INTEGRATING GLOBAL ORGANIZATIONS THROUGH PERFORMANCE MEASUREMENT SYSTEMS

How systems of performance management helped GE and Nestlé Waters achieve cultural alignment.

BY CRISTIANO BUSCO, MARK L. FRIGO, ELENA GIOVANNONI, ANGELO RICCABONI, AND ROBERT W. SCAPENS

The last 20 years have witnessed a massive transformation in corporations, especially in global ones that have been forced to redefine their strategies, structures, and processes. Market globalization has caused company executives to turn their attention to merger-and-acquisition strategies and has encouraged them to secure a competitive advantage through innovations in products, production, and information technologies. This process continues today.

World-class corporations face the challenge of ongoing alignment of *local* business processes with *global* corporate strategies as they continuously learn and change the way they do things to win in their market.

In this environment, companies have to organize and monitor their resources to achieve goals that underpin the corporate vision. Corporate leaders have to translate their broad mission and strategies into specific objectives and measures as well as communicate them across the organization. To do so, more and more companies, General Electric (GE) and Nestlé Waters (NW), to name two, are relying on comprehensive, corporate-wide performance measurement systems as a common organizational language. The result is integration, which we define as the effective collaboration among different specialized organizational entities that is necessary to achieve unity of effort.

Consider how great the challenge is for executives seeking integration at a global organization, which is a group of wholly or partially owned affiliates located on different continents. Integrating a global organization means managing and coordinating global organizational relationships—both the vertical and hierarchical ties between the parent company and its subsidiaries and the horizontal and lateral ties between different subsidiaries belonging to the

ILLUSTRATION: J.W. STEWART/WWW.JWSTEWART.NET same global organization. It's worth the effort. The resulting synergy through aligning efforts and resources can lead to superior financial performance, and the company ultimately can become more than the sum of its parts.

GE and Nestlé Waters make the case for integration processes that emphasize performance management systems.

GE: GROWING GLOBALLY BY ACQUISITION

GE provides an excellent example of how a company can achieve integration through deploying a common management style. Theirs is known as the GE Way or, as GE top management says, "the social architecture of the company." The message is clear: Shared organizational knowledge is key to winning. Over the past 20 years, GE has grown by acquisition using a common culture to align the strategies of its global and heterogeneous businesses.

GE's acquisition of Nuovo Pignone illustrates how the company relies on performance measurement systems to integrate local cultures within its global organization. Originally established as Pignone in 1842 in Florence, Italy, Nuovo [New] Pignone (NP) was set up in 1954 following its acquisition by ENI, a state-owned holding company. In1994, it was acquired by GE. Established as a cast-iron foundry, the company grew over the years and prospered through the design and manufacture of specialized equipment such as electrical turbines, compressors, pumps, and turbines for energy-related industries. Its technical achievements include the world's first gas-powered internal combustion engine. Given NP's well-earned reputation for the quality of its engineering and products and also its extensive market portfolio, GE decided to acquire this major competitor, and today NP represents a core brand of GE Oil & Gas, whose headquarters is located in Florence.

The GE Way is built around a series of initiatives that are bound by the GE Operating System and driven by the language of measurement and accountability. The GE Operating System represents the GE Way in action. This is a year-round series of intense learning sessions where business CEOs, top managers, and corporate initiative champions meet to share views and best practices from across the company. For newly acquired companies, the GE Operating System often represents a major challenge. With no chance to escape or postpone, they're urged to adapt and integrate very quickly through the Operating Managers Meetings, Corporate Executive Councils, Quarterly Business Reviews, Sessions C (individual appraisal), Sessions I (strategy review), Sessions II (budgeting), and Sessions D (compliance).

As the GE Way was applied, Nuovo Pignone underwent a massive process of cultural transformation with performance measurement systems playing a crucial role in integrating NP's technical culture with the GE Way of running the business. While NP had no tradition of using performance measurement systems, GE's management and organizational style relied extensively on such systems for both communication and control. As a state-owned and largely bureaucratic company, NP had to produce budgets and various reports for both headquarters and the state bureaucracy, but they were mainly for ceremonial purposes and weren't integrated into management practices.

Although GE implemented organizational restructuring programs ranging from downsizing and delayering to boundaryless working and outsourcing, the integration process at NP was grounded essentially in a major change in the understanding of measurement, especially performance measurement. In particular, there were two major drivers that enabled NP to come to terms with the GE Way: The first was the redesign of the company's systems of control and accountability, and the second was the 1996 implementation of the Six Sigma initiative—a measurement-based quality improvement program. A highly disciplined program aimed at increasing profitability and customer satisfaction, Six Sigma helps deliver high-quality products and services by measuring how far a given process deviates from "perfection."

After their company was acquired, everyone within NP had to learn a new language based on measurement and accountability. As the integration process began, the first three GE individuals to arrive at NP were the chief financial officer, the financial planning and analysis manager, and the corporate auditor. GE knew it was buying a state-run company that had good product technology but poor measurement systems and little financial management. Very early in the integration process, significant effort was put into creating a measurement system aligned with the business goals that could provide timely and accurate information as well as link NP with GE's global environment. Within the first six months, NP went through a metrics revolution.

Redesigning their systems of accountability involved major extensions to the company's financial systems and restructuring the accounting and finance function. The company reorganized Manufacturing Finance, the department traditionally responsible for cost accounting, and established new departments: namely, Financial Planning and Analysis and Commercial Finance. In addition, GE created and assigned a new task force of finance managers to individual divisions or streams to serve as finance experts to support the businesses.

By integrating financial and nonfinancial measures, Six Sigma extended the culture of measurement to all parts of NP. As a result of using the Six Sigma language, operating managers within NP can share technical improvements and their consequences in financial terms with other GE managers wherever they're located and whatever business they are in.

"By empowering engineers and technical experts with finance fundamentals, they [NP management] didn't create new figures, and they didn't reproduce accountants," an NP project manager explains. "On the contrary, they have infused operating roles with a broader view of the business. They created a minimum common base of knowledge to talk about contents—to reach the shop floor without losing any time arguing about meanings."

Before NP initiates a project, it quantifies the potential financial benefits and cost savings of prospective process improvements and then uses this information to help select and prioritize projects. Benefits and savings are constantly reevaluated to ensure that the cost of improvements will be justified by the project's financial benefits.

"The rigor associated with linking Six Sigma projects to business financials," the project manager emphasizes, "reinforces alignment within the company as the entire managerial structure—including CEO, CFO, and line managers—are looking to this initiative as an opportunity to reduce expenses, boost cash, and increase productivity."

Viewed from both inside and outside the company, major change took place within NP as the local culture met the global GE Way of managing the business. Consequently, NP experienced a major cultural change from a bureaucratic, state-owned Italian company to an important part of one of the most profit-oriented global corporations. NP has preserved its existing technical culture, which is complemented by the culture of measurement. Furthermore, the Six Sigma initiative supported the measurement-based revolution by building on and extending NP's traditional focus on production excellence. This initiative enabled a measurement-based philosophy to penetrate all levels of the company.

An NP project manager sums up the Six Sigma effects: "Although quality has always been about improving processes, products, and services by eliminating defects and the root causes of those defects, through Six Sigma process improvements we strengthen the ties with their consequences in financial terms."

Considerable learning and transformation have taken place in the Italian organization as the engineering-oriented capabilities of NP met GE's focus on bottom-line results. Yet although a cultural revolution has taken place within NP, it doesn't represent a discontinuity with the past. It has come about through a combination of existing expertise and a global organizational language based on shared performance management systems.

Later this year, the authors will be organizing a conference on **Integrating Global Organizations: The Role of Performance Measurement Systems**.

It will be held on July 13-14, 2006, in the historic Italian city of Siena in the heart of Tuscany. For information and registration, visit www.unisi.it/ricerca/dip/sas/igo/index.html.

NESTLÉ WATERS: CREATING A GLOBAL BRAND IDENTITY

While GE provides an example of a company that has been growing globally by acquisition for 20 years or more and has centrally directed its new acquisitions through common management systems, other multinational organizations have been managed differently. Consider Nestlé, which in the 1980s and 1990s also pursued a worldwide growth strategy by acquisition with its local subsidiaries being largely autonomous.

For many decades Nestlé's strategy has been one of decentralizing its products, brands, and communications in order to best respond to local needs. This strategy led each legal entity to operate as an isolated unit with corporate executives making no attempt to integrate companies across the Nestlé world. As a result, for instance, Nestlé used to have five e-mail systems and 20 versions of accounting and planning software. This created serious coordination problems because most employees didn't have access to production and sales figures from units other than their own. Nestlé America, for example, used to pay more than 20 different prices for vanilla from the same supplier because each factory identified vanilla with a different code, so local managers couldn't compare what the vendor was charging the other factories!

As market turbulence and competition increased in the mid-1990s, Nestlé recognized a need for greater integration to facilitate global learning, to exploit synergies, and to obtain cost reductions. Following its acquisition of new businesses, which increased the heterogeneity and complexity of Nestlé's product portfolio, the company began to change its strategies by managing some of its businesses by product category as well as geography. This was the case with the Nestlé Waters division, whose mineral water business was the first example within Nestlé of a management structure based on product categories rather than geography.

Developing the mineral water business and its growth through acquisition meant that Nestlé Waters had to redefine its approach to the market. The need for greater coordination characterized the organizational restructuring of Nestlé Waters, which redefined its strategies, structures, and processes around the introduction of two business units (BUs) in 2000. Created to coordinate local markets through a global product/brand strategy, the two BUs act as coordinators, decision makers, and owners of the international brand strategy and profitability:

1. The French business unit (PV) manages all the activities, from production to distribution of the French international brands (Perrier, Vittel, and Contrex, bottled in France by Perrier-Vittel and sold in both the French and international markets);

2. The Italian business unit (SP) manages all the activities of the Italian international brands (S. Pellegrino and Acqua Panna, bottled in Italy by San Pellegrino and sold both in the Italian and international markets).

These business units centralize all activities and functions of the French and Italian international brands. They link a number of different legal entities belonging to Nestlé Waters: the producer of the international brands (i.e., SP for the Italian BU and PV for the French BU) to the internal distributors (i.e., distributors that belong to Nestlé Waters group, such as Nestlé Waters North America, Nestlé Waters United Kingdom, etc.). The new structure gives prominence to lateral relations as the means of coordinating all activities within the same BU. By doing so, the new structure has changed the pattern of interactions within Nestlé Waters, as lateral relations have combined with vertical relations in building these international brands.

By introducing the two BUs within Nestlé Waters, the performance measurement system has been restructured in order to fulfill the new information and control requirements and to achieve integration "by brand" through the different subsidiaries. Currently, the planning processes of the two BUs follow a common calendar.

The planning and budgeting process of the international water brands starts with the development of the global brand strategy according to a standard format prescribed by Nestlé Waters' headquarters and used by the two BUs. The global brand strategy concerns the brand positioning, pricing strategy, brand development, and volume strategy, and it is put together by the individual BUs and approved by headquarters. The global brand strategy is then translated into a plan (called a market development program) for each distributor that defines market priorities, volumes, and price targets, as well as budgets for the resources to be committed. Each distributor then draws up a program and discusses it with the relevant producer until both parties are in agreement. The market development program forms the basis for the long-term plan (LTP). Once it's approved by both producers and distributors, the first year of the LTP will be the basis for the operating plan. Finally, an End-to-End (ETE) P&L statement is produced by consolidating data from both the producers and distributors; it shows the international brand profitability in terms of the joint profitability of the producers and distributors (that is, the end-to-end profitability).

In doing this, the budget preparation entails both vertical and lateral relations that include the following phases:

1. Definition of the international brand profitability and the profit rate of the distributors, which is used by Nestlé Waters headquarters to calculate the transfer prices (vertical relations);

2. Preparation of the budgets by distributors—i.e., the distributors propose market prices, volume targets, expenditures for marketing, sales force and merchandising, storage and distribution, administration (lateral relations);

3. Discussions between BUs and distributors (lateral relations) that continue until an agreement on the previous parameters (see phase 2) is reached;

4. Determination of transfer prices based on resale prices less an agreed percentage (the "resale less" method) using the parameters defined in the first three phases;

5. Production of the international brands ETE P&L (by the BU finance managers) followed by discussion and a revised ETE P&L until agreement is reached (lateral relations);

6. Definition and validation of the budgeted ETE P&L by the finance department of the BU (lateral relations); and

7. Final approval by Nestlé Waters headquarters (vertical relations).

Implementing the new planning and budgeting process has required a considerable amount of communication and information exchange among the producers and the distributors. Currently, the reporting requirements from the distributors to the BUs include:

Monthly: actual sales statistics; specific comments on trends regarding international brands.

Quarterly: P&L outlook by brand.

Annually: actual P&L by format and brand; budget monthly sales by format; budget P&L by brand and format.

Conversely, the reporting requirements from the BUs to the distributors include:

Monthly: general global comments on the sales performance of international brands and specific comments on international brands.

Quarterly: End-to-End P&L by brand and market.

Annually: actual End-to-End P&L by brand, format, and market.

Before the BUs were created, lateral information exchange among the different NW companies was very limited, and no attempts were made to integrate the international brand strategy and calculate the international brand profitability worldwide. With the introduction of the BUs and the implementation of the ETE P&L, Nestlé Waters producers and distributors are forced to think strategically in terms of joint profitability as equal partners belonging to the same global organization. In this respect, as argued by a San Pellegrino finance manager, "The new performance measurement and accountability centered around the ETE P&L has brought a new end-to-end mentality, fostering the BU integration through shared goals between the producer and the distributor. On the one hand, it improved the producer's control over the distributors' activities. On the other hand, it links the distributors and the producer to a common faith as they have a shared goal to achieve, and, in so doing, it favors identification around a global brand commitment."

THE POWER OF INTEGRATION

As global organizations consider how to achieve better integration, they need to take a close look at performance measurement systems and processes. The GE Way of managing its business relies on creating a common corporate culture to align the strategy of the many and diverse businesses that comprise the GE global organization. This shared culture at GE is constantly reinforced through its performance measurement systems. The Nestlé Waters case shows how the formal structure of the performance measurement systems changed with the introduction of the two business units and brought with it new patterns of vertical and lateral interactions. In particular, new planning and budgeting procedures were introduced (in line with emerging patterns of vertical interaction between the NW headquarters and the BUs), and a specific system of end-to-end profitability was implemented to support the lateral relations between the producer and the distributors of the international brands.

For companies like GE and Nestlé Waters, performance measurement systems will continue to be an integral part of the process of adapting to changing market conditions and integrating across the different functions, businesses, and subsidiaries that characterize the management of global corporations. ■

Cristiano Busco, Ph.D., Elena Giovannoni, Ph.D., and Angelo Riccaboni, Ph.D., are from the University of Siena in Italy. Cristiano is an associate professor of management accounting, Elena is a lecturer in accounting, and Angelo is dean of the faculty of economics and chairman of CRESCO, The Center for Evaluation and Control. You can reach Cristiano at busco@unisi.it, Elena at giovannoni@dii.unisi.it, and Angelo at riccaboni@unisi.it.

Mark L. Frigo, Ph.D., CMA, CPA, is director of The Center for Strategy, Execution and Valuation and Eichenbaum Foundation Distinguished Professor of Strategy and Leadership in the Kellstadt Graduate School of Business at DePaul University in Chicago. He's a leading expert in strategy design and execution and co-creator of the Return-Driven Strategy framework with Joel Litman. You can reach Mark at mfrigo@depaul.edu.

Robert W. Scapens, Ph.D., FCA, is professor of accounting in the Accounting and Finance Group in the Manchester Business School at the University of Manchester and a professor of management accounting at the University of Groningen in the Netherlands. He is also the editor-in-chief of Management Accounting Research, *an international journal that publishes research on management accounting. You can reach him at robert.scapens@mbs.ac.uk.*

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