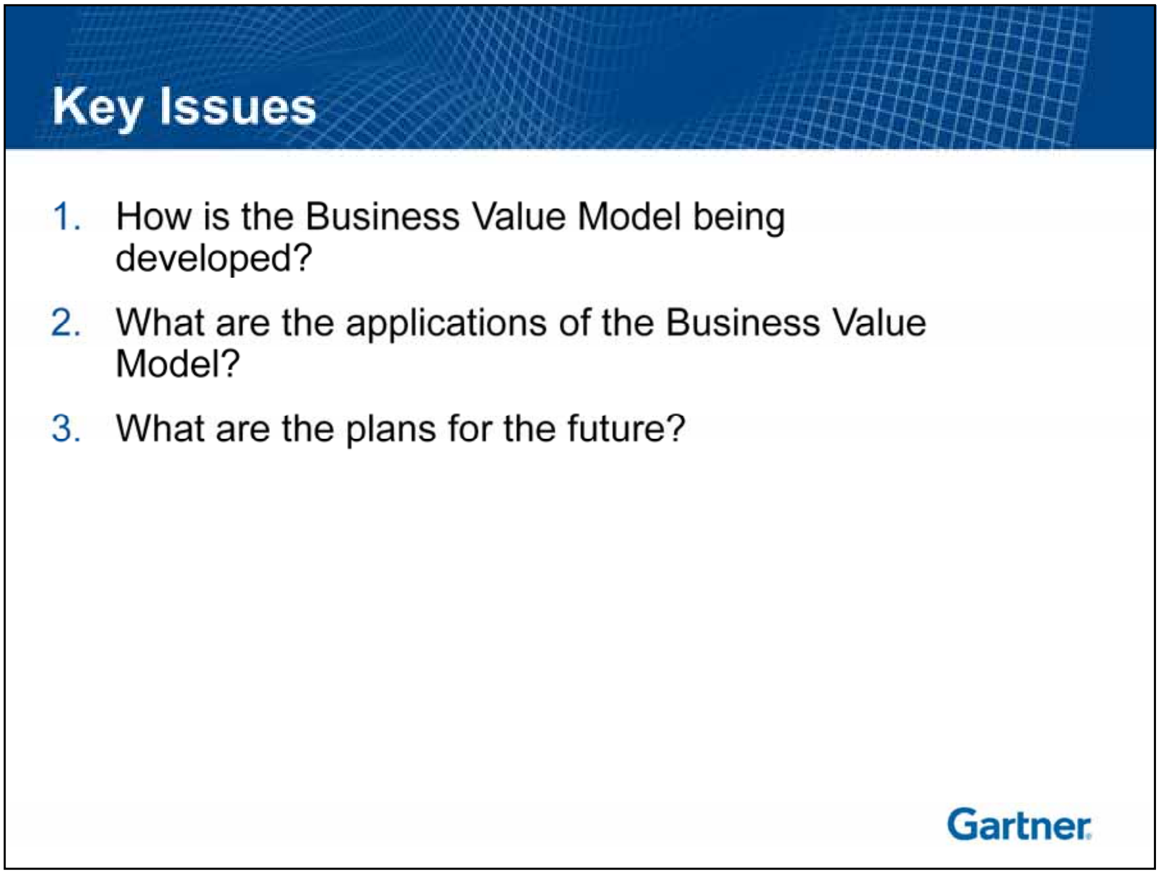
Gartner®



For over a decade, Gartner has conducted an annual CIO survey, which lists business intelligence (BI) as a top technology priority year after year. Over the past several years, CEO and CFO surveys from PricewaterhouseCoopers (PWC), Deloitte and IBM list better information for decision making as a top priority. The persistence of these priorities suggest an unmet need, and the focus suggests why this need remains unmet. CIOs view BI as a technology, while senior business executives view BI as information content.

The Gartner Business Value Model is all about information content and is targeted at providing senior business executives with the information they need to make better decisions.



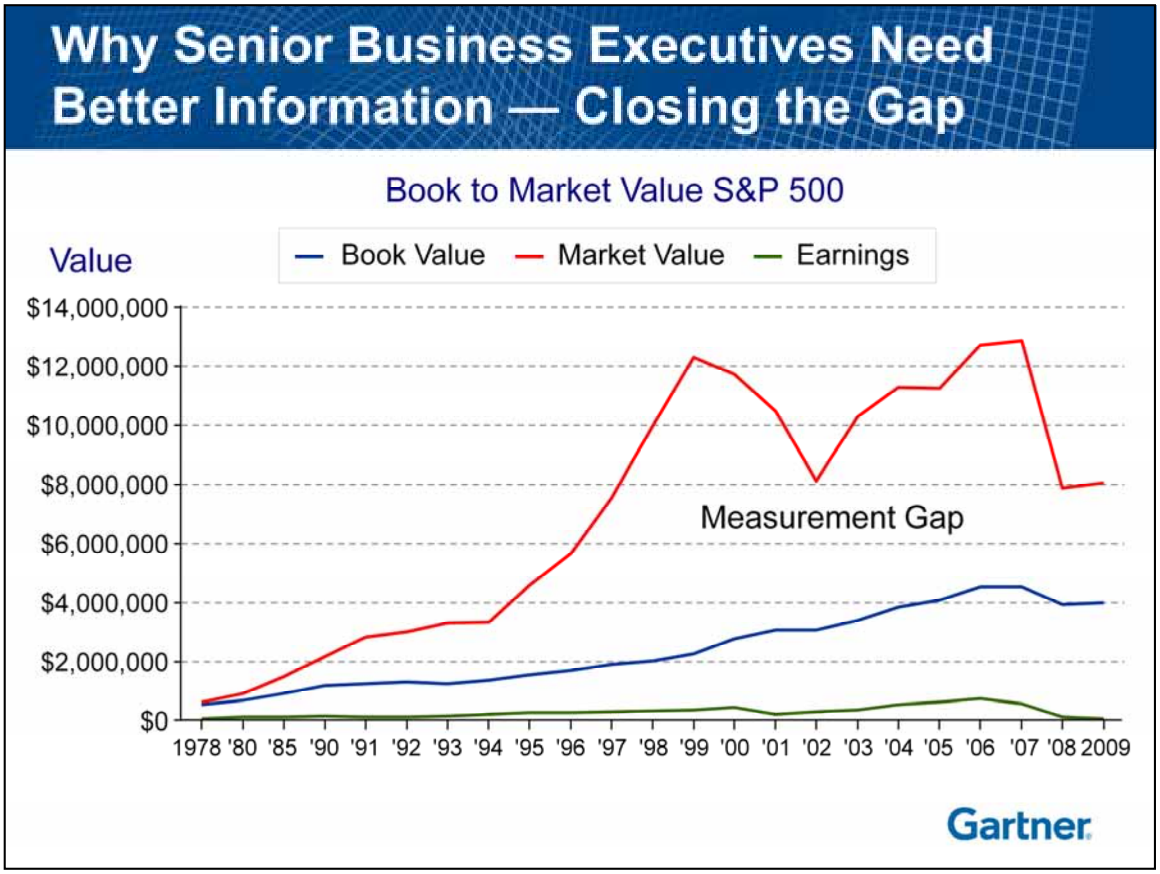
The key issues we will address in this presentation are:

• How is the Gartner Business Value Model being developed? What criteria are being used to select the metrics that provide real insight on how business value is created?

• What are the applications of the model? How can internal management teams use the model to make better decisions? How can senior executives use the model to communicate more effectively with external stakeholders?

• What are the plans for the model in the future? How will the metrics be recognized as industry standards?

Key Issue: How is the Business Value Model being developed?



The Internet and housing bubbles of the last decade can be used to illustrate the effects of risk and uncertainty, as well as the potential value of improved information. This slide shows the volatility of the S&P 500 over the past 30 years. The red line is the market capitalization (the value of which they are trading) of all 500 companies. The blue and green lines are the currently disclosed accounting measures of financial value and performance. The "measurement gap" exists because current "industrial" accounting measures do not give stakeholders enough insight into company performance to really understand how a business is performing. The re-occurring bubbles in market value (years '95-'99 and '03-'07) are caused by factors that are not represented in current financial disclosures. This gap in visibility to facts that are critical to assessing market value creates periods of uncertainty and risk in which exploitation (excessive executive compensation) can occur on the upswing, and dislocations (high unemployment) on the downswing. Current financial reporting provides very limited information on market value and is usually too late for stakeholders to anticipate issues. Filling this gap is what business executives are seeking to mitigate risks and exploit opportunities.

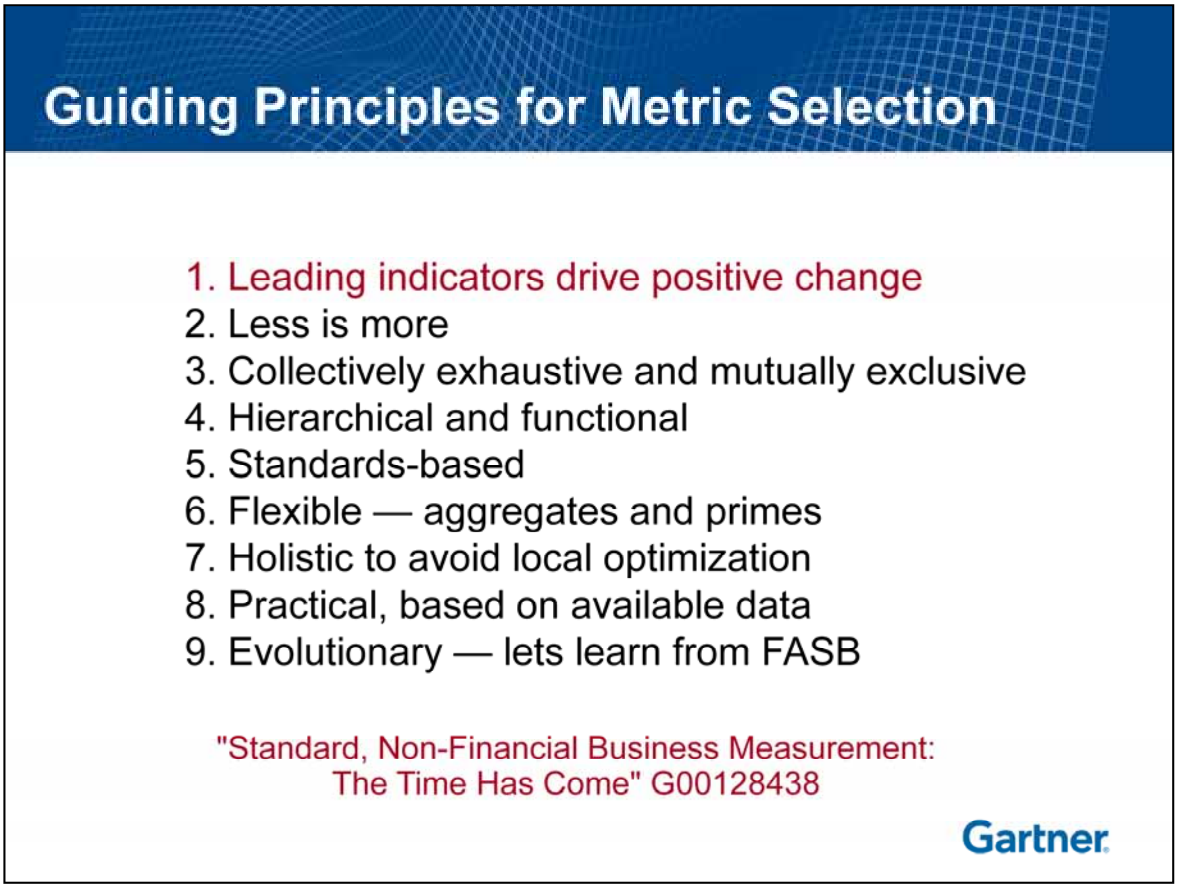
Key Issue: How is the Business Value Model being developed?

The Initiative: To identify and develop industry standard measures that are predictive of financial results. There is a difference between identifying such measures and establishing them as industry standards. This initiative will do both.

The Opportunity: Exists for the primary stakeholders (such as corporations, investors, sell-side analysts and IT providers). The opportunity is to be among the first to recognize the need for voluntary industry standard measures that are predictive of financial results, develop the competencies and capabilities in the areas being measured, and harvest the benefits.

Who Is Involved: Gartner, The Enhanced Business Reporting Consortium, World Intellectual Capital Initiative, XBRL International, financial analysts and investors.

Strategic Imperative: A standard business performance framework is required to close the measurement gap in corporate performance management.



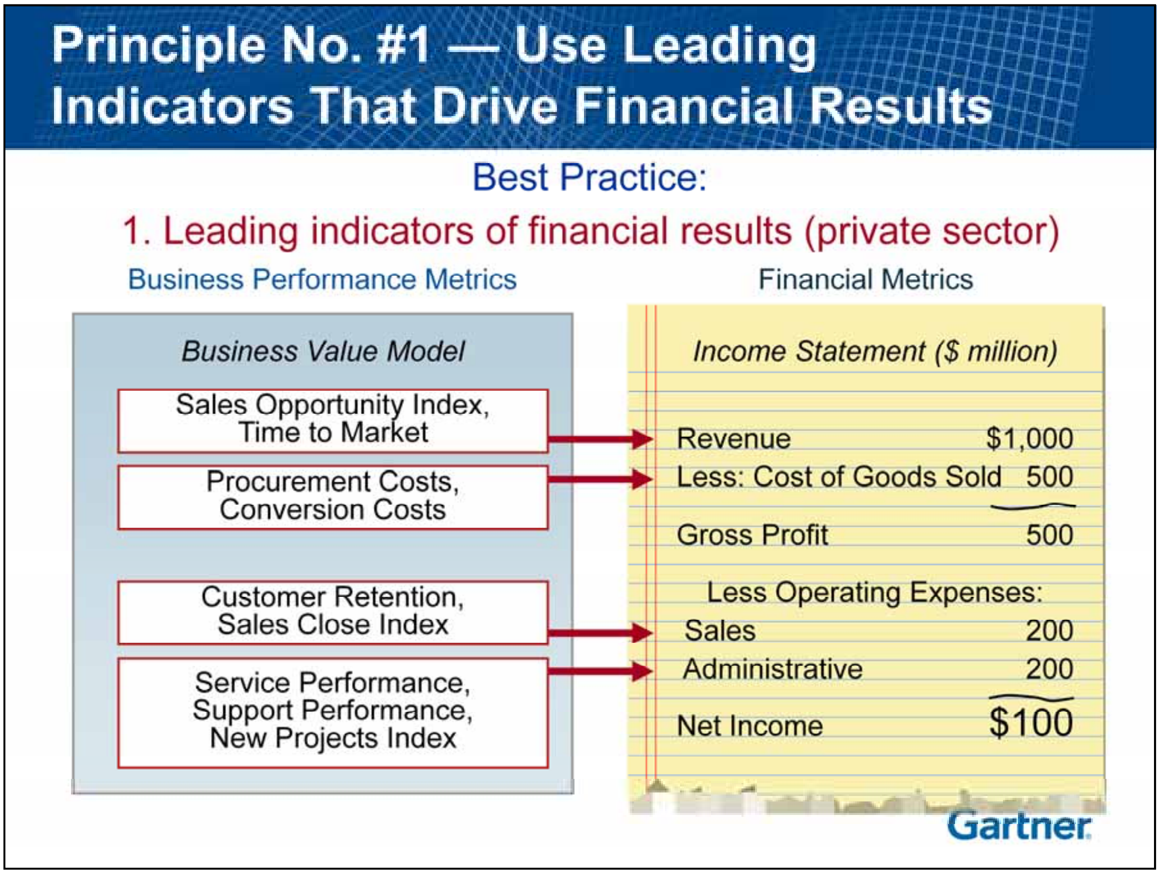
Key Issue: How is the Business Value Model being developed?

The following principles were developed to guide the development of the Gartner Business Value Model (see "Standard, Non-Financial Business Measurement: The Time Has Come" G00128438):

- All metrics, when used collectively, are leading indicators of financial performance.
- No more than seven (plus or minus two) metrics are to be used at any given level.
- The metrics should be collectively exhaustive and mutually exclusive.
- The metrics should focus on the executive and middle management levels.
- The metrics should be based on standard prime metrics to foster collaboration and enable the comparison of internal and external entities.
- The metrics should be made flexible by an architecture that allows many combinations of standard and custom metrics.
- The holistic nature of the model should capture the cause-and-effect relationships between business functions.
- The metrics should be selected based on data available in automated business systems.
- The model should evolve and develop over time by adding and deleting metrics.

Action Item: Become familiar with the guiding principles for metric selection before building your enterprise metrics framework..

Decision Framework: Business performance metrics must disaggregate financial (or regulated) metrics into categories that can be clearly monitored and managed. This is the first step in identifying what processes influence financial results.



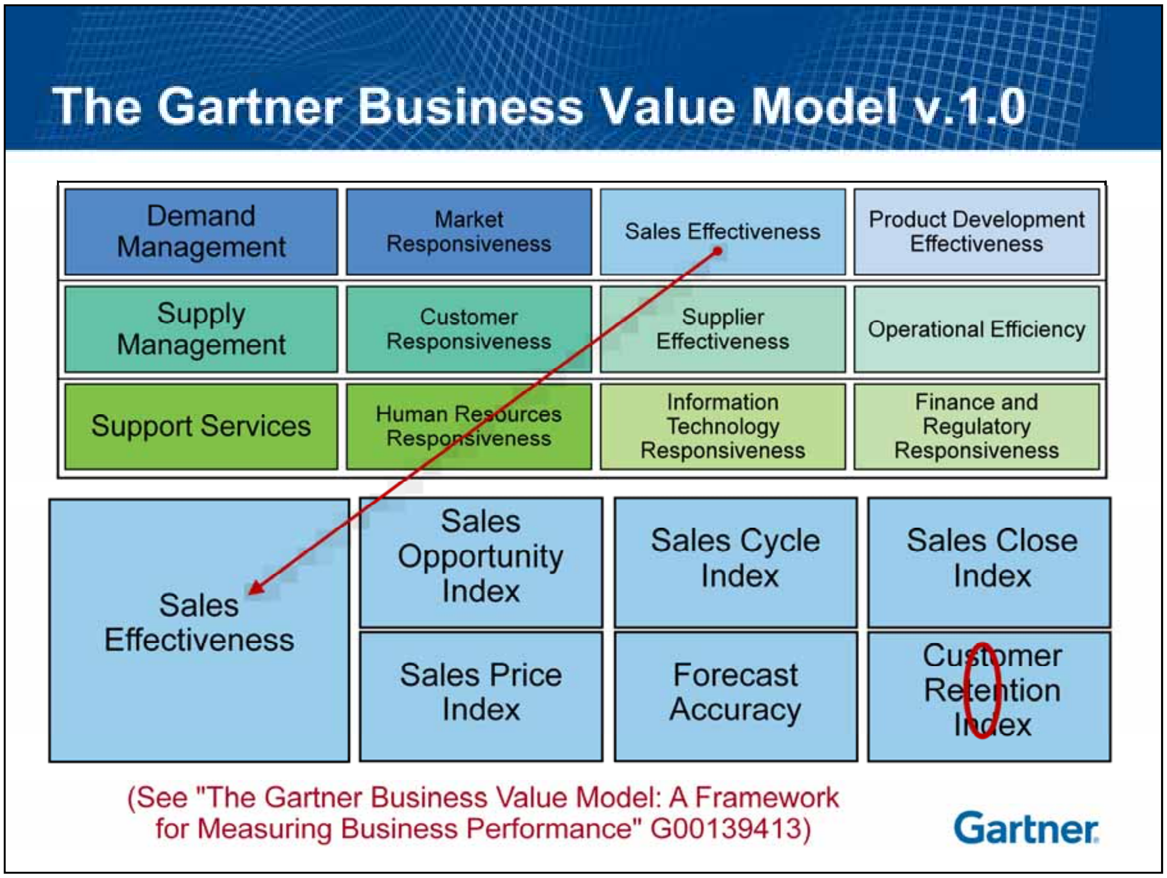
Key Issue: How is the Business Value Model being developed?

One of the best practices for selecting Level 2 performance metrics is that they need to be leading indicators of financial results. What exactly is a leading indicator? It depends on what you are trying to predict. In for-profit companies, the end-state value objective is the income statement (example above). To find the leading indicators of profitability, we start by mapping your business processes to the income statement.

A business process is a series of activities to accomplish a business purpose. By measuring the activities that are performed inside these processes, we can determine the leading indicators of financial results. For example, one of the activities in a typical sales process is qualifying a sales lead. Measuring the number of qualified sales leads in a given time period is a leading indicator of the end-state objective: revenue. The principles for selecting performance metrics cannot be used in isolation. Consider all the principles in combination before selecting performance metrics.

Action Item: Map the business process important to your organization to the strategic position being considered. Identify the processes that support the strategic position and the activities these processes include. Measure the activities to provide the leading indicators for your strategy.

Definition: Business performance metrics disaggregate financial (GAAP/ISA) metrics into categories that can be more clearly monitored and managed. This is the first step in establishing which activities influence financial results.



Key Issue: How is the Business Value Model being developed?

Each aggregate measure breaks down further into what we call prime measures. This slide shows the prime measures for sales effectiveness. There are prime measures behind each of the other aggregates shown on the slide. Our research looked at a number of outside organizations and thought leaders, such as the supply chain council and the product development and management association, in compiling these prime measures. To guide us in this process, we followed the nine principles described earlier. One of those principles is that the measures selected for each aggregate must be "mutually exclusive and collectively exhaustive." This is a fancy way of saying that there should not be any gaps or overlaps in the measures. If you look at the prime measures listed here, you can see that each one measures a different attribute of sales effectiveness. The sales opportunity index measures new opportunities being generated; the sales cycle index measures the length of time it takes to process a sales opportunity; and sales close measures the success rate of the sales process. The same approach was used for the other aggregates and primes.

Action Item: Build a well-balanced set of mid- to high-level performance metrics that can be used for various managerial decisions. Quantifying project benefits is easier when the performance metrics have been predetermined and are not project-specific.

Tactical Guideline: Sales executives should focus on established metrics that assess the effects of investments and strategies that improve sales effectiveness.

The Format of the Metric Definitions Example: Customer Retention Index

Customer Retention Index

Business Aspect: Demand Management **Aggregate Measure:** Sales Effectiveness

Definition	The Customer Retention Index shows how well existing customer needs are being identified and satisfied.
Calculation	Customer Retention Index = Customers Who Have Made a Purchase Within the Pervious 12 Months / Total Customers Where: Buying Cycle = baseline buying cycle time for industry in which organization competes, typically one year.
Example	ABC Computers operates in an industry with buying cycle = 6 months. Total existing customers = 75 Customers who made no purchase within last 6 months = 30 Customer Retention Index = 1 – (30 / 75) = 60%
Applications	A higher index demonstrates the organization's ability to satisfy existing customer needs, measured by their desire to purchase more products or services. It is cheaper to retain a customer than to have to acquire a new one. The income statement account most affected by the Customer Retention Index is **revenue**.
Potentially Affected Primes	Market Share Index, Sales Cycle Index, Sales Close Index, Sales Price Index and Cost of Sales Index

Key Issue: How is the Business Value Model being developed?

This slide shows an example of the format for the definitions for each of the metrics in the Business Value Model. The formats include:

- The definition
- The calculation
- An example
- Application of the metric and the financial metrics affected
- Other metrics in the business model affected by changes in the one defined

Because the metrics are based on standard definitions, benchmarks are available from a variety of data aggregators by industry.

Warning: This Is An "Eye Chart" — The Complete Gartner Business Value Model

Business Aspect	Aggregate Metrics	Prime Metrics			
Demand Management	Market Responsiveness	Target Market Index	Market Coverage Index	Market Share Index	Opportunity/Threat Index
		Product Portfolio Index	Channel Profitability Index	Configurability Index	
	Sales Effectiveness	Sales Opportunity Index	Sales Cycle Index	Sales Close Index	Sales Price Index
		Cost-of-Sales Index	Forecast Accuracy	Customer Retention Index	
	Product Development Effectiveness	New Products Index	Feature Function Index	Time-to-Market Index	R&D Success Index
Supply Management	Customer Responsiveness	On-Time Delivery	Order Fill Rate	Material Quality	Service Accuracy
		Service Performance	Customer Care Performance	Agreement Effectiveness	Transformation Ratio
	Supplier Effectiveness	Supplier On-Time Delivery	Supplier Order Fill Rate	Supplier Material Quality	Supplier Service Accuracy
		Supplier Service Performance	Supplier Care Performance	Supplier Agreement Effectiveness	Supplier Trans-formation Ratio
	Operational Efficiency	Cash-to-Cash Cycle Time	Conversion Cost	Asset Utilization	Sigma Value
Support Services	Human Resources Responsiveness	Recruitment Effectiveness Index	Benefits Administration Index	Skills Inventory Index	Employee Training Index
		HR Advisory Index	HR Total Cost Index		
	Information Technology Responsiveness	Systems Performance	IT Support Performance	Partnership Ratio	Service-Level Effectiveness
		New Projects Index	IT Total Cost Index		
	Finance & Regulatory Responsiveness	Compliance Index	Accuracy Index	Advisory Index	Cost-of-Service Index

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Key Issue: How is the Business Value Model being developed?

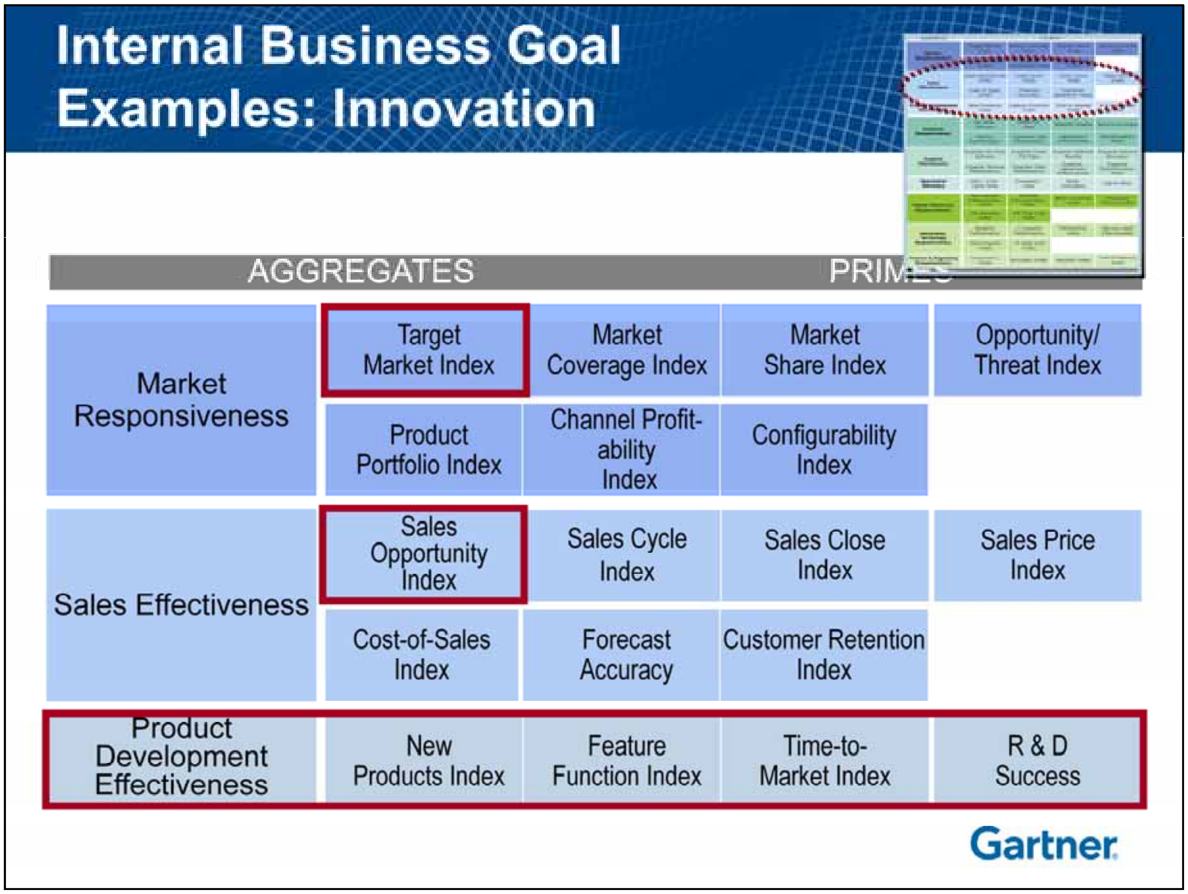
The Business Value Model (see "The Garter Business Value Model," G00139413) provides the common language necessary to bridge the gap between high-level strategic positions and the tactical activities necessary to make them happen. It does not replace standard financial metrics, it extends them. The Business Value Model adheres to the best practices for building a causal model. It is made up of leading indicators of financial results. The metrics are mutually exclusive and collectively exhaustive at a mid to upper management level, there are no more then 7 (+/- 2) metrics at any given management level and the relationships between the metrics (cause and effect) have been documented.

The activities measured fall into three broad groups: demand management, supply management and support services. They are further broken down into "aggregate measures." Each aggregate measure breaks down further into what we call prime measures. This slide shows the prime measures for sales effectiveness. There are prime measures behind each of the other aggregates shown on the slide. Our research looked at a number of outside organizations and thought leaders, such as the Supply Chain Council and the Product Development and Management Association, in compiling these prime measures.

This model is a tool that can be used to reduce the time and risk of identifying, building and managing an integrated set of activities necessary to execute a strategic position.

Action Item: Compare your organization's broadly used operational metrics to the standard metrics that can be benchmarked in the Gartner Business Value Model, noting gaps and overlaps.

Key Issue: What are the applications of the Business Value Model?

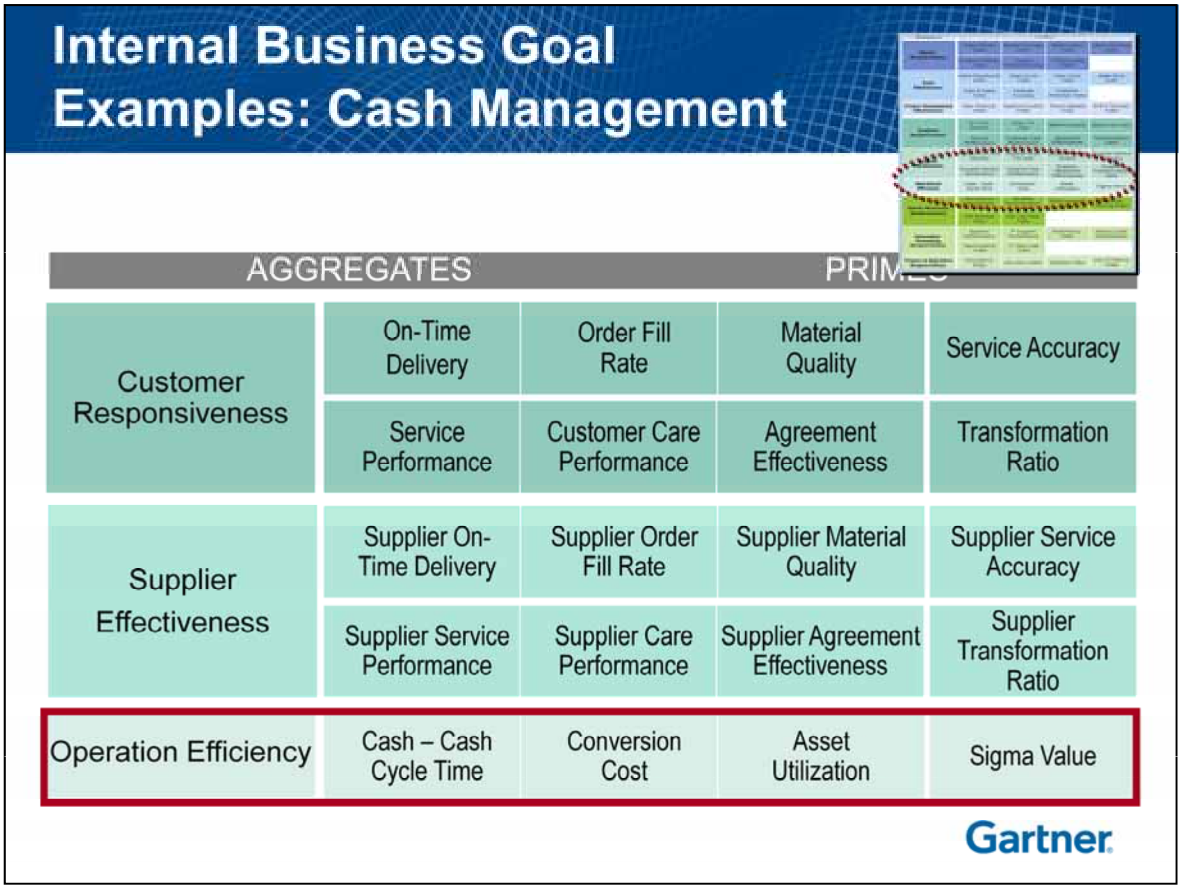


The following few slides contain common business aspirations:

- To be innovative
- To improve cash management
- To increase sales profitability
- To increase customer satisfaction
- To improve supplier management

Without metrics to measure performance, these goals are often difficult to achieve. The following slides provide examples of how the Business Value Model can be used for this purpose.

Action Item: The Business Value Model has many internal applications.


Internal Business Goal
Examples: Cash Management
AGGREGATES
PRIM
Customer Responsiveness
On-Time Delivery
Order Fill Rate
Material Quality
Service Accuracy
Service Performance
Customer Care Performance
Agreement Effectiveness
Transformation Ratio
Supplier Effectiveness
Supplier On-Time Delivery
Supplier Order Fill Rate
Supplier Material Quality
Supplier Service Accuracy
Supplier Service Performance
Supplier Care Performance
Supplier Agreement Effectiveness
Supplier Transformation Ratio
Operation Efficiency
Cash – Cash Cycle Time
Conversion Cost
Asset Utilization
Sigma Value
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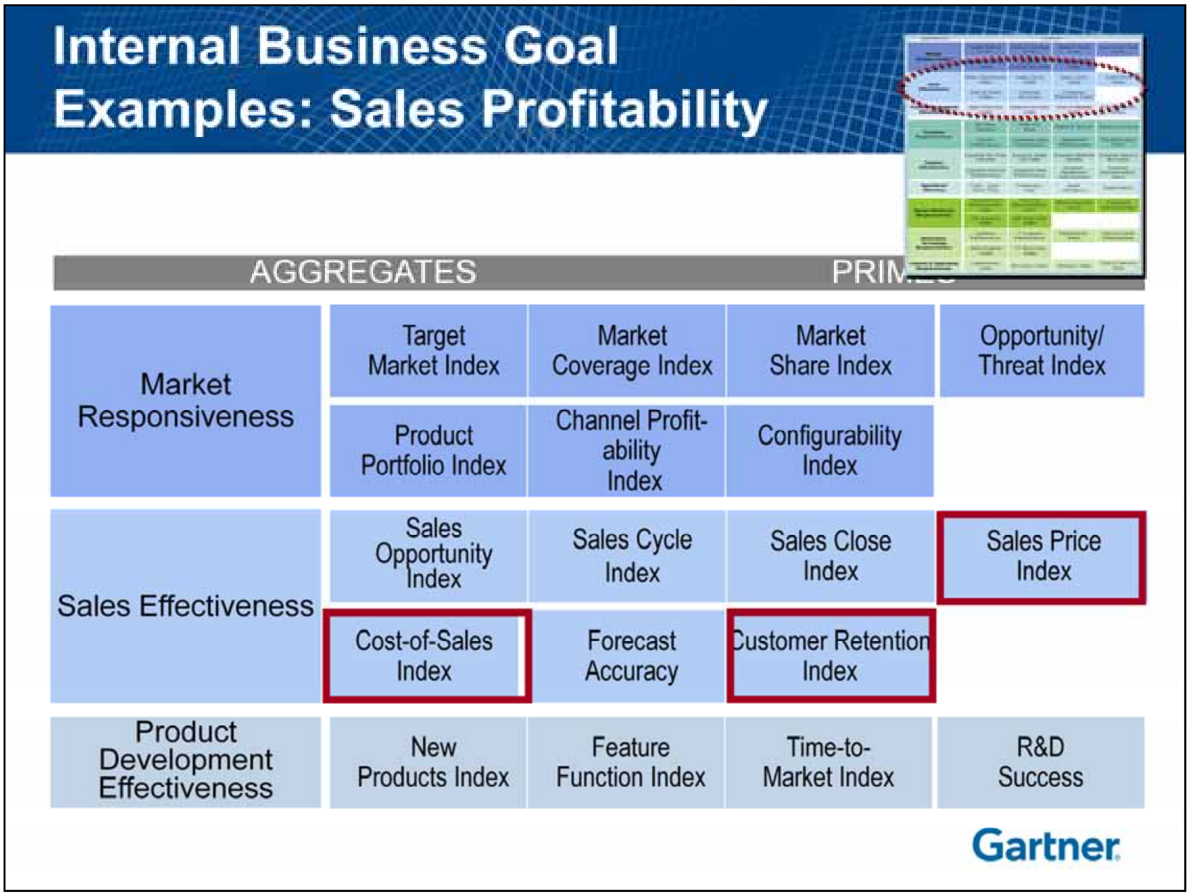
Internal Business Goal
Examples: Sales Profitability
AGGREGATES
Market Responsiveness
Target Market Index
Market Coverage Index
Market Share Index
Opportunity/ Threat Index
Product Portfolio Index
Channel Profit-ability Index
Configurability Index
Sales Effectiveness
Sales Opportunity Index
Sales Cycle Index
Sales Close Index
Sales Price Index
Cost-of-Sales Index
Forecast Accuracy
Customer Retention Index
Product Development Effectiveness
New Products Index
Feature Function Index
Time-to-Market Index
R&D Success
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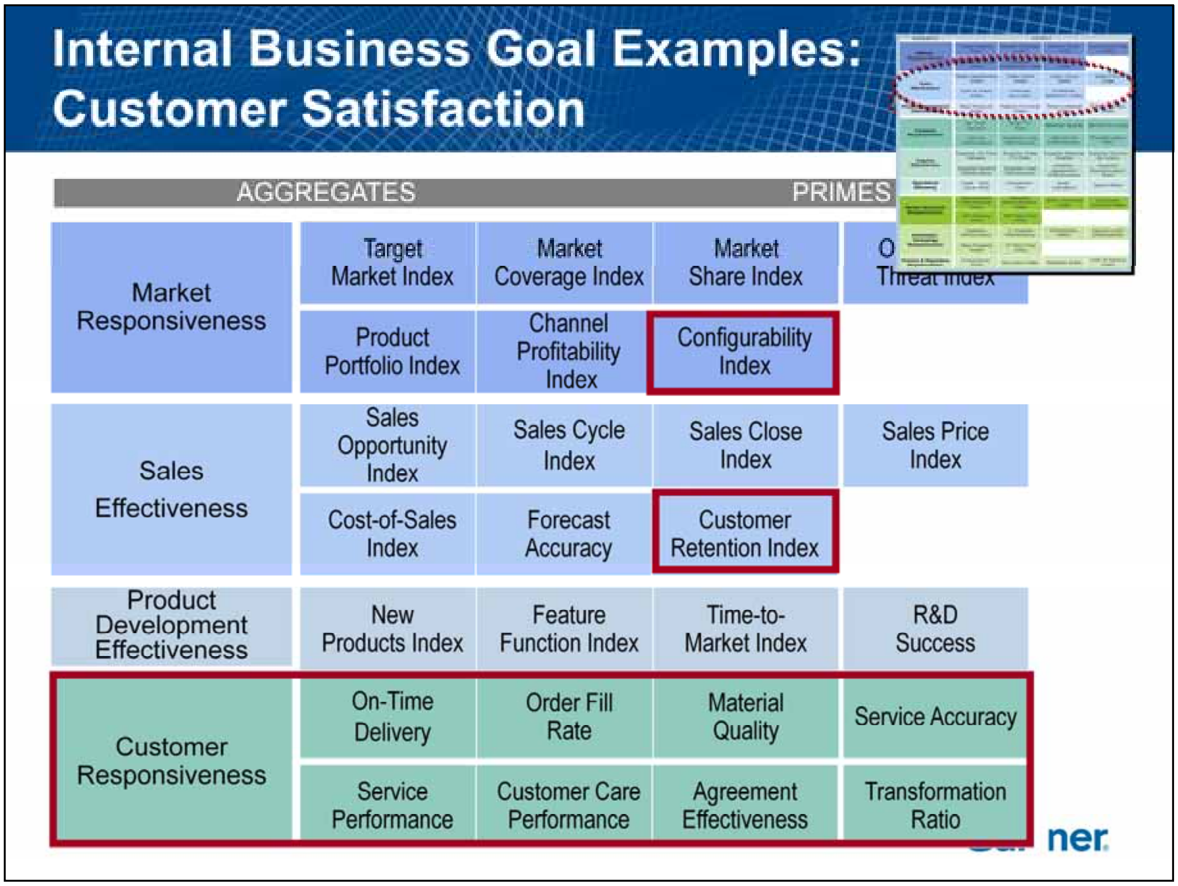
Internal Business Goal Examples:
Customer Satisfaction
AGGREGATES
PRIMES
Market Responsiveness
Target Market Index
Market Coverage Index
Market Share Index
O
Threat Index
Product Portfolio Index
Channel Profitability Index
Configurability Index
Sales Effectiveness
Sales Opportunity Index
Sales Cycle Index
Sales Close Index
Sales Price Index
Cost-of-Sales Index
Forecast Accuracy
Customer Retention Index
Product Development Effectiveness
New Products Index
Feature Function Index
Time-to-Market Index
R&D Success
Customer Responsiveness
On-Time Delivery
Order Fill Rate
Material Quality
Service Accuracy
Service Performance
Customer Care Performance
Agreement Effectiveness
Transformation Ratio

Internal Business Goal Examples: Supplier Management

AGGREGATES	PRIM			
Customer Responsiveness	On-Time Delivery	Order Fill Rate	Material Quality	Service Accuracy
	Service Performance	Customer Care Performance	Agreement Effectiveness	Transformation Ration
Supplier Effectiveness	Supplier On-Time Delivery	Supplier Order Fill Rate	Supplier Material Quality	Supplier Service Accuracy
	Supplier Service Performance	Supplier Care Performance	Supplier Agreement Effectiveness	Supplier Transformation Ratio
Operation Efficiency	Cash – Cash Cycle Time	Conversion Cost	Asset Utilization	Sigma Value

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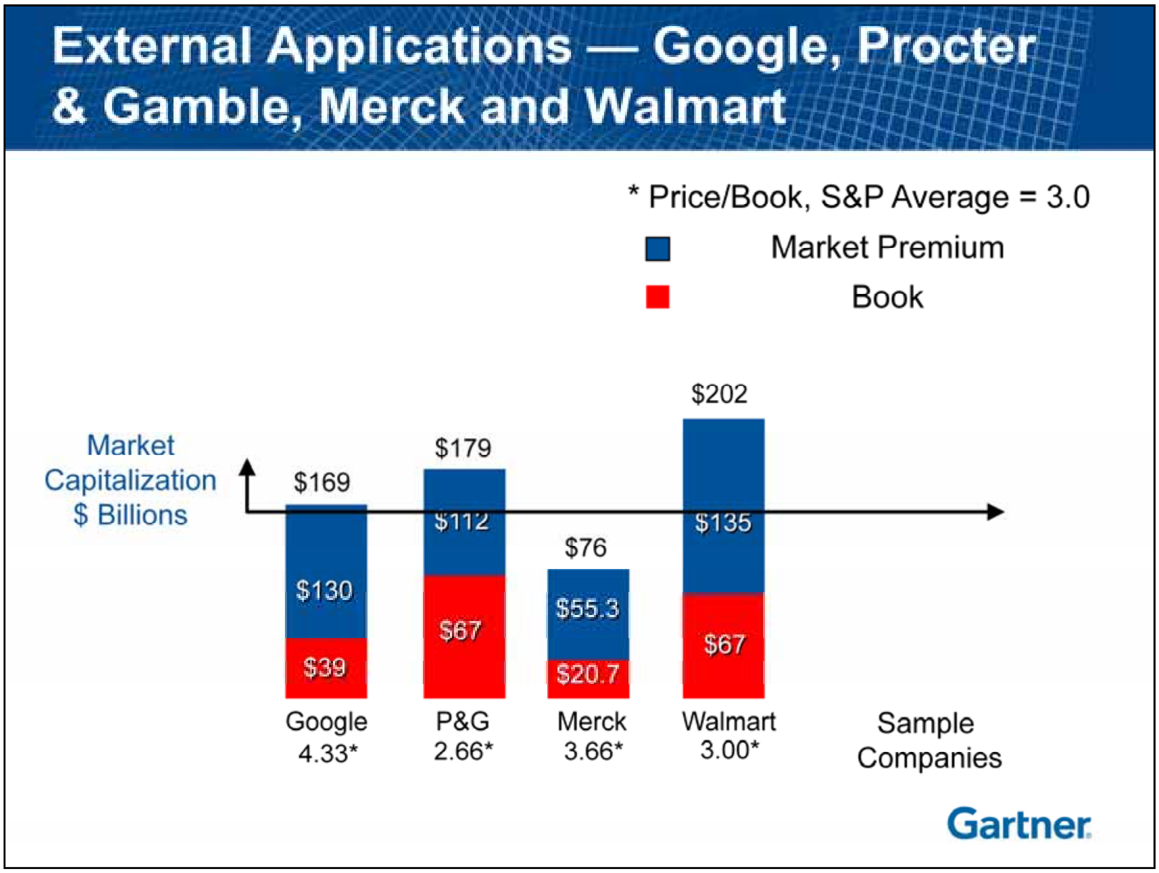
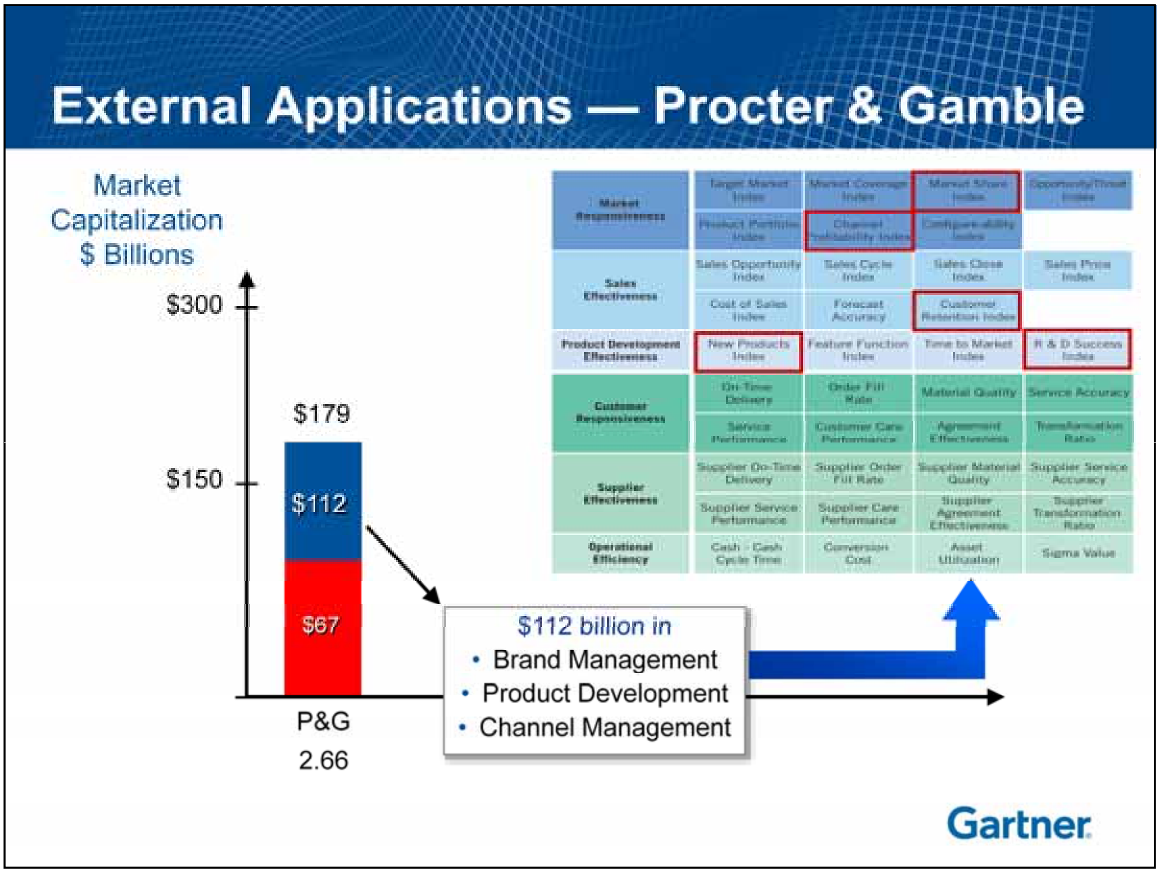


Key Issue: What are the applications of the Business Value Model?

The following two slides demonstrate how the Business Value Model can be used to communicate with external stakeholders.

Companies can use the standard metrics to explain business strategy.

Action Item: The Business Value Model has many external applications.


External Applications — Procter & Gamble
Market Capitalization $ Billions
$300
$150
$179
$112
$67
P&G
2.66
Market Responsiveness
Target Market Index
Market Coverage Index
Market Share Index
Opportunity/Threat Index
Product Portfolio Index
Channel Profitability Index
Configure-ability Index
Sales Effectiveness
Sales Opportunity Index
Sales Cycle Index
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Agreement Effectiveness
Transformation Ratio
Supplier Effectiveness
Supplier On-Time Delivery
Supplier Order Fill Rate
Supplier Material Quality
Supplier Service Accuracy
Supplier Service Performance
Supplier Care Performance
Supplier Agreement Effectiveness
Supplier Transformation Ratio
Operational Efficiency
Cash - Cash Cycle Time
Conversion Cost
Asset Utilization
Sigma Value
$112 billion in
• Brand Management
• Product Development
• Channel Management
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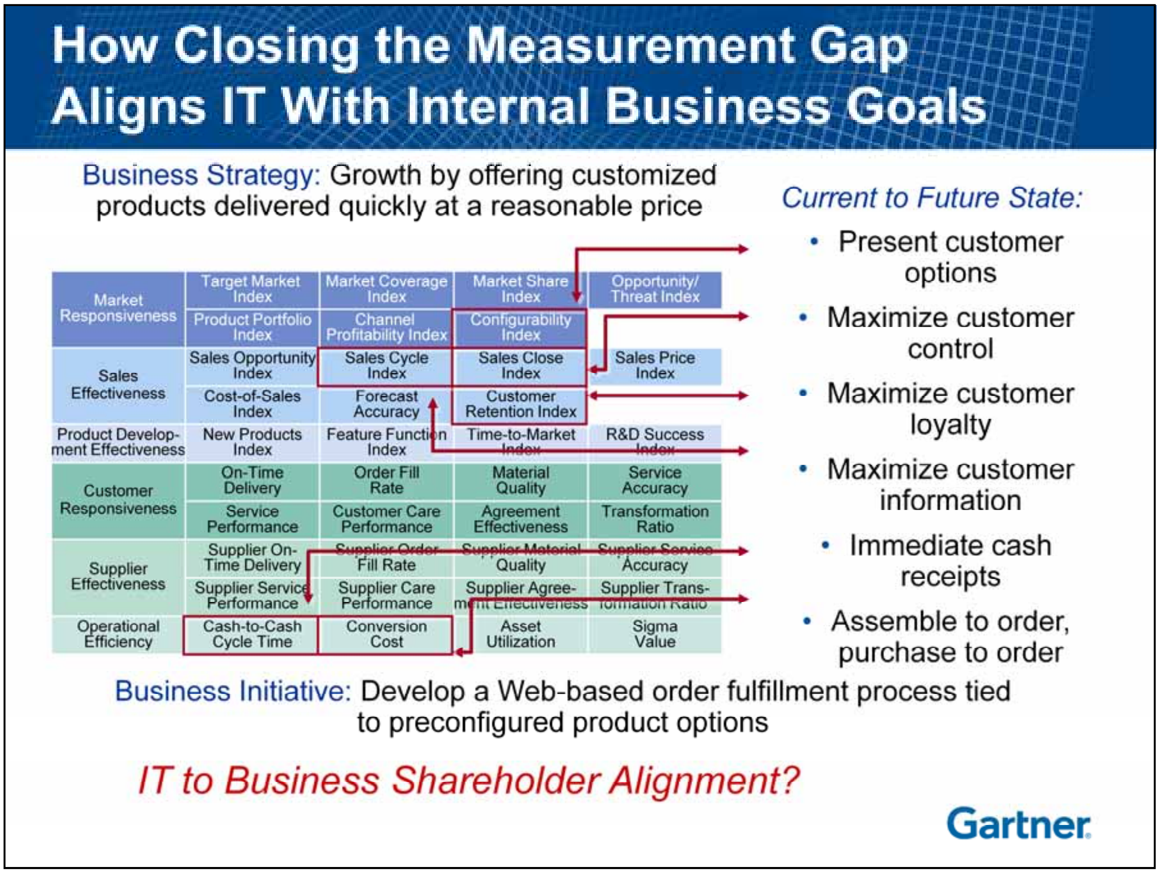
Strategic Imperative: Translate vision into action with the common language of performance metrics.



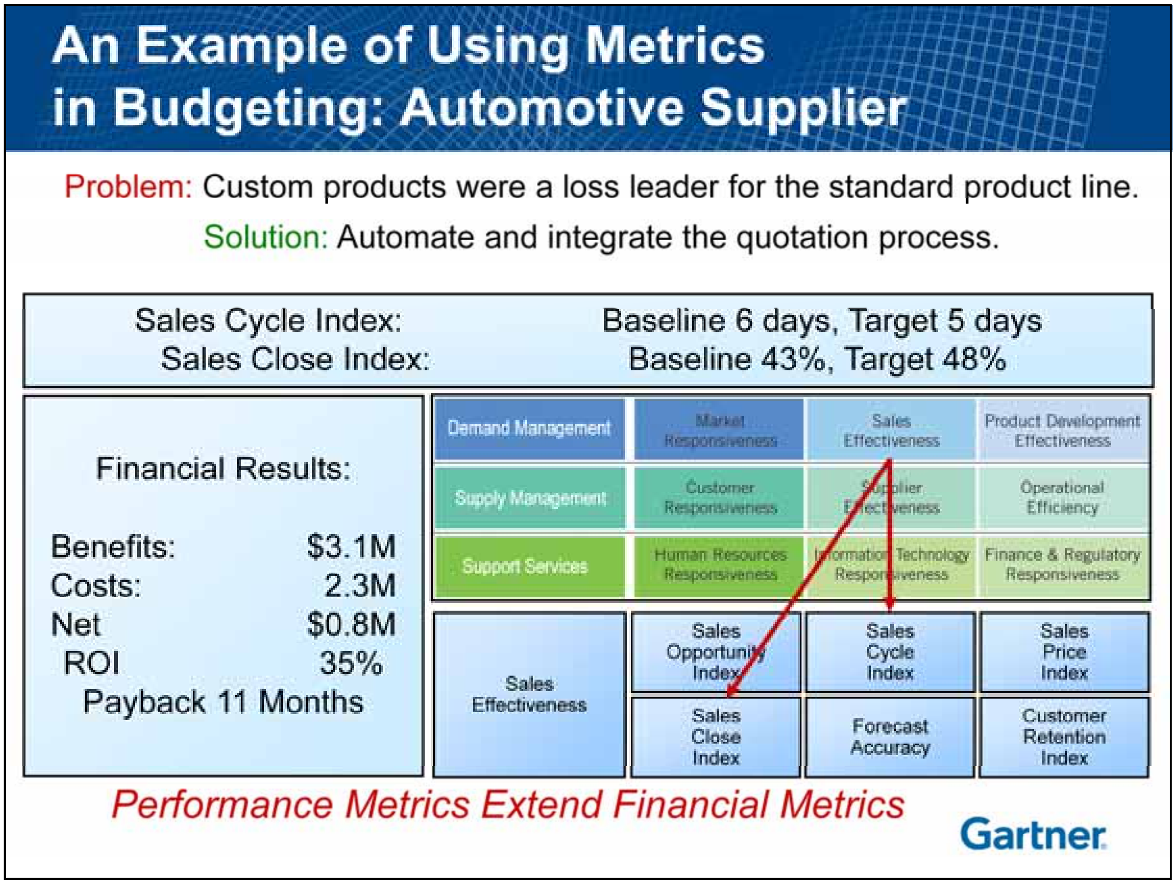
Key Issue: What are the applications of the Business Value Model?

The following is an example of how to use performance metrics to identify the activities necessary to optimize the business strategy. In this example, the business executives have identified a strategic position to exploit unmet consumer demand for customized products with quick delivery and at a reasonable price.

In the example on the slide, the Business Value Model is used to identify activities that support this strategic position. Marketing and sales activities are selected to focus on consumer needs and ways of engaging them. Operational activities are selected to ensure profitability at a reasonable price. Using the metric definitions, data can be collected on each of these activities to baseline performance. Then the management team can begin to look for ways of improving performance in each of the activities selected. Process improvements enabled by technology as well as organizational changes can be identified and form the basis of a list of candidate objectives. The management team then estimates the targeted improvements to the performance measures selected, resulting from various combinations of candidate objectives. These targeted improvements are translated into financial results using the relationship documented in the Business Value Model. This approach reduces the time and risk of identifying an integrated set of activities that optimizes execution of the strategy. It also provides business executives and their management teams with a way to monitor progress objectively.

Action Item: Conduct a pilot strategy-mapping exercise using the Business Value Model with a business unit or profit-and-loss center in your organization.

Case Study: This is an example of an ROI calculation, produced by a Tier 2 automotive supplier in EMEA. It demonstrates how to use business performance metrics to identify, measure and monitor financial results.



Key Issue: What are the applications of the Business Value Model?

Client Company TVO Proof of Concept Strategy Document

Total revenue from the business units covered in this pilot was $1.31 billion. Operating profit from these business units was $25 million. Total sales opportunities per month = 10,500; total successful sales per month = 4,500. Average duration of the sales process = six days.

1. Sales Cycle Index — Baseline six days, targeted improvement 17% to five days

Financial sensitivity = % improvement * sales close index * revenue * net operating income as a percentage of company revenue

Results for Quotation Solution:

Financial Sensitivity = .17 * .43* 1,310,000,000 * (25/1,310) = $1,827,500

2. Sales Close Index — Baseline 43%, targeted improvement 11.6% to 48%

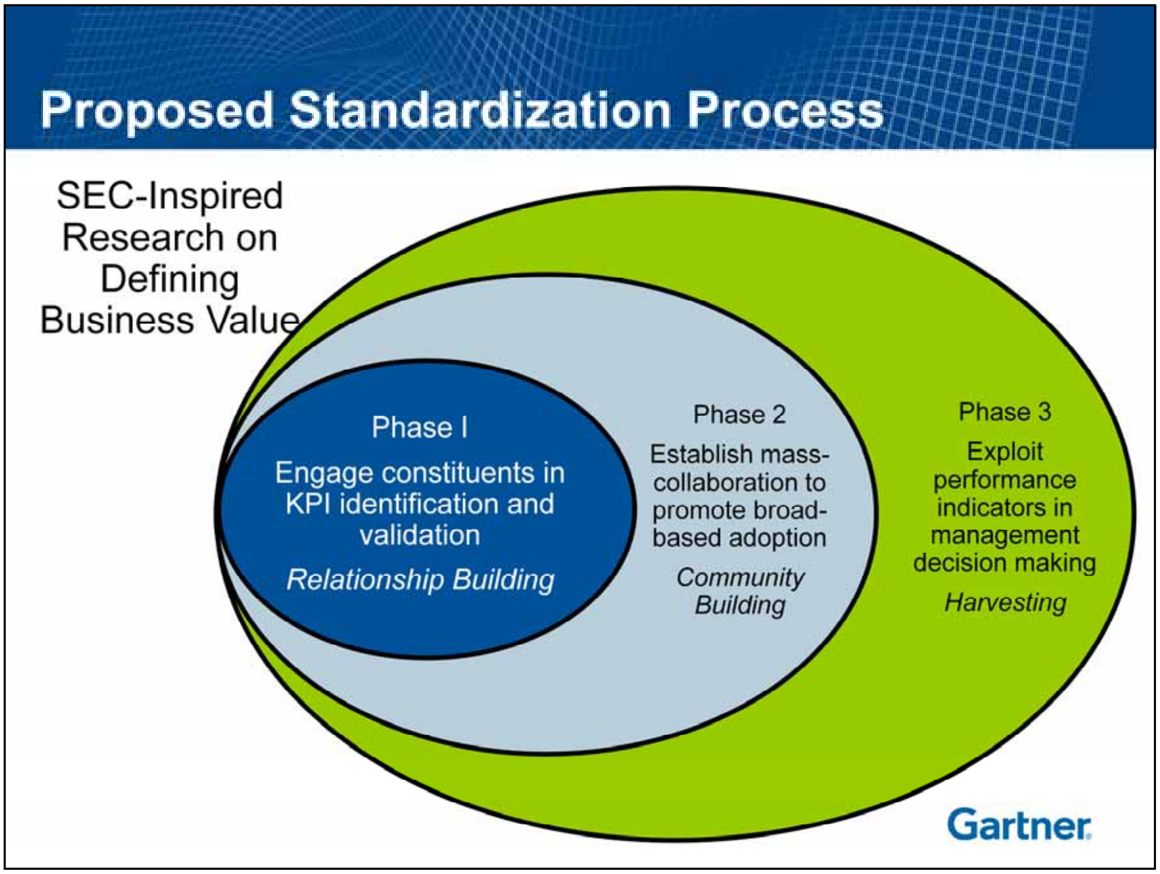
Successful sales opportunities (4,500)/total sales opportunities (10,500) = .43

Financial sensitivity = baseline *% improvement * net operating income

Results for quotation solution:

Financial sensitivity = .43 * .116 * 25,000,000 = $1,247,000

Key Issues: What are the plans for the future?



Phase I:

1. Chose three industries based on top tier of Reuters industry classification schema. For each industry:
2. Recruit representatives from each of the following constituents: corporations (business executives), financial analysts and institutional investors, and IT providers (software and services)
3. Conduct the research study (three to six months). Deliverables include:
   - Top 5 to 9 (two levels) industry measures that are predictive of financial results
   - Voluntary and anonymous benchmark study
   - Empirical value driver analysis study
   - Participating corporations become charter members of Phase 2

Phase II:

1. Complete remaining top-tier industry multiclient studies
2. Contribute Phase 1 results to World Intellectual Capital Initiative (WICI)
3. Engage institutional and retail investors and buy-side analysts: Extend and share value analysis studies, solicit feedback, share benchmark study with those providing contributions
4. Engage remaining corporations within first three industries:
   - Share research on metrics and value analysis studies
   - Share responses from institutional and retail investors and sell-side analysts
5. Engage IT providers:
   - Share research on metrics and value analysis studies
   - Encourage development of tools for generating these metrics
   - Encourage development of XBRL tools for internal and external reporting on these metrics

The Top 10 Leading Indicators for the High Technology Industry

Business Domain	Aggregates	Recommended Primes				
Demand Management	Market Responsiveness	Net Promoter Score	Listening to Customer Index			
	Sales Effectiveness	Contract Value Index	New Customer Index	Wallet Share Index	Effective Quota Index	Sales Capacity Index
	Product Development Effectiveness	R&D Funding Index				
Supply Management	Customer Responsiveness	Lost Customer Index				
	Supplier Effectiveness					
	Operational Efficiency	Backlog Index				

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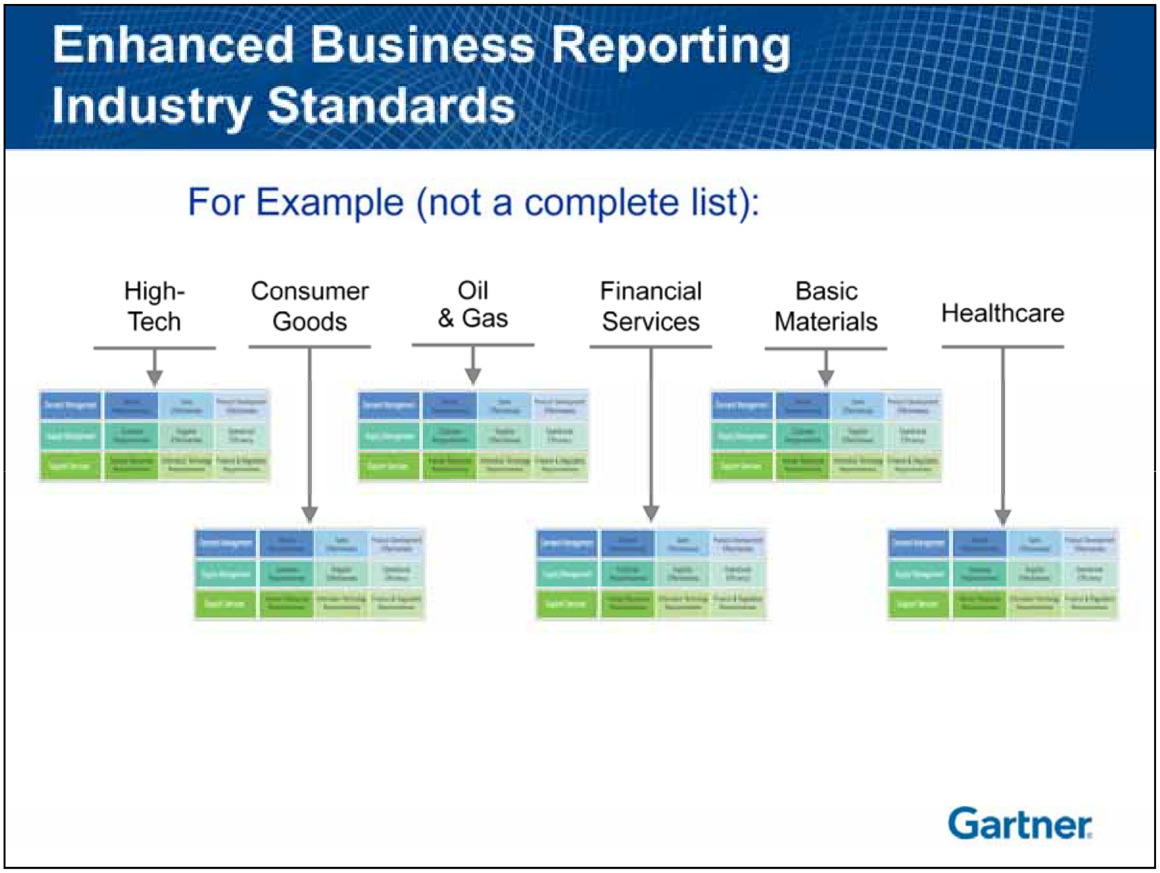
Key Issues: What are the plans for the future?

In 2009, Gartner began Phase I for the high tech industry. We recruited financial executives from Cisco, Microsoft, Oracle, SAP and Software AG. We also recruited 10 financial analysts who cover the high tech industry from CFA Institute. The round table discussion took place over a three-month period and resulted in the following extensions to the Business Value Model for high tech (see slide). The participants were eager to begin Phase II, which is currently under construction on the AICPA website.



Key Issues: What are the plans for the future?

Our plan is to complete Phase I for a remaining 15 industries, some of which are shown on this slide. If you are interested in learning more about these studies, please contact michael.smith@gartner.com.

Related Gartner Research

- ***"Tutorial for Using the Gartner Business Value Model to Create an Enterprise Metric Framework "*** *by Michael Smith* (G00161799)
- ***"Tutorial for Creating An Enterprise Metrics Framework"*** *by Nigel Rayner* (G00161718*)*
- ***"The Gartner Business Value Model: A Framework for Measuring Business Performance"*** *by Michael Smith, Audrey L. Apfel, Richard Mitchell* (G00139413)
- ***"Transparency Provides Opportunities and Threats in the 21st Century"*** *by Michael Smith, Paul E. Proctor, Betsy Burton, Yvonne Genovese* (G00169930)
- ***"The 21st Century Disclosure Initiative Will Reprioritize Your Business Intelligence and Performance Management Strategies"*** *by Michael Smith, Bill Hostmann, John E. Van Decker* (G00164491)