



The Business of Process drives the Process of Business

Clarifying the Business Analysis starting point

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Whitepaper

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Identifying the Fundamental Process

A Common Currency

Identifying the fundamental business process is essential for management to effectively identify real organizational constraints, and allocate appropriate resources to relieve those constraints. Without a clear and easily articulated outline of the process, management can be distracted and invest ineffectively.

Uncovering the fundamental processes of a business is often more difficult than it would first seem. Like trees obscuring the forest, the myriad processes that exist and inter-relate within an organization can obscure the simplicity of the fundamental process.

Once the fundamental process description is uncovered, it provides a powerful mechanism to communicate the organisation's purpose and align personnel and management thinking accordingly.

Organisational Objectives

When attempting to understand the fundamental business process i.e. what the company is trying to achieve - many will turn to the company's mission statement as a place to begin. Unfortunately, this often puts people on the wrong track. A quick survey of some leading companies' mission statements reveals the following:

Commonwealth Bank:

The key financial objective of the Bank is to have Total Shareholder Return in the top quartile of our Australian listed peers rolling over each five-year period. Total Shareholder Return is calculated as the growth in the value of the investment in the Bank's shares, assuming all dividends are reinvested in shares at the point dividends are paid.

Leighton Holdings:

Leighton Holdings' purpose is to maintain and further develop a diversified contracting and project development business, which is profitable, financially sound and creates wealth for shareholders.

These corporate objectives focus on creating value for shareholders. Others focus on creating value for customers:

BHP Billiton:

Our purpose is to create value through the discovery, development and conversion of natural resources, and the provision of innovative customer and market-focused solutions.

Microsoft:

We are committed long term to the mission of helping our customers realize their full potential. Just as we constantly update and improve our products, we want to continually evolve our company to be in the best position to accelerate new technologies as they emerge and to better serve our customers.

The long-term pre-requisite for both of these objectives is this: The business must be profitable – it must make money.

None of the mission statements will be achieved for long (or at all) if the business is not profitable. Even those organizations with charitable and philanthropic objectives cannot pursue these noble objectives without making money – at least they can't in the long term.

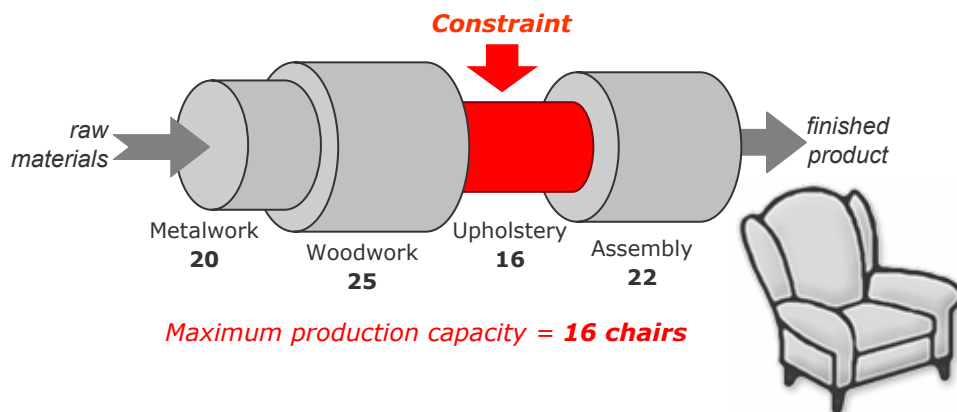
From this perspective, a business is a mechanism to produce profit, so that the stakeholders can then use that profit for whatever purpose they deem appropriate. Essentially, the business must produce profit – therefore the purpose of the business is to produce profit.

This is precisely the conclusion reached by Eliyahu Goldratt in his Theory of Constraints seminal work *The Goal*¹.

Taking the view that profitability is the common purpose for all businesses is helpful to our analysis - we can now look at the business in terms of its production of profit, and identify the process by which that profit is achieved. The process can be analysed for capacity and constraints using profit as the common measurement.

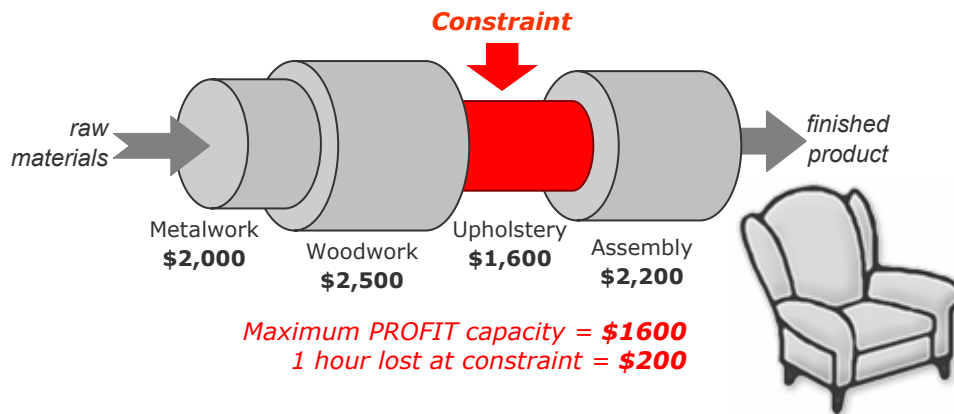
When examining simple process examples, this means that we should consider capacities and constraints not in terms of units of product, but rather units of profit. This gives a clearer understanding of the impact of the constraint, and also the impact of investment at the constraint.

In previous papers, we have used the chair manufacturing process as an example.



¹ Eliyahu, M. Goldratt *The Goal*, 1992 North River Press Publishing Corporation

Now, rather than using chairs as the unit of capacity, we should use profit. Let's say that each chair generates \$100 of gross profit. Our gross profit capacity is therefore \$1600. The impact that lost throughput at the constraint has on the bottom line is now very clear.

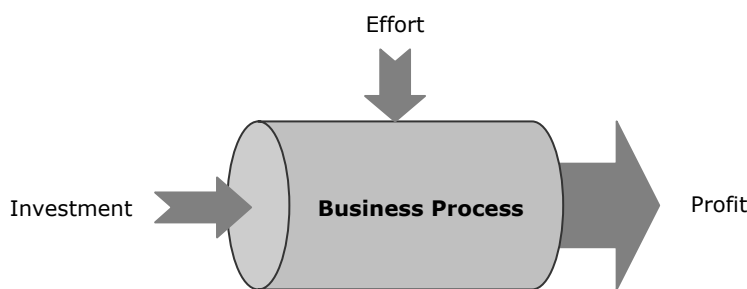


I.E. If our upholsterer has one hour of 'down time', our factory will only produce \$1400 of profit that day.

The Fundamental Process

So, now we know that the output of the business process is profit i.e. dollars. Using profitability as the 'currency' of the process, we can also be sure of the input to the process. If profitability is generally the difference between what something is sold for and what it cost to provide, then the input to the process must be the 'cost to provide' i.e. investment.

The business process takes an investment as an input, and through some process converts that investment into a profit.



The Business Process

Clearly, the investment can take many forms, as can the way that profit is derived. In our manufacturing example, the investment is in raw materials and the profit is derived from the sale of the finished goods. Another business may invest in advertising and products at wholesale to realize a profit by selling those goods at a higher price.

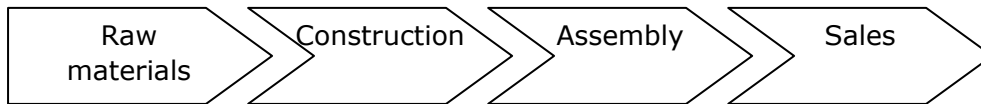
The next step is to identify the fundamental business process. To do this, we ask the question:

What does this business invest in, and by what fundamental process does it convert that investment into profit?

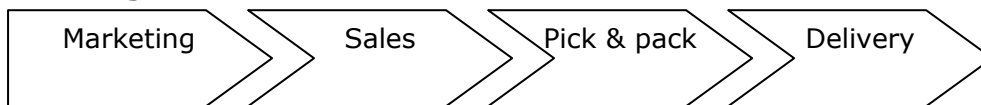
In the real world, businesses are not as simple as the chair-manufacturing example. It is important to understand that *at the highest level*, there will be one, or at most very few fundamental business processes. All other processes 'roll up' into these. The fundamental processes typically represent the basic business models that the business runs on.

In reality, there are probably relatively few business processes. For example:

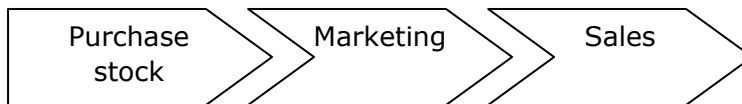
Manufacturing



Wholesaling



Retail



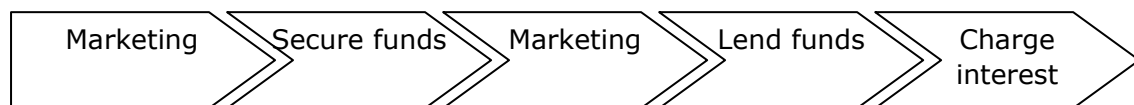
Entertainment/Leisure/Property Management



Media, Information



Finance



It is important to understand that even at this level of process simplification, complexities and interdependencies can arise. For example, some manufacturing processes might 'make to order' meaning that sales occur before raw materials are purchased. Similarly, in the Media/Information process, the Information Acquisition stage may in fact occur in parallel or after the marketing stage. The important thing to keep in mind is that we are seeking the *general* path by which investment becomes profit, with the objective of achieving that conversion as optimally as possible.

Some questions that will assist you with this analysis of your business are:

Where does investment occur? Are materials purchased then converted into product? Do you buy goods to resell? Is specialised training required to deliver your service?

Where does your revenue come from? Do you derive income from the use of your assets? Are products that you have made or bought sold to customers? Is time or skill a service that you sell?

What are the necessary conditions to operate? You may need to purchase plant and equipment to operate your business. For the purposes of defining the process, these are not necessarily considered as investment. Identifying these (and separating them) will help clarify the process.

Using these kinds of questions will help to outline the general flow from investment through to profit. Keep the level of analysis intentionally high.

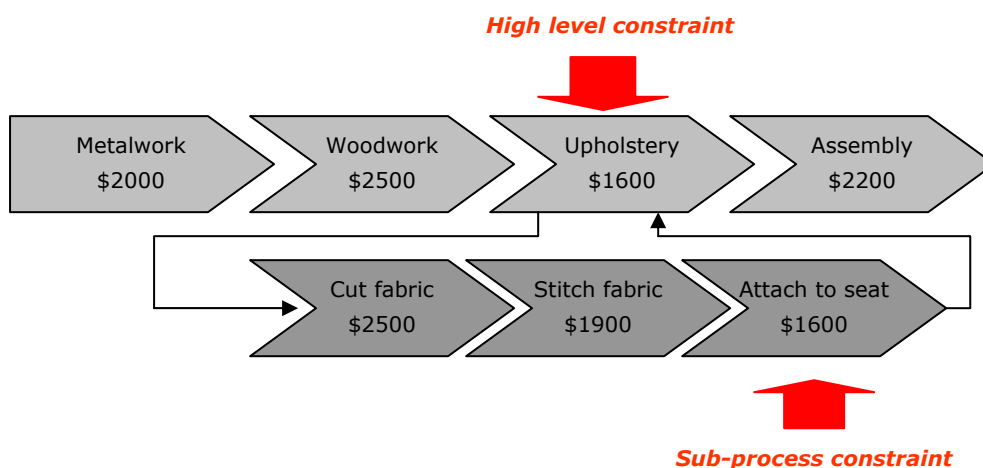
A good manager usually has a gut-feel about where the constraint may be found, and this level of process identification can help articulate that gut feel; managers generally have an idea of relative capacities. E.g. "We can pick & ship around \$20,000 worth of orders per day. At Christmas, we can get \$30,000 worth of orders per day" etc. This identifies where constraints may occur, but does not give an indication as to why.

In order to find out why, we need to drill down on the stage that is acting as the constraint.

Drilling Down

Consideration of these examples shows how sub-processes roll up into these top-level processes. We can drill down into each step of the above processes and visualize real examples of the sub-processes that contribute to the fundamental process.

To understand sub-processes, let's examine our chair manufacturing constraint.



Drill down of Upholstery constraint

We may initially assume that upholstery is the constraint because it requires specialist skills. However, drilling down into this example, we see that the constraint within the upholstery process is at the stage of attaching the stitched

fabric to the seat. It may be that this task does not require advanced upholstery skills, and so cheaper additional resources can be deployed to elevate the constraint.

This perspective allows us to deal with the perception that our specific business process has many constraints. This perception that there are 'many constraints' usually indicates that many processes are being considered. This is quite valid when there are inter-dependent processes. In these cases it is important to understand that even with interdependencies, backtracking and the like, there is still a higher-level process that represents the general flow from investment through to profit. At the highest level, the steps in the process tend to be very obvious. For example, you must get a customer before you can sell to them.

Once you have established a small number of high level processes it should become obvious that there is only one constraint per process. At any point in time there is only one constraint: If you pull a chain hard enough to break it, it's only going to break in one place.

The only exception to this is the unusual situation where a constraint shifts regularly.

Summary

The purpose of a business is to convert investment into profit. By doing so, the business can then go on to create value for shareholders, customers, employees and generally any other pleasant by-product that can only be sustained in the long term by making money.

Since we are starting with investment, and resulting in profit, there is a fundamental process that the business uses to perform this conversion. This is the key process to identify.

Profitability should be used as the common measure for analysis of this process. Each stage in the process should have an identified profit capacity. This allows us to identify constraints.

Once areas of possible constraint are identified, we can use the same techniques to drill down into the sub-processes to determine the appropriate actions to increase the business' profitability.