

From Cost Control to Dynamic Business Planning: Elkay's Path to an Integrated Management System

By Anne Field, Contributing Writer

Elkay, the Chicago-based manufacturer of cabinets, sinks, countertops, and other commercial and residential products, has step by step built what amounts to a Holy Grail of management systems. Its integrated system arms employees and managers with the ability to make smarter, faster business decisions that translate into big savings and better profits.

Founded in 1920 with a vision “to make the best sinks and provide the best customer service,” Chicago-based Elkay Manufacturing is a major producer of a wide array of residential and commercial products, from cabinets, sinks, and countertops to drinking fountains and bottle-filling stations. Employing some 3,800 people in North America and such international markets as Mexico and China, the privately held company has experienced consistently profitable growth, even amid the current recession.

Only three years ago, however, the picture looked less promising for Elkay. In 2007, the U.S. home building industry had already started to decline. New low-priced Chinese competitors had begun challenging the company's lower-priced product lines. And several major customers were pressuring Elkay to reduce its prices.

Beginning in late 2007, in an effort spearheaded by John Hrudicka, today Elkay's chief financial officer, the company has methodically, piece by piece, built a business and performance management system using a variety of best-of-breed software. This effort has transformed Elkay into a highly efficient, strategically aligned organization that's able to make fast decisions based on sophisticated

data analysis. Ultimately integrating the Balanced Scorecard with profitability analytics, customer relationship management (CRM), and business planning, Elkay is creating something of a Holy Grail of management systems: the ability for managers and many other employees to make real-time, strategically aligned business decisions.

Introducing Discrete Product Costing

Hrudicka did not set out with a holistic vision of an integrated system. When he was hired as vice president of finance, his directive was to find a way to get a more precise picture of costs. Elkay's existing costing process was cumbersome and inaccurate because it didn't allow the company to analyze results at the customer or product level—thus providing only a partial view of performance. This limited view impeded the company's ability to make the right decisions about everything from product design to customer service.

Elkay's standard costing system allocated factory overhead to products as a percentage markup over direct labor costs, and corporate overhead as a percentage of sales. And although the accounting system was able to measure the direct costs of production, it couldn't

track large sales deductions or the cost of serving individual customers. Moreover, it couldn't deconstruct the reasons underlying the increased costs caused by a sharp rise in the number of products Elkay was manufacturing. Accounting for equipment costs was also inaccurate.

Hrudicka and Plumbing Products division president Steve Rogers (today, Elkay's COO), a co-champion of the initiative, realized that activity-based costing (ABC)—more precisely, time-driven activity-based costing (TDABC)—would allow managers to drill down deeper and get a more accurate, actionable understanding of costs.¹ More important, they knew these methods could help Elkay develop a productivity tool that would enable employees to analyze costs as far down as the customer order level. Because one Elkay manufacturing plant had previously made an unsuccessful attempt to introduce ABC, Rogers proposed to call the process discrete product costing (DPC). When Hrudicka and Rogers presented this new approach to Tim Jahnke, the company's new CEO, he responded immediately, “How could you run your business without it?”

To begin, in December 2007 the DPC team (led by Chris Gast, then director of business profitability) launched two pilot projects within the Plumbing Products division, which at the time was experiencing disappointing results. One pilot was carried out at a retail sink manufacturing plant, the other, at a distribution center. In 2008, the team expanded the pilot to the division's two other U.S. sink manufacturing plants. In every case, project teams pinpointed the costs associated with each activity and then assigned those costs to the resulting products. Ultimately, the system calculated the total time each activity consumed and the costs for every order for a particular item every month,

¹ ABC is a costing model co-invented by BSC co-creator Robert Kaplan. The model counts the activities that go into making a specific product or delivering a specific service and attempts to calculate the costs of those activities. In this way, an organization can precisely estimate the cost of individual products and services so that it can identify and eliminate those that are unprofitable and work to lower the prices of those that are overpriced.

Unlike traditional ABC, TDABC (also co-developed by Kaplan) requires estimates of only two parameters: the unit cost of supplying capacity and the time required to perform a transaction or an activity. It is an improvement over the traditional ABC model, which involves high costs to interview and survey people, the use of subjective and costly-to-validate time allocations, and the difficulty of maintaining and updating the model. TDABC is thus faster, simpler, and more flexible.

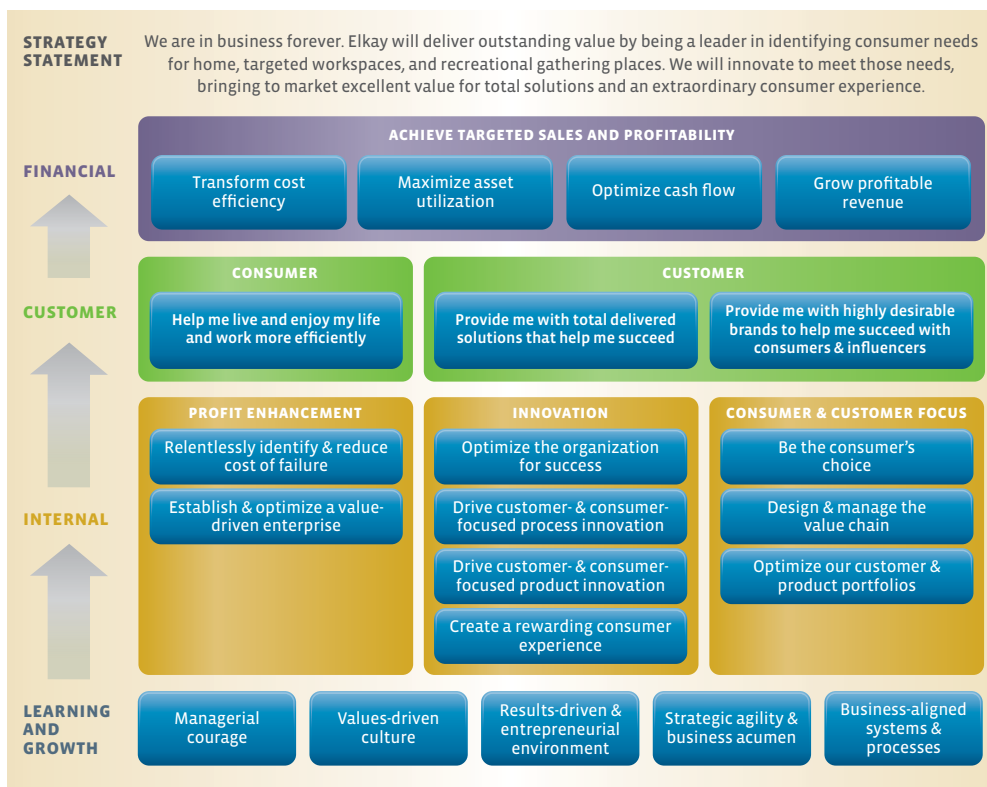


FIGURE 1:
ELKAY'S ENTERPRISE-LEVEL STRATEGY MAP
The BSC serves as the glue for Elkay's integrated management system. The company's strategy map proved critical in communicating the strategy clearly throughout the organization—and in supporting the company's reorganization in January 2010 from a product to a channel orientation.

arriving at the product's total manufacturing costs.

The results were a revelation. Salespeople were now able to identify which customers (and even which orders) were profitable and which ones were causing losses—and to devise ways to deal with low-profit accounts. To illustrate, when Mark Whittington, then VP of sales, brought the P&L statement of an unprofitable customer to a meeting with the customer's management team, he put his hand over the account name and asked the team members whether they would do business with this account if it were their client. When the managers replied that they wouldn't, Whittington removed his hand to reveal the account's identity. Consequently, the customer agreed to a series of changes—including a small price increase—and soon became profitable for Elkay.

Part of the DPC process also involved creating "simple language" P&Ls that discussed cost activity in straightforward, descriptive terms, and not in accounting jargon. Almost immediately, employees could quickly understand the implications of the data and make

rapid business decisions. Consider what happened during the first meeting held to roll out the new P&Ls. One line in the Plumbing Products' statement, "finishing," represented the cost associated with finishing sinks. Division president Rogers took one look at the hefty cost and within seconds announced he was going to modify that activity right away—a move that ultimately saved the company millions.

More recently, Elkay began introducing DPC in its Cabinetry and Decorative Surfaces divisions. Although the implementation is still under way, the company has already begun experiencing improvements. For example, in the Decorative Surfaces business, where the customer's distance from fabrication centers is an important determinant of profitability, Elkay can now calculate the optimal distance for shipments to maximize profitability.

Enter the Balanced Scorecard

Next on Elkay's list was strategy. Several Elkay executives realized that the company's strategy was not being communicated well throughout the organization,

a problem that was hindering strategy execution as well as organizational alignment. Without a widespread understanding of the strategy—and the support that such understanding brings—strategic initiatives never got identified or resourced. Hrudicka, who had been introduced to the Balanced Scorecard at a previous employer, decided it was time to adopt the methodology at Elkay.

In June 2008, the company established an Office of Strategy Management (OSM) and proceeded to implement the Balanced Scorecard process in its Plumbing Products division. A division strategy map was created and cascaded to business units and functional support areas. Scorecards were developed, and prioritized initiatives were mapped to support the key objectives and measures. In October of that year, Elkay rolled out a BSC and strategy map in its Cabinetry division, and followed suit in January 2009 in its Countertops division. During the company's reorganization in January 2010—to shift from a product to a channel orientation—the strategy map served as an invaluable guide in aligning changes with new organizational objec-

Tips for Building Your Integrated Management System

- **Don't try to create the end vision too early** in the process. Build the individual components and then integrate them.
- **Start with the initiatives that will add the most immediate value** to the organization to build credibility that will help influence the development path for follow-up components.
- **The individual components of the management system are inextricably linked.** Don't treat them separately.
- **Recruit the early adopters of the key elements** of the management system components to sponsor, teach, and drive adoption throughout the rest of the organization.
- **Wherever possible, deploy specific software applications** to drive success with the individual management system components.
- **Be patient.** Driving organizational change with new management systems and their associated tools and practices takes time.

tives. It was also effective for communicating to employees the reasons for the change as well as the new objectives.

Particularly notable was the effect of organizational alignment on strategy management, something that had previously received little emphasis. Now, every two weeks, the company's 18 manufacturing facilities hold a web conference to review strategy maps using eight key common metrics. Going measure by measure and plant by plant, they review performance against target for each metric and discuss the execution progress of key supporting initiatives—all in an integrated strategy management application.

What's more, the BSC has also had the unforeseen benefit of supporting Elkay's strategic alignment with customers. Eyal Altman, director of strategic management, points to a general manager who decided to take a chance and show an executive at a large customer his channel's (BU's) strategy map. In response, the customer promptly pulled out his company's map. By sharing key metrics, the two organizations reinforced their mutual alignment—thus instantly deepening their relationship. Elkay and its customer now periodically review those metrics together.

From CRM to a New Way of Budgeting and Forecasting

In 2009, Elkay turned its attention to developing a CRM system. For Elkay's executive team, that meant adding an essential ingredient that team members felt most CRM systems lacked: customer profitability.

Finally, in August 2010, Elkay launched what may be its most ambitious effort of all: a new budget process. Continuous planning, soon renamed dynamic business planning (DBP), would supplant the traditional budget process, which Hrudicka and his fellow executives considered too slow, too inflexible, and offering too limited a horizon in today's fast-changing environment. DBP constitutes an 18-month rolling forecast system that calls for updates every quarter. Eventually this system could move to a more fluid "real-time" update cycle driven by changes in key business drivers. Driver-based forecasting will help instill ownership of the planning activity in the various areas of the business, enhancing accuracy and facilitating more timely updates, instead of leaving managers to extrapolate trends based solely on assumptions.

Central to the DBP process is creating a more forward-looking demand planning cycle. To that end, Elkay has added the ability to analyze a host of leading indicators that are likely to have an impact on sales—indicators ranging

from macroeconomic data (such as unemployment and foreclosure rates) to an index of remodeling activity (produced by Harvard University's Joint Center for Housing Studies) and data on architectural billings. Also included are such diverse cost drivers as commodity material prices, customer rebates, freight costs, and fuel surcharges.

DBP, still in its infancy, will eventually empower managers to monitor changes and tweak forecasts for their area in real time. For example, a manager in a sink manufacturing unit might update profitability forecasts based on new information about the price increases of nickel, a key material used to manufacture sinks.

For Hrudicka, the ultimate goal is driving competitive advantage. "It's about speed. If you can identify changes in your environment quicker than the other guys and take action, you will be able to create sustainable competitive advantage—and ultimately achieve your financial objectives."

Greater Than the Sum of Its Parts

The real power of Elkay's new processes lies not in the sum of each individual effort but in the integration of the parts. About three years ago, after introducing the BSC and before building the new CRM system, Hrudicka began contemplating how all the pieces of the puzzle fit together. He decided to integrate the existing systems, along with the two he planned to introduce, into one cohesive unit dubbed the Elkay Management System.

The glue for the system would be the BSC. As the centerpiece of strategy formulation and execution, the BSC would provide the underlying framework that would tie the component parts together. "All the pieces support the execution of strategy," says Altman. Strategy map objectives in the customer and internal process perspectives, for example, are linked directly to the use of data analytics to improve decision making. To help meet the customer objective "Provide me with total delivered solu-

tions that help me succeed,” the CRM system tracks the strategic initiatives that drive new product categories (e.g., high-end faucets) for select channel customers to enhance the customer relationship. For that same objective, the BSC for Manufacturing Operations Support cascades key delivery and quality metrics, and associated initiatives, down to the department level and down to the proverbial operator on the shop floor. The cascading nature of the Balanced Scorecard system allows for employees throughout the organization to understand how their specific actions drive business performance and success for Elkay.

Consider some of the many ways the various pieces are linked. To boost the predictive capability of the demand planning cycle, Elkay integrated the CRM application into the DBP process. The demand planning manager now uses a set of pipeline dashboards from the CRM application (which includes probability estimates), enabling him to obtain numbers for the demand planning cycle. Elkay also recently introduced a process for prioritizing strategic initiatives that takes into account such data points as the amount of internal resources needed. The necessary investment and projected outcomes for each initiative are then plugged in to the DBP’s 18-month rolling forecast and the strategic plan.

The company is also in the process of integrating demand planning cycle analytics into the CRM system so that salespeople can bring up the P&L for any given account. “When the salesperson walks through the customer’s door, he or she will have the most complete picture ending in the most recent P&L,” says Hrudicka. “It’s literally a 360-degree view”—something CRM vendors claim their systems provide, notes Hrudicka, but in reality, no commercially available applications do. Salespeople will be able to run different scenarios for specific customers to determine their

impact on profitability on their own without a finance person by their side to assist them.

Faster, Strategic Decision Making

Ultimately, the Elkay Management System gives employees at many levels of the organization tools with which they can make fast, effective, strategically aligned decisions. A worker on the shop floor of a manufacturing plant can better understand which initiatives are most important and what he or she should be working on to support strategic objectives. The general manager of a business unit can work with sales managers to analyze a customer’s profitability and decide what changes need to be taken to drive improvements. A sales manager analyzing costs can examine individual drivers to understand more clearly why certain expenses might be high or low. If freight costs are excessive, for example, the manager can look at such relevant drivers as shipping preferences and options and come away with an objective explanation—one based on data and not guesswork. “We arm our people with the right guided analytics so they have the ability to get to the root causes of performance,” says Hrudicka.

At the same time, having that ability has transformed behavior. Hrudicka recalls a situation early in his time at Elkay when a regional sales manager sought him out at a sales meeting dinner to show an inch-thick pad of heavily annotated customer P&L statements. “This is how I run my business,” the manager proclaimed proudly. The new system has enabled—and inspired—salespeople to change their focus from price to service and quality. Thanks to robust, integrated data and leading indicators, they no longer need to shoot from the hip. They can get detailed analysis on the spot that fosters informed, timely decision making.

The Elkay Management System has also helped the company experience profitable growth, even during a recession that has hit its industry harder than

most. Its cash conversion cycle has improved significantly, the proportion of on-time shipments from plants has consistently improved, the company’s product portfolio profitability continues to rise across all categories, productivity has increased in the plants, and customer care response rates keep reaching new company highs. From procurement to manufacturing to pricing decisions, the company can now react more quickly to emerging trends—and, in fact, proactively respond to leading indicators it had never before factored in. “We’re a more aligned company, with better collaboration between our channels and support functions, and better utilization of resources,” says Altman. Quite simply, he adds, “We’re leaner, quicker, and more responsive.”

As CEO Jahnke likes to point out in strategy review meetings, when reflecting on the efforts of the channel teams, “You are all working together successfully to create new growth opportunities for our company and to uncover innovative ways to make Elkay the best—and easiest—company in our industry to do business with.” ■

To learn more

For more on integrated performance and strategy management systems, see the following BSR articles:

“Integrating Strategic Planning and Operational Execution: A Six-Stage System,” by Robert S. Kaplan and David P. Norton, BSR May–June 2008 (Reprint #B0805)

“Dynamic Forecasting: A Planning Innovation for Fast-Changing Times,” by Bjarte Bogsnes (head of Statoil’s BSC program), BSR September–October 2009 (Reprint #B0909C)

“Integrating Planning and Performance Management at Nordea,” BSR January–February 2005 (Reprint #B0501B)

“Luxfer Gas Cylinders: Mastering the Strategy-Operations Linkage,” BSR May–June 2008 (Reprint #B0805B)

Continue the dialogue

Meet Elkay’s Eyal Altman and learn more about integrating multiple management systems into a holistic system at www.thepalladiumgroup.com/bsr/eyalaltman.

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