BENCHMARKING

A SIGNPOST TO EXCELLENCE IN QUALITY AND PRODUCTIVITY

Bengt Karlöf & Svante Östblom

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JOHN WILEY & SONS
Chichester · New York · Brisbane · Toronto · Singapore

Original Swedish version published under the title of *Bench Marking: Vägvisare till mästerskap i produktivitet och kvalitet* by Svenska Dagbladets Förlags AB

English translation published 1993 by John Wiley & Sons Ltd,
Baffins Lane, Chichester,
West Sussex PO19 1UD, England
National Chichester (0243) 779777
International +44 243 779777

Reprinted May 1994

Other Wiley Editorial Offices

John Wiley & Sons, Inc., 605 Third Avenue,
New York, NY 10158-0012, USA

Jacaranda Wiley Ltd, 33 Park Road, Milton,
Queensland 4064, Australia

John Wiley & Sons (Canada) Ltd, 22 Worcester Road,
Rexdale, Ontario M9W 1L1, Canada

John Wiley & Sons (SEA) Pte Ltd, 37 Jalan Pemimpin #05-04,
Block B, Union Industrial Building, Singapore 2057

Library of Congress Cataloging-in-Publication Data

Karlöf, Bengt, *1939–*
[Bench marking. English]
Benchmarking : a signpost to excellence in quality and productivity / Bengt Karlöf and Svante Östblom; translated by Alan J. Gilderson.
p. cm.
Includes bibliographical references and index.
ISBN 0-471-94180-8 (cloth)
1. Benchmarking (Management) I. Östblom, Svante. II. Title.
HD62.15.K3713 1993
658.5'62—dc20 93-5131
CIP

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN 0-471-94180-8

Typeset in 11/13 pt Palatino from author's disks by
Dobbie Typesetting Ltd, Tavistock, Devon
Printed and bound in Great Britain by Biddles Ltd, Guildford and King's Lynn

Benchmarking

Preface

Benchmarking is a continuous, systematic process for comparing your own efficiency in terms of productivity, quality and practices with those companies and organizations that represent excellence.

Management buzzwords come and go. Their semantic clarity is often unsatisfactory, and the efficacy of models, methods and approaches varies within wide limits. It is undoubtedly true that waves of fashion roll over the somewhat fuzzily defined field of management. Concepts such as internal marketing, time compression and endless variations on the theme of quality are launched and highlighted from time to time, not infrequently at the instigation of us consultants.

Sometimes these models and approaches look like "rain-dances" performed by the parts of an organization whose function is to promote change and activity in general. Many activities are started without any particular purpose other than to demonstrate that something progressive is being done.

At first sight, benchmarking may appear to be just the latest fashion in management. But benchmarking is not a management fad; it possesses an unusually large content of substance. Let us, without anticipating our introductory chapter, consider some of the factors that explain why this is so.

Large areas of our organized world exist in conditions of planned economy. Departments of companies make internal deliveries to users who in practice are not free to choose alternative suppliers. Although the result of a company at the aggregate level can be read from its accounts, there are many functional parts of it which are not subject to measurement of performance in terms of profit and loss. Benchmarking offers a substitute for the spur to efficiency that is one of the functions of a free market economy. When the unseen hand of market forces is not there to compel efficiency (the function of value and productivity), benchmarking performs that function instead. The same thing applies to all tax-financed systems, which likewise lack the spur to efficiency of a free market economy.

Apart from its effect of closing gaps in productivity or quality, the effect of benchmarking on the development of organizations has astonished us. We call this phenomenon benchlearning. The process of making people adopt the practices of their benchmarking partners removes any blinkers they may be wearing and opens their minds; it creates a learning organization in the true sense of the term. Without being ecstatic about it, we can justifiably claim that this makes the personnel manager's dream come true—the dream of integrating education, leadership development and organizational dynamics with the actual work being done, and of making that work more efficient in terms of quality and productivity.

Benchmarking, as we see it, thus exerts a powerful leverage effect on the organization. Its force for survival would therefore seem to be beyond doubt, as we hope to prove in this book.

We welcome counsel and comments on the contents from readers.

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Introduction

When somebody writes a book about an idea, readers are apt to get the impression that the authors regard the idea they are describing as the only road to salvation. Such is not the case here. Both of us work for a consultancy firm that uses a variety of models and approaches to develop organizations and companies. We do not believe that any particular doctrine is the sole path to salvation, but that leaders in business and administration must choose the tools, approaches and models best suited to themselves and their circumstances.

There are plenty of advocates of a single method, whether it be called PIMS, TRIM, LOTS, Lean Production or something else. Consultants can get away with this kind of one-track behaviour as long as the market, i.e. management, is relatively ignorant of the available options. Over the past decade, however, we have noted a substantial increase in awareness of methods and approaches among business people. Knowledge of the art of management as such, which is neither economics, engineering nor law, has grown much more widespread. However, much still remains to be done.

Having said that, we must hasten to add that we have yet to work with a method that offers so much inherent potential for improvement as benchmarking. There are many reasons for this, but on a relatively high level of abstraction we can cite two:

1 Benchmarking is aimed directly at increasing operative and strategic efficiency, i.e. the actual content of an organization's work.

2 This leads to a reorientation of culture towards learning, skill enhancement and efficiency, which in turn leads to an unsurpassed process of development.

Benchmarking, properly applied, is an incomparably effective means of improving the organization that uses it. Over the past few years we have been involved with numerous organizations of varying size. We have approached the theory behind the concept of benchmarking by the route of solid practical experience with several organizations, and we have seen the powerful influence that benchmarking exerts on their behaviour, values, methods and aims.

Fairly recent studies of competitiveness in business have underlined the power of a well-run benchmarking process. The MIT Commission on Industrial Productivity found, for example, that a common characteristic of the best-performing companies in North America, regardless of size, is that they apply benchmarking to their products, functions and practices, using the leading companies in their respective fields as references. Similarly, effective application of external benchmarking is one of the criteria for the coveted Malcolm Baldrige National Quality Award.

The situation is the same in Europe; the Swedish Institute for Quality Development, for example, emphasizes "Learn from Others" in its guidelines, and is launching a powerful drive to promote benchmarking in 1993.

In the first two chapters of this book we shall have more to say about the two aspects that make benchmarking such an effective tool for accomplishing change. In the remaining chapters we describe the method stage by stage, giving practical examples designed to help the reader to apply it in various situations.

EFFICIENCY: DEFINITION AND DYNAMICS

When we started working on this book, we naturally read up on the existing literature on benchmarking and related subjects such as quality and productivity. Nowhere did we find that any author had tried to go back and look for the fundamental explanation of why benchmarking has proved so successful.

In most cases benchmarking is treated simply as an approach, which of course it is. It may however be helpful to readers if we go back and try to understand what makes this method so powerful.

The superiority of a free market economy compared to a planned economy actually depends on one thing only: the fact that the customer is always free to choose between alternative suppliers. However, no such freedom exists in the great majority of economic activities, whether in the public sector or in business. We refer here to all those departments of companies and organizations which deliver to other departments of the same organizations. Recipients of goods and services in such macrosystems hardly ever have any real freedom to choose their suppliers.

We can thus note that although a company can measure its aggregate efficiency from its profit-and-loss account, the aggregate conceals much undefined room for improvement within individual subfunctions. The value of benchmarking is that it provides a substitute for the efficiency-boosting effect of market forces in units that are not exposed to market economics. Pressure to be efficient diminishes with distance from the customer.

The purpose of all organized activity is

TO CREATE VALUE WHICH IS GREATER THAN THE COST OF CREATING IT.

This statement, in all its platitudinous simplicity, embodies the profound truth that is the driving force of all economic activity, and embraces all the components that the management of an organization can influence. It applies to *all* organized activity, not just economic activity. The value concerned can be of many kinds. Churches, co-operatives, professional associations and trade unions, for example, must offer something of value to their members which the members regard as higher than the cost of their membership dues. The same criterion applies to time, effort or anything else expended for the sake of getting something worth while. The public sector is currently experiencing a crisis in so far as many of its operations fail, in the opinion of many people, to contribute anything of value to the common weal. We shall have more to say about this later.

The special advantage of the benchmarking method is that it provides an incentive for non-competitive parts of the staff organizations that manage companies to improve their efficiency. Let us therefore review the various components of efficiency.

Efficiency

The concept of efficiency is made up of four basic components:

1 Quality (utility).
2 Price.
3 Production volume.
4 Cost.

Value is the quotient of quality and price. It is value that determines how many units are sold in a free market economy, i.e. one where the customer has a free choice of what to buy.

The quotient of production volume and cost is called productivity. The motive force for efficiency in a market economy, then, is that the value which is delivered, and which the customer is willing to pay for, must be higher than the cost of producing a unit of the product or service that represents the value.

Thus efficiency is a function of value and productivity. The graph in Figure 1 illustrates the relationship. The cost per unit produced should logically determine the lowest price that can be charged, if the producing company is to stay in business in the long term. Quality or utility, on the other hand, should determine the highest price that customers are willing to pay.

So while the unit cost of production is important with regard to the price that must be charged in the long term, the customer's perception of quality is decisive with regard to the acceptable cost of production because it sets the maximum price. Modern management has begun to apply "reverse engineering" to a growing extent. This proceeds from the customer's perception of value, meaning quality in relation to price, and works back from there to decide the acceptable cost of producing goods or services.

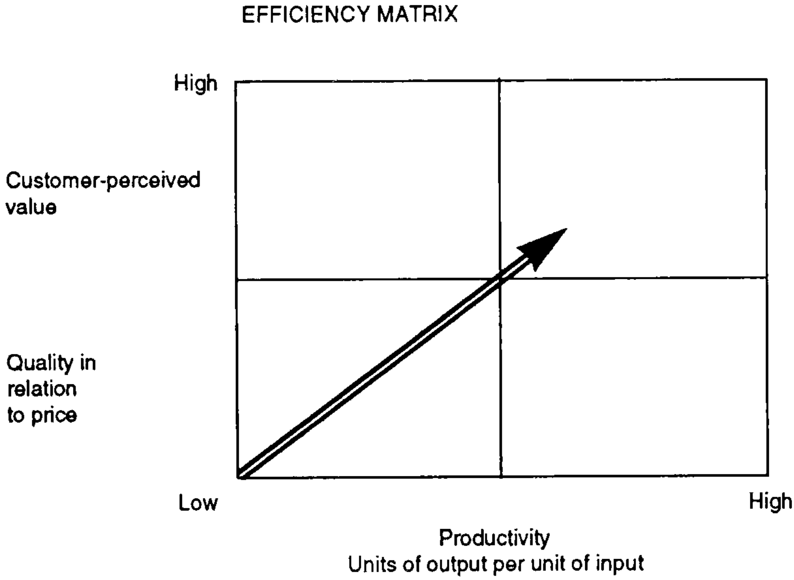

Figure 1

Let us take a few examples to illustrate the relationships expressed in the Figure 1 graph and definitions. We thus find that inefficiency, in principle, can imply one of two things.

In the first case the value delivered may be acceptable to the market, but the operation is inefficient because the cost of producing the value is greater than the price paid for it. Two current examples of this situation are Saab and Jaguar cars. A given Saab or Jaguar model fetches a given market price which customers are willing to pay for the value that a Saab or Jaguar represents to its owner. The problem is that both factories are inefficient today because the costs of developing, manufacturing and distributing their cars are higher than the prices that the market is willing to pay. The reason for their inefficiency is that productivity is too low.

Let us stay with the analogy of the automotive industry to illustrate the second case. Let us imagine that the evil-smelling little East German Trabant could be manufactured with Japanese productivity, less than 30 man-hours per vehicle. Even if this were possible, there would still be no future in manufacturing Trabants because their quality in relation to price—any price—would still not persuade customers to buy them. That, incidentally, is one of the major problems of the former Eastern Bloc. The goods sold in the shops of Moscow, Prague and St Petersburg are quite unsaleable in Western Europe with the quality standards that customers have come to expect there. Price ceases to exist as the denominator in a quotient of value where the quality is so poor that price no longer makes any difference.

One of the gigantic problems in the welfare economies of Western Europe is the existence of numerous large systems which, however productive they may be, contribute too little of value to society. Our public sectors abound with luxury production whose value is low but which continues because the customer never has to weigh its quality or utility against the sacrifice he must make to buy it. Let us cite here an example from Sweden, both sublime and ridiculous, of the kind of luxury public production that we all consume:

> *Almond buns investigated*
> The Municipal Environment Administration in Stockholm decided that a checkup on almond buns was called for; the almond paste they contained might not always be almond paste. Operation Almond Paste was therefore mounted. Buns were purchased at 52 shops. The investigators found that some of them contained substitutes; but on the other hand the suppliers had not claimed that they were selling the genuine article.
>
> The Environment Administration is in the midst of an economy drive. But morale is important in times of cutbacks, say leading officials, and a bun probe gives the staff something to bite on.
>
> From *Dagens Nyheter*, 14 October 1992

Exactly the same phenomenon exists in all large organizations, whether they be companies, trade unions or something else. Big corporations contain many people and departments who justify their jobs, and their existence, by high productivity—by pressure of supply. People work hard and keep themselves fully occupied making studies and writing reports which are then distributed to recipients within the system. Many staff units justify their existence in this way, by push of supply rather than pull of demand.

The same applies to numerous absurdities that we can observe in the public sectors of various countries in Western Europe. These units actually operate under the conditions of a planned economy. They have substituted internal transactions for market transactions and are thus shielded from the pressure for efficiency that is exerted in a free market economy by the customer's freedom of choice between alternative suppliers.

A planned economy can in fact be characterized as a system which is incapable of producing even that which people do not want.

A planned-economy relationship with the outside world leads in the long term to deteriorating value production and quality as well as lower productivity. One reason why benchmarking has proved to be such a powerful way of making companies more efficient is that it supplies the same lessons and incentives which come from market transactions in a free economy. Benchmarking can be applied to both axes of the value graph, replacing the action of the "invisible hand" in constantly guiding productivity and quality towards improvement.

Efficiency and productivity are too often confused with each other in European debate. Yet the distinction is of monumental importance and needs to be understood by everybody operating in our microeconomies. Classical economics deals mainly with commodity goods, i.e. those whose quality relationships with each other are fully comparable. Such is hardly ever the case in real-life economics. Quality has acquired great importance at a time when that classic unit of economics, the bushel of wheat, has been relegated to a secondary economic role. A car cannot be directly compared with any other car. A Trabant and a Rolls-Royce are not the same thing—a fact which has brought quality into focus in a way which classic economics ignores.

The *raison d'être* of products, departments, administrations and whole companies is called in question today more often and more repeatedly than ever before. The woods are full of competitors and substitutes. If for example you consider the airline business in isolation, ignoring the threat of video conferences as a substitute for its function, your analysis is likely to lead to the wrong conclusions.

Benchmarking, the making of measurements with reference to a fixed datum point, has come into use as the name of a method for measuring and evaluating those parts of an organization which operate under planned-economy conditions. This includes all departments of companies and organizations, as well as practices, productivity figures and quality or customer-perceived value.

The two axes of the efficiency graph and their derivatives are in fact the parameters that a leader can manipulate. All employees, all subcontractors, consultants and owners, must likewise proceed from these parameters to attain short-term or long-term success.

Value, Productivity and People

One of the most difficult dichotomies of businessmanship is the one between productivity, maximized output, on the one hand and value creation, high customer-perceived quality, on the other. We shall discuss this in more detail in the next chapter.

During the eighties, moreover, the realization grew that ability to manage people in an organization in an effective way can help to enhance both customer-perceived quality and the productivity of the organization. This is because of the simple fact that people who are well treated, and therefore feel motivated, make a greater effort to serve the customers who ultimately pay their salaries and wages, and also put much more energy into their work. This leads in turn to a win–win situation in which the employer enjoys increased productivity while at the same time the employees are more content with their lot.

Productivity

Frederick Winslow Taylor was a pioneer in the field of productivity. He was actually the first to apply benchmarking to the case of workers shovelling coal at Bethlehem Steel's steelworks. Taylor's method was simply to identify the best way of performing a given operation and then apply that method to other similar operations.

The pursuit of pure productivity which prevailed from the end of the nineteenth century up to the outbreak of World War II led to ruthless exploitation of labour. During that period the market was at the mercy of capitalists, as it now is in Eastern Europe. The capitalists there have a monopoly, a duopoly or at best an oligopoly with fixed prices and so on. In such a situation customers lack any real freedom of choice, and employers can