

top or bottom?  
average or excellent?  
leading or lagging?  
how do you compare  
with the rest?

here's your chance to find out!

“ Being made aware of performance gaps is of considerable value in itself, but it is acting upon the findings where the real benefit lies. ”

For small companies to be able to compete on the world stage, it is essential that they are aware of their performance in relation to their competitors. Benchmarking is a fundamental element of this process and is an invaluable first step for any organisation wishing to improve its performance.

The Small Business Service's (SBS) Benchmark Index has reached a pre-eminent position in the sphere of company benchmarking in a remarkably short time, bringing an extensive database of valuable performance comparison information within easy reach of SMEs.

But benchmarking is only a means to an end. Being made aware of performance gaps is of considerable value in itself, but it is acting upon the findings where the real benefit lies. This principle of applied benchmarking underpins all our activities in the promotion of the Benchmark Index.

Over 2000 assessments have now been undertaken using the service and its success has been further endorsed now that the European Commission has asked to use it as part of a major European benchmarking project. In the drive to improve the competitive performance of SMEs across the EU, it is proposed that up to 1500 companies will be benchmarked in nine member states against the Benchmark Index's database. The exercise will be repeated before the end of 2001 to assess actual changes in relative performance.

Taken with other activity on the international front (eg USA, Australia and Singapore), this will considerably augment the database's international dimension. As British businesses are competing on a global front, being

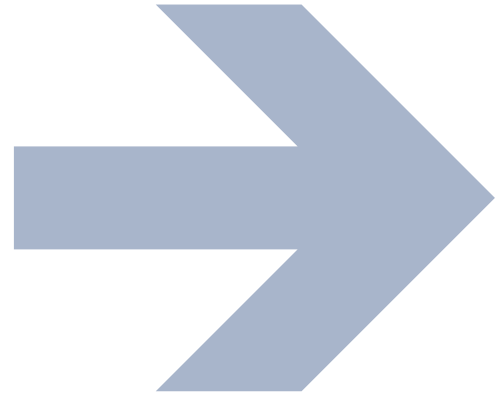
able to compare performance against overseas competitors and learn from best practice exemplars outside the UK will be of particular benefit.

The Benchmark Index database provided a wealth of information that was drawn upon for the analysis of the factors affecting differing SME performance that was described in the first 'Closing the Gap' report. In the two years that have elapsed since the report was produced considerably more information has become available. Data on so many diverse aspects of company performance on the Index's database is rarely available for such close scrutiny.

It is clear that many companies are performing well over a broad range of measures, but gaps in performance both within and between sectors indicate that many companies are failing to reach their full potential. It is thus evident that opportunities for improvement are to be found in all companies, however good their performance.

While Britain's overall competitiveness has been improving in recent times, there remains a substantial amount of work that needs to be done to assist all companies to compete successfully – a key role for the SBS.

**David Irwin**  
Chief Executive, Small Business Service



## Small Business Service · Closing the Gap

The performance of SMEs within the Benchmark Index

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British companies are no longer simply competing against each other. As information and communication technologies continue to shrink the globe, competition stakes are being raised. It can be cheaper and easier to order books from America or a car from Japan than from your local high street. There is more competition and often it is of a world-class standard. This pressure means that businesses need to be more streamlined and innovative than ever before to compete, both in terms of price and dynamism. The imperative to improve the competitiveness of SMEs is intense. The Benchmark Index has an important role to play in helping SMEs understand how their current performance compares against their competition. Since its original development in 1996 it has become firmly established not only as one of the best benchmarking tools in the UK, but also as one of the most comprehensive sources of SME performance data world-wide. Over 2000 companies have undertaken the assessment in which highly trained advisers measure some eighty business functions covering key financial, management and business excellence measures. These are compared with the performance of thousands of other SMEs held in a central database to produce a detailed analysis of the company performance. Companies can quickly establish whether they fit in the upper or lower quartile (25%) or rank somewhere near the average. Differences between the extremes can be dramatic.

The Benchmark Index covers all industrial sectors, geographical regions and company sizes giving a true reflection of the key issues that are relevant to all SMEs up and down the country. Below is a breakdown of the companies that have taken part in the Benchmark Index.

Region	Co's / %
Central London	4
Central Southern	4
East Anglia	4
East Midlands	4
Home Counties (outside M25)	2
North East	9
North Scotland	2
North West	7
Northern Ireland	5
Outer London (inside M25)	4
South East	8
South West	4
Southern Scotland	11
Wales & Welsh Borders	1
West Midlands	31
<b>TOTAL</b>	<b>100%</b>

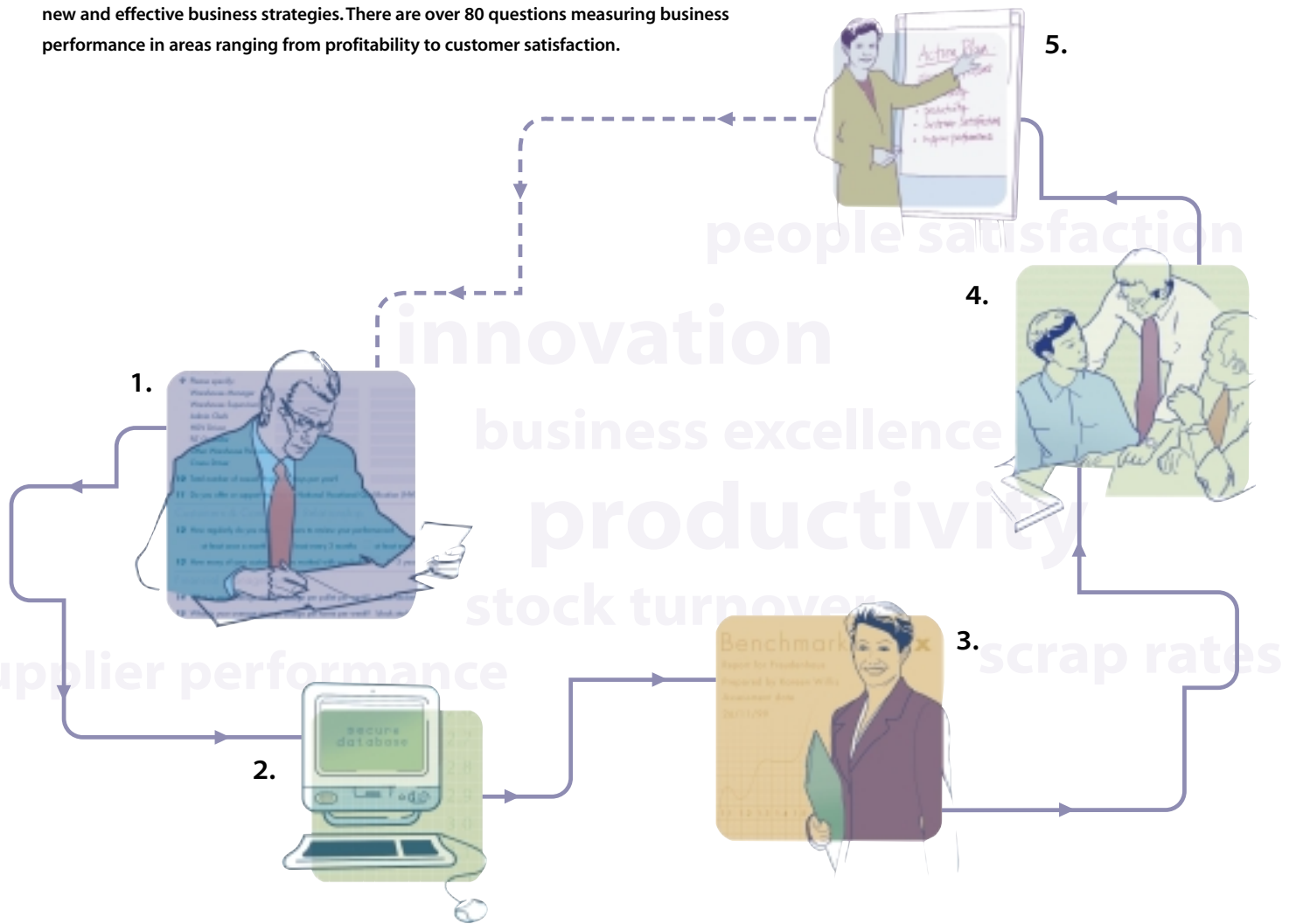
Turnover Range	Co's / %
Less than £1m	28
£1m - £5m	39
£5m - £10m	14
£10m - £30m	13
Over £30m	6
<b>TOTAL</b>	<b>100%</b>

Employee Range	Co's / %
10 and Under	13
11 - 20	15
21 - 50	25
51 - 100	21
101 - 250	18
251 - 500	5
Over 500	3
<b>TOTAL</b>	<b>100%</b>

Industry	Co's / %
Farming, Forestry & Fishing	.4
Mining & Ore Extraction	.1
Food, Drink & Tobacco (M)	4
Textiles & Clothing (M)	2
Wood & Paper (M)	6
Chemicals, Plastics & Ceramics (M)	9
Metal Products (M)	20
General Machinery (M)	6
Electrical & Electronics (M)	9
Transport (M)	8
Utilities, Telecommunications & Post	.1
Retail & Wholesale Goods	7
Tourism	.4
Transport Services	5
Financial / Property Services	1
Social / Government Services	2
Other Services	10
Construction / Contracting	6
Other Manufacturing	3
Education	1
<b>TOTAL</b>	<b>100%</b>

(M) - Manufacturing

The benchmarking process has been designed for maximum simplicity and time efficiency, with a commitment to improvement and an organised data collection mechanism. A number of benchmarking organisations and initiatives exist. Of these, the Benchmark Index is one of the most comprehensive. Using a computer-based system, it provides the objective results and human support that enable companies to implement new and effective business strategies. There are over 80 questions measuring business performance in areas ranging from profitability to customer satisfaction.



The benchmarking process is quick, straightforward and logical, but its impact is measurable and long lasting

1. The first step is filling in a questionnaire. The company answers quantitative and qualitative questions as well as selecting the criteria of those companies against which it will be benchmarked. The process is facilitated by Business Advisers, who are on hand to help with any queries.

2. The Business Adviser transmits all the data to a secure database, which immediately generates the Benchmark Index report. This report provides comprehensive and quantifiable performance indicators, highlighting the company's strengths and weaknesses against the comparison group chosen.

3. A preliminary analysis is then carried out by the Business Adviser.

4. The Adviser visits the company and together they review the results of the report. This process provides the basis for improvement.

5. Improvement action plans are developed and implemented on a systematic basis.

**Benchmarking is not a one-off process. To fully enjoy the benefits, it must become a regular process that is embraced within the culture of the business.**

How to improve performance is an issue that concerns every manager in every organisation. Performance in this context can mean financial performance – profitability, return on investment or non-financial performance – customer satisfaction, employee satisfaction, and so on. In fact, it is now widely accepted that the drivers of future financial performance are non-financial. Employee satisfaction today will affect the level of customer service delivered. The service customers receive when they interact with the organisation will affect their satisfaction. Their satisfaction with today's transactions will affect whether they come back again tomorrow, or the next day, or next month. So the best way of ensuring good financial performance in the future is to deliver great service to customers today.

Of course, this is a somewhat simplistic picture. Delivering great service to customers is undoubtedly important, but one way of delivering great service would be to spend a fortune looking after customers. The net result might be very satisfied customers and a bankrupt organisation. So there is more to delivering outstanding financial performance than simply delivering great service. Managing costs, margins and productivity are all crucial as well.

This report builds on these themes and explores the levers that managers in SMEs can pull if they want to improve financial performance in their businesses. The great strength of the report is that it is not based simply on theory. Instead, it identifies the levers managers can pull by analysing performance data that has been collected from real companies. Since its launch in October 1996, the Benchmark Index has established itself as one of the most comprehensive sources of SME performance data anywhere in the world. To date, over 2000 companies have benefited from the service through a network of specially trained advisers operating out of business support agencies across the UK. The value of the Index has been recognised by the Small Business Service (SBS), which has adopted it as one of its national MANAGEMENT BEST PRACTICE services. Comparative benchmarking data from overseas is also becoming increasingly available, as countries such as United States, Singapore, Australia, Germany and Spain adopt the methodology used.

Benchmarked companies submit data that allows over 60 key performance measures to be calculated, under the general headings of Finance, Management and Business Excellence. Every company that participates in the process receives a customised benchmarking report that enables them to compare their performance with that achieved by similar organisations. Gaps between company performance and best in class in any particular dimension highlights what can be achieved. Company specific, focused and actionable improvement programmes can then be constructed in light of the insights provided by the benchmark data with the help of the company advisers. In this way the benchmarking process not only helps individual companies achieve higher levels of performance, but also raises the UK's competitive position as a whole.

*"I was amazed at how far behind we were compared to many of our competitors. The Benchmark Index exercise has led to a complete overhaul of our systems and processes."*

some eye-opening results from the Benchmark Index...

25% of companies are destroying value by pumping money into organisations that are achieving less than the cost of capital.

**If creditors called in their debts tomorrow, 25% of the sample would go bust.**

The bottom 25% of companies are achieving profit levels that are one tenth those achieved by the top 25%!

Supplier performance is poor. Lower quartile companies clearly do not have control over their suppliers as up to 75% (by value) of the supplies they receive are delivered late.

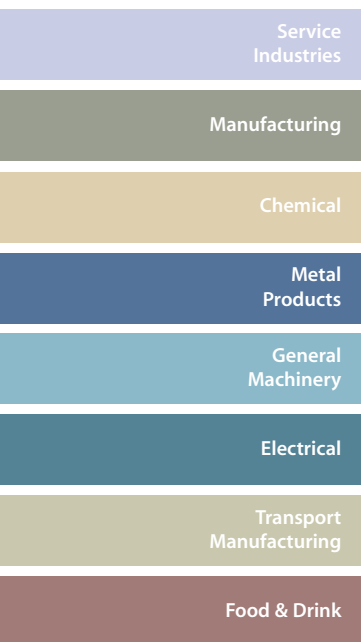
Overhead management is a key issue. The bottom 25% of companies require three times as much overhead as the top 25%. They have three times the number of indirect employees and require twice as many managers per employee.

**Many companies invest more in marketing – claiming they have specific capabilities – than they do in actually building these capabilities. For every £100 spent on marketing, £60 is spent on R&D and only £30 on training.**

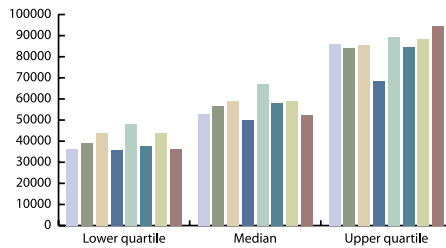


The Benchmark Index uses a series of measures to track the financial performance of companies. These in turn can be split into three sub-categories – **sales and profit performance**, **value creation** and **asset management**. The variation between companies across these three performance dimensions is massive. In the lower quartile, those that fall within the bottom 25%, generate half the turnover per employee and one tenth of the profits per employee than the upper quartile do. Importantly the variations across sectors are not as great as the variations within sectors. This suggests that companies in all sectors can be successful with the right combination of people, products and processes. In the analysis that follows, comparisons are made between Service and Manufacturing sectors, with Manufacturing then split further into Chemical, Electrical, Food & Drink, General Machinery, Metal Products and Transport Manufacturing.

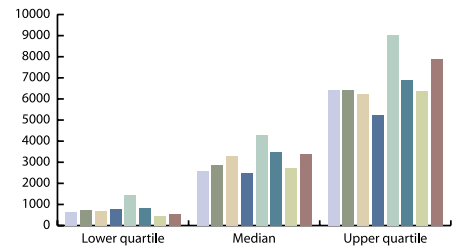
Key to Graphs



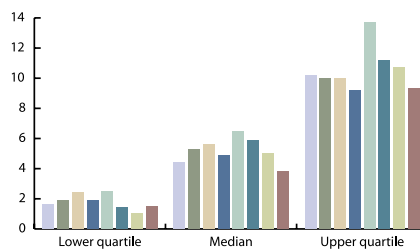
Sales turnover per employee (£)



Pre-tax profit per employee (£)



Pre-tax profit/turnover (%)



profit figures are startling - the bottom 25% of companies achieve profit levels that are **one tenth** those achieved by the top 25%!

*“Without these measures of performance it is like working in the dark”*



**The difference in turnover per employee from lower quartile to upper quartile companies is...**

**massive!**

The sales turnover per employee achieved by upper quartile companies is almost twice that achieved by the lower quartile, regardless of sector. The greatest difference is in the food and drink sector where the lower quartile only manage to achieve 39% of the sales turnover per employee than the upper quartile do.

The sales turnover per employee achieved by companies operating in the metal products sector is consistently lower than that achieved by those in any other sector.

The variation in pre-tax profit per employee is huge. Lower quartile companies achieve pre-tax profits per employee that are one tenth those achieved in the upper quartile. In the transport manufacturing and food and drink sectors lower quartile companies achieve only 7% of the pre-tax profit per employee than upper quartile companies.

The general machinery sector appears to out-perform the others in terms of pre-tax profits per employee. Lower quartile general machinery companies achieve twice the average pre-tax profits per employee compared to manufacturing as a whole. Upper quartile general machinery companies achieve 40% higher pre-tax profits per employee than manufacturing overall. The median pre-tax profit was 5.3%, however 25% of the companies (lower quartile) achieved a profit of less than 2%.

1.8% of the sales turnover of lower quartile companies forms their pre-tax profit. This compares with 10.1% for the upper quartile.

The difference between lower and upper quartile pre-tax profit as a % of sales turnover is greatest in the transport manufacture sector. Here lower quartile companies generate just 1% pre-tax profit as a % of sales turnover, whereas upper quartile companies generate 10.7%.

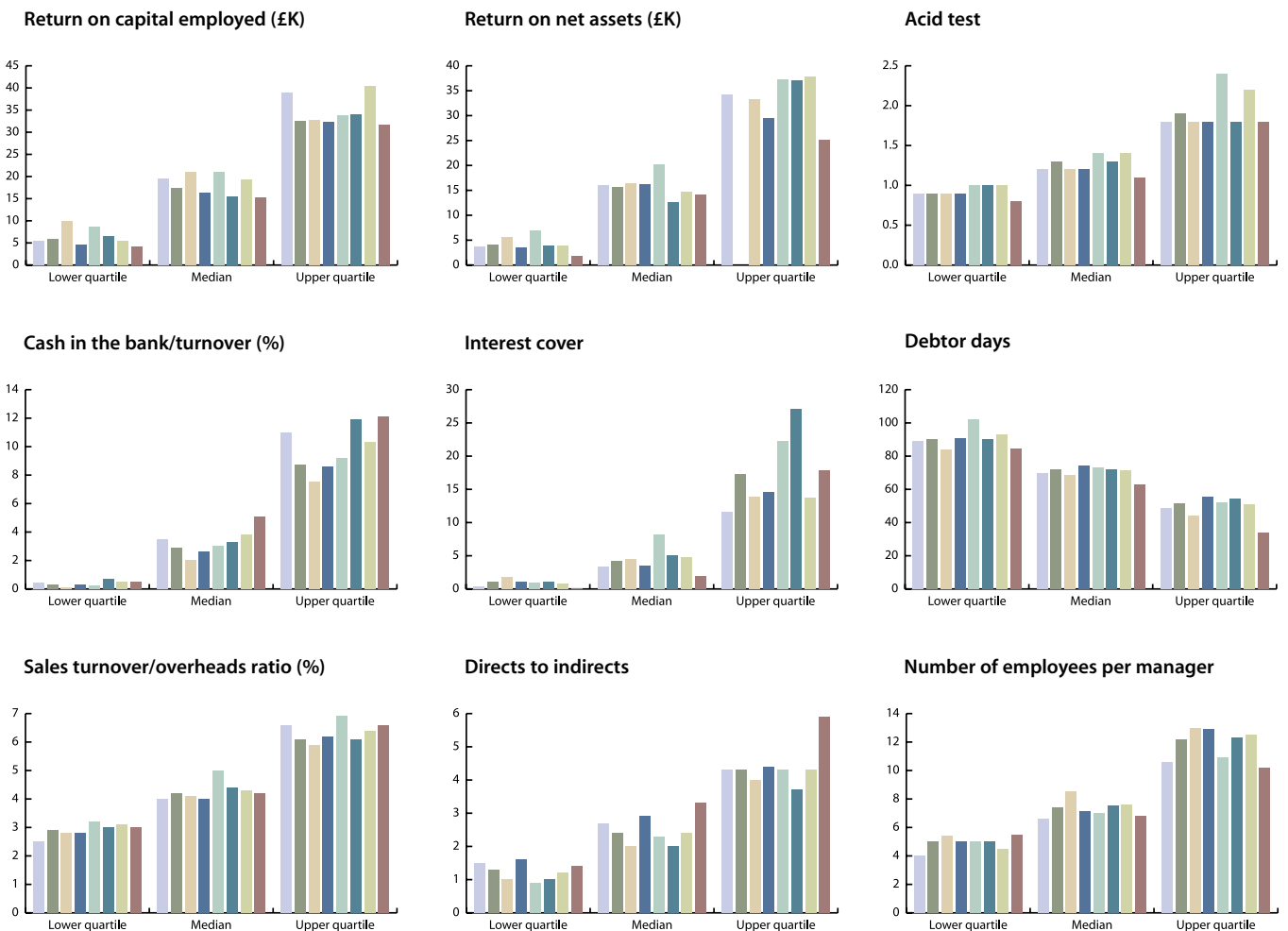
The variation between upper and lower quartile companies is smaller in the chemical sector. Here the upper quartile generates 10% pre-tax profit as a % of sales turnover, while the lower quartile generates 2.4%.

Once again the general machinery sector out-performs the others. Upper and lower quartile performers in the general machinery sector generate over 30% more pre-tax profit as a percentage of sales than the equivalent quartiles within manufacturing as a whole.

**General machinery companies achieve twice the average pre-tax profits per employee than for manufacturing as a whole**



Sales and profit performance are only part of the picture and their major weakness as measures is that they do not establish whether or not a company is creating value. All organisations require investment. No matter where this investment comes from - banks, venture capitalists or private finance - a key role of management is to minimise the amount of capital that has to be invested and, more importantly, to maximise the return on that investment. It is commonly accepted that today the cost of capital is in the region of 12%. Therefore, if an organisation is generating less than 12% return on capital employed, then the capital that has been invested will effectively be worth less at the end of the investment period than it was at the start. Why is this? Because investors can achieve a guaranteed return of approximately 6% by placing their money in no risk bonds. They also need to take account of the fact that inflation, which is roughly 3%, will result in their money becoming worth less over time. And they need to consider the tax they have to pay on any returns they receive (equivalent to another 3%). Hence if the return on capital employed is less than 12% the firm is effectively destroying value. Over 25% of firms in the Benchmark Index fall into this category.



Over 25% of firms appear to be destroying value. They are generating return on capital employed at a rate of less than 12% (the commonly accepted figure for the cost of capital). Upper quartile companies are achieving return of capital employed figures which are six times as great as lower quartile companies. The average level of return on capital employed for lower quartile companies in the manufacturing sector is 5.9% compared to 32.6% for those in the upper quartile.

The picture for the return on net assets is similar. Over 25% of companies are failing to generate 12% return on net assets. The figures for the electrical sector are even more concerning, for here almost 50% of the sample are failing to achieve a return on net assets of over 12%.

The key to achieving high returns on capital employed and net assets is asset management. There may be a need to accept low returns for short periods of time, for example, during major periods of investment. In the longer term, however, it is essential that the return on capital employed and the return on net assets is driven up. Two significant levers for driving up returns can be identified through the Benchmark Index data - cash management and overhead management.

The acid test compares the value of liquid assets to the value of current liabilities. If the ratio is less than 1 it means that the organisation does not have enough liquid assets to cover its current liabilities. Well over 25% of companies in the Benchmark Index sample are in this position. If their creditors called in their debts tomorrow 25% of the sample would go bust.

A significant reason why so many companies have a problem with the acid test is that they have very little, if any, cash in the bank. Lower quartile companies have 0.4% of their sales turnover as cash in the bank. Even the median companies only have 3.2% of their sales turnover as cash in the bank. Interestingly upper quartile companies are cash rich and have, on average, 9.9% of their sales turnover as cash in the bank. Rather than simply leaving cash in the bank, some of these companies should be looking to expand their investments.

Interest cover measures the proportion of profits that are required to cover interest payments. On this performance measure the difference between the upper and lower quartile is huge, with some companies spending 20 times as much of their profits as others to simply cover interest payments. The electrical sector is particularly badly hit by this with a quarter of companies having to spend over 25% of their profits meeting interest payments.

Interest payments are not the only reason why SMEs have such small amounts of cash. The average number of debtor days across the entire sample is 70.8 days. Even upper quartile companies suffer with an average number of debtor days of 50.0. This compares very favourably with lower quartile companies, however, who have to wait an average of 89.4 days. Upper quartile companies in the food and drink sector are the ones to learn from, as they have managed to drive down debtor days to 33.8 days.

In addition to cash management, overhead management appears to be a significant problem in the lower quartile. The upper quartile are able to achieve a sales turnover to overhead ratio more than twice as strong as that achieved by the lower quartile. That is, lower quartile companies require twice as much overhead than upper quartile companies to achieve the same level of sales turnover. One of the reasons why the lower quartile has significant problems with overhead is that they require three times as many indirect employees as the upper quartile with the same number of direct employees. There can be several reasons for this, but one explanation is that lower quartile companies have poor control over their business processes - hence they require far greater management intervention.

Managers in upper quartile companies are responsible for two and a half times as many employees as managers in lower quartile companies. This lends support to the argument that the lower quartile requires more management intervention because they have not taken control of their basic business processes. Coupling this with the wide discrepancies in debtor days that were observed earlier, it is clear that there is a requirement for many companies to undertake some fundamental process management initiatives.

## Would your company pass the

# acid test?

The acid test compares the value of liquid assets to the value of current liabilities. If the ratio is less than 1 it means that the organisation does not have enough liquid assets to cover its current liabilities. Well over 25% of companies in the Benchmark Index sample are in this position. **If their creditors called in their debts tomorrow, 25% of the sample would go bust.**

The massive discrepancies within sectors on all of the financial performance measures highlight the fact that there are some significant gaps to be closed. While there are as many theories as there are management gurus on how such gaps can be closed, some clear messages shine through from the Benchmark Index data. The first is **focus on value**. Too many companies in the sample are not generating a return above the cost of capital. One of the reasons for this appears to be poor cash and overhead management. Too many companies have too many managers and have processes which fail to operate correctly. They find it difficult to collect cash from their debtors and this means that they are constantly facing a cash flow crisis. Of course, simply collecting the cash that is owed to the company will not ensure that all of the financial performance gaps are closed. The key here is to identify what the levers are that managers can pull and understand how far these levers have to be pulled. The table below illustrates how a 1% increase in sales revenue (either through a 1% increase in volume or margins), accompanied by a 1% reduction in costs, can result in a 100% improvement in profit after tax for a £5 million business. Performing a similar sensitivity analysis on your own business will highlight the practical steps that you can take if you want to close the gap in terms of your company's financial performance.

### The Sensitivity Analysis

This sensitivity analysis is based on one prepared originally by Geoff Smith of G.Smith & Partners. It is deliberately designed to illustrate the power of sensitivity analysis and highlight the impact that very small changes in performance can have on the bottom line of businesses that are not currently performing particularly well.

Income and expenditure	Current	1% improvement	Result
Total sales revenue	5,081,600	increase price or volume	5,132,416
Less all external costs	3,747,600	reduce spend and waste	3,672,648
<b>Created value</b>	<b>1,334,000</b>		<b>1,459,768</b>
Less payroll costs	980,000	1% heads, 1% costs	960,400
Less depreciation	188,600		188,600
<b>Operating profit</b>	<b>165,400</b>		<b>310,768</b>
Borrowing costs – net	20,700		20,700
<b>Profit before tax</b>	<b>144,700</b>		<b>290,068</b>
Tax (at 24%)	34,728		69,616
<b>Profit after tax</b>	<b>109,972</b>		<b>220,452</b>

**100%** increase in profits from just 1% improvement!

Formston Evans, a producer of beechwood frames for the furniture industry, was a company bumping along the bottom until the Benchmark Index highlighted some key problems



The two directors, Alan Formston and John Evans, were so involved in sorting the day-to-day problems that no attention was being given to winning new business or making operational improvements. Staff turnover was at depressingly high levels and process control was so loose that new business could only be handled with the greatest of difficulty.

Turning for guidance to their local Business Link five years ago, the owners were not best pleased to be confronted with a comprehensive comparative exercise. However, early scepticism was soon overcome and the SBS's Benchmark Index graphically illustrated the prime cause of their problems. Value added per employee was very low and, measured against their peers, productivity was virtually non-existent.

The inability to retain and motivate staff was very costly. Assembling the beechwood frames may not have been a high skilled job, but it did require competent carpenters. On a turnover of £150k per year, hourly rates were little more than the minimum wage. All too often, people would leave after six weeks for a better job elsewhere. Apart from the cost of replacing them, supervisory skills were walking out of the door.

On the basis of these findings from the Benchmark Index, the first step which Philip Stott of Bolton & Bury Business Link recommended was to

introduce profit-related pay. Over time, results have been dramatic. Value added per employee is up 60%. Hourly rates are now £6 an hour, retention turnover is well down and a supervisory structure is now in place. As a result, the director's time has been freed up to develop the business. Turnover is up to £400k and the company is looking to move to new 20,000 sq. ft. premises.

Process control has also improved. Previously, the directors had little knowledge of the margins achieved with different customers and the company's delivery performance was appalling. In particular, one major customer regularly placed orders expecting them to be turned around in ten days. Time and again, Formston Evans would deliver 3-4 days late.

After measuring the process, it transpired that it actually required four days work to produce the order. The rest of the time was spent as material in progress. By introducing tighter controls and schedules, work has started to flow more smoothly.

Formston Evans is now scoring well above average on the Benchmark Index, but much remains to be done. As in any deep change programme, there are lulls and setbacks. By regularly measuring improvements internally, the company is able to remind itself of just how far it has come.

**Are SMEs performing for customers?**

The sensitivity analysis presented in the previous section assumed that it will be possible for managers to achieve a 1% increase in either prices or volumes, while simultaneously achieving a 1% reduction in costs. Of course this may well be possible, but it will only be so if management focuses attention on the key non-financial levers – customers, people, suppliers – and continues to build for the future by investing, by developing new products and markets and by continually improving the company’s business processes. The Benchmark Index contains a significant amount of data on each of these dimensions of performance and it is this data which is presented in the sections that follow.

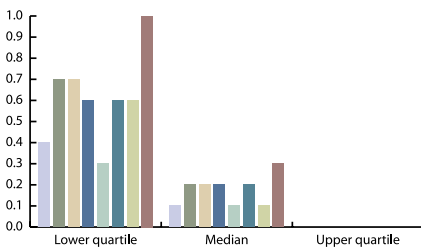
In today’s highly competitive global market place it is essential that firms deliver excellent customer service. Of course, customer service is a multi-dimensional concept and it is in recognition of this that the Benchmark Index captures data on - complaints per customer, complaints per order, order value of complaints as a percentage of turnover, orders not delivered on time as a % of total orders and orders rejected during warranty as a % of total orders.

the company does not make it easy for frustrated customers to complain and has no mechanism in place for capturing, and presumably resolving, complaints once they are received. The hidden message in this data then is that at least 25% of the sample do not have the processes in place to enable them to track whether they are receiving customer complaints.

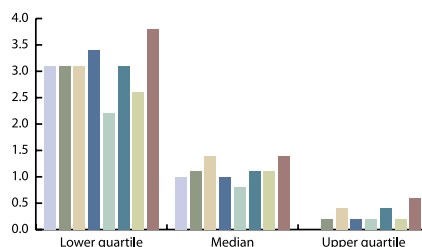
Two issues are worth bearing in mind when reviewing this data. First, research evidence suggests that only one in ten people who feel like complaining actually do complain. Second, zero complaints per customer may not be a good thing. It is highly unlikely that all of the company’s customers are satisfied all of the time. Zero complaints per customer might simply indicate that

**“ It wasn’t until we set up a customer satisfaction survey after undergoing the Benchmark Index that I started to understand exactly what the customer wanted ”**

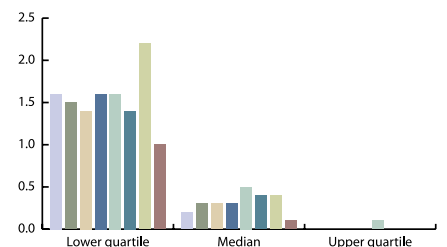
**Complaints per customer (%)**



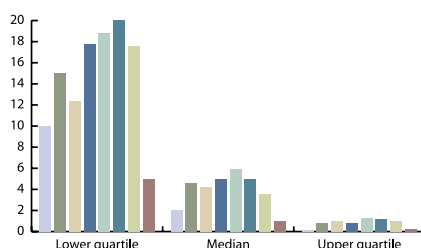
**Complaints per order (%)**



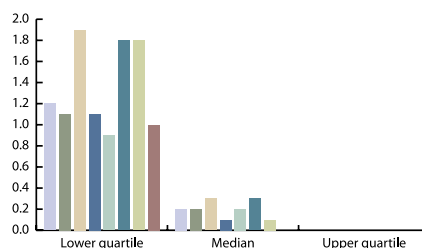
**Order value of complaints/turnover (%)**



**Orders not delivered on time (%)**



**Orders rejected during warranty (%)**





## Only 1 in 10 customers who feel like complaining actually complain... so, how happy are *your* customers?

Once again there are substantial variations between the upper and lower quartile performers. With the upper quartile performers reporting no complaints per customer and the lower quartile performers reporting 6 complaints per 1000 customers on average. The complaints per order data shows similar trends but, interestingly, this time the upper quartile companies report that they receive 0.2% complaints per order, which suggests that while they cannot track complaints per customer they are able to track complaints by orders.

Of course, the same comments apply to this data as to the complaints per customer measure. Namely that a low number of complaints per order may not be symptomatic of good performance. Instead it may highlight the fact that the organisation does not make it easy for customers to complain.

The order value of complaints as a percentage of turnover is a particularly important measure as it illustrates what proportion of the company's total order value is the subject of customer complaints. The lower quartile performers receive complaints totalling about 1.6% of their orders by turnover. This 1.6% of turnover comes straight off the bottom line and is accompanied by a substantial set of hidden costs – i.e. the cost of collecting the faulty goods/services, replacing them, scrapping them (if necessary) and re-building the relationship with the customer. Upper quartile companies claim that the order value of complaints they receive is negligible. Again, this raises the question as to whether these companies have appropriate processes in place for tracking customer satisfaction.

A key dimension of customer service for many organisations is delivery on time. The definition of 'on time' can vary from sector to sector, but the benchmark definition is 'on time in full' (OTIF) – i.e. everything the customer ordered should be delivered at the time requested by the customer.

Despite the massive efforts that have been exerted in recent years to improve delivery performance, many organisations still appear to find meeting promised delivery schedules incredibly difficult. Investments in information technologies, such as Enterprise Resource Planning (ERP) systems, may have improved the situation, but lower quartile companies still only manage to deliver 87.5% of their products on time. Upper quartile performers, on the other hand, achieve excellent delivery performance and manage to deliver 99.5% of their products on time. Once again, this data suggests that there is much the lower quartile performers can learn from their upper quartile peers.

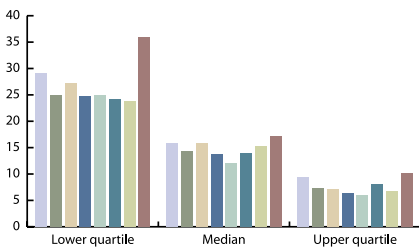
Lower quartile performers have another significant problem, for even when they do deliver products, 1.2% of them are rejected during the warranty period. As with complaints, this comes with significant hidden costs. Interestingly, upper quartile performers claim that none of their orders are rejected during the warranty period. It is not clear from the data whether this is indeed the case and, if so, how they achieve this excellent performance. Or, whether the 'so-called' upper quartile performers for this dimension of performance make it difficult for their customers to reject product during warranty.

At the heart of all organisations are people. The last 20 years has seen a massive rise in popularity of phrases such as, 'our people are our greatest asset'. Does the data in the Benchmark Index bear out this statement? Does it suggest that SMEs value their people as a real asset? And, if so, does it suggest that SMEs have developed sophisticated recruitment and retention processes for managing their people? Sadly, the answer is a resounding...

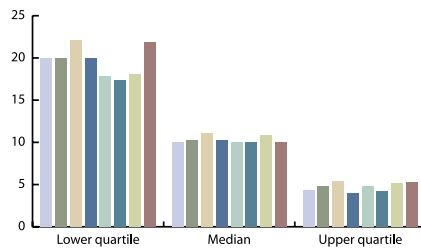
# NO!

The Benchmark Index collects people performance data under several different headings - new employees, total leavers, early leavers, days lost to absenteeism, accidents, number of employees per manager, directs compared with indirects and graduates as a % of employees. Some of this data was presented early when the question was explored – are the SMEs featured in the Benchmark Index managing overheads well? This section will concentrate on the remaining data.

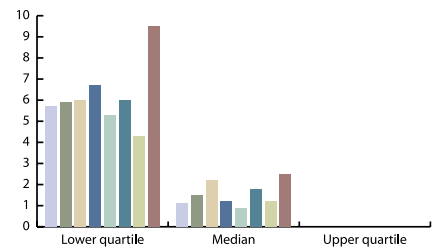
New employees/total employees (%)



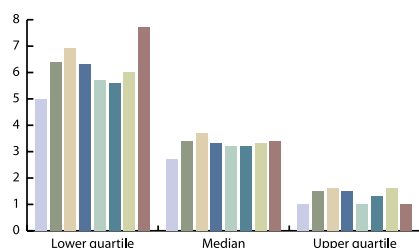
Total leavers/total employees (%)



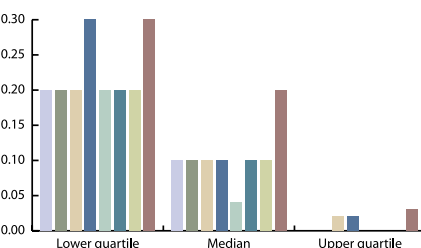
Early leavers/total employees (%)

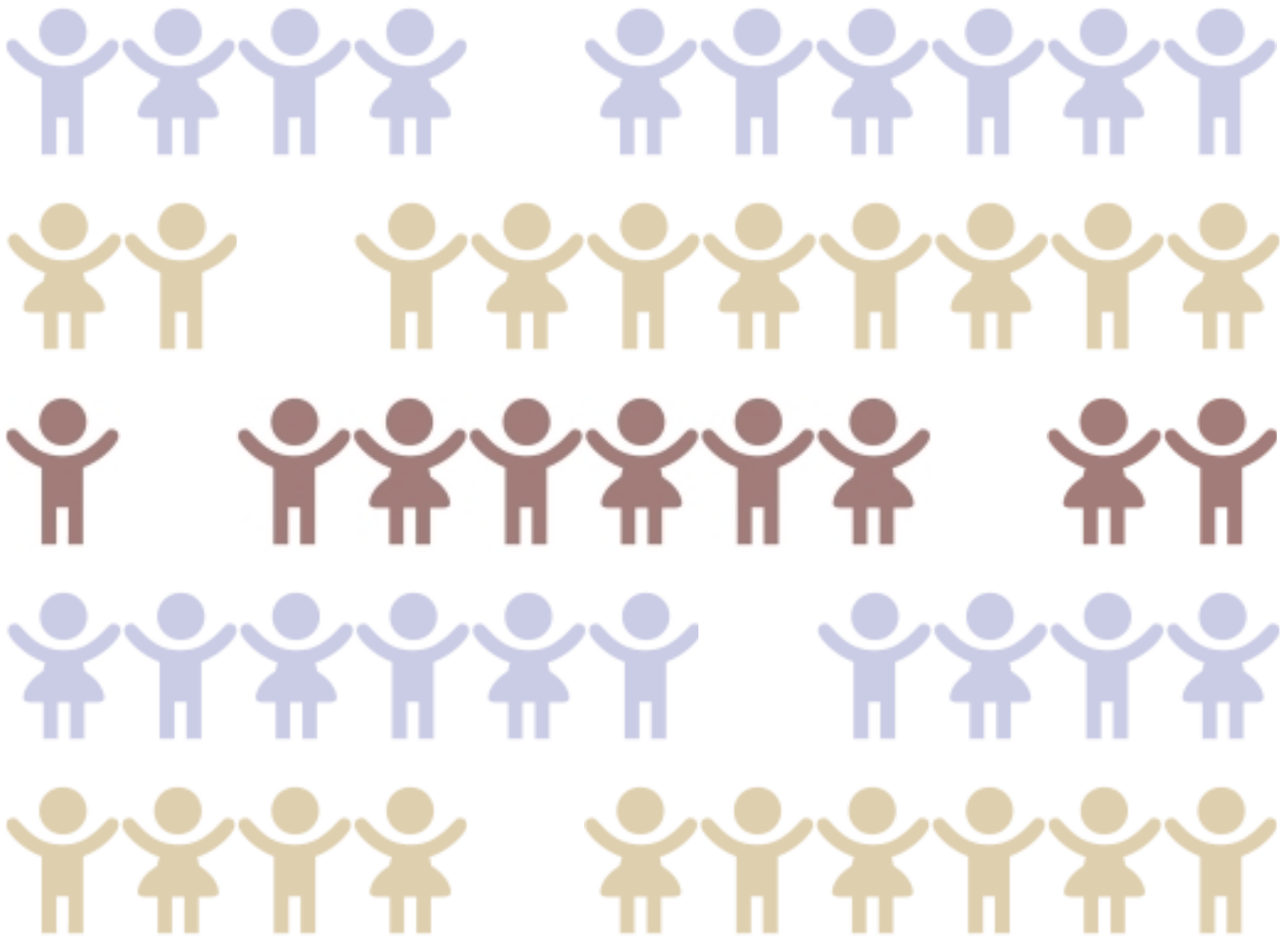


Days lost to absenteeism per employee



Accidents per employee





Lower quartile companies lose 6 days a year per employee through absenteeism. This is equivalent to a 500 person business losing **12 person years** through absenteeism for every year worked!

The rate of employee recruitment in the sample companies is significant. The lower quartile has to recruit over 25% of their employees annually. Even in the upper quartile they have to recruit just under 10% of their employees annually. If the reason for this high rate of recruitment was rapid expansion, then it would be an attractive position. However, the lower quartile performers featured in the Benchmark Index data set lose 20% of their employees per year. While the upper quartile performers lose just under 5% per year.

Perhaps the most concerning fact of all is that one third of the employee turnover in lower quartile companies is due to early leavers - i.e. people who leave within six months of joining the company. The reason that this is particularly concerning is that it suggests that the company's employee recruitment and induction processes are not under control. People leaving their jobs within six months generally do so for one of two reasons. Either they prove to be incapable of doing the job and are therefore dismissed. Or they decide that they do not wish to do the job, in which case they leave. In either event the individual concerned should never have been offered the job in the first place.

The relatively high staff turnover suggests that people are not particularly happy working in many of the SMEs featured in the Benchmark Index data set. It is generally accepted that an alternative measure of employee

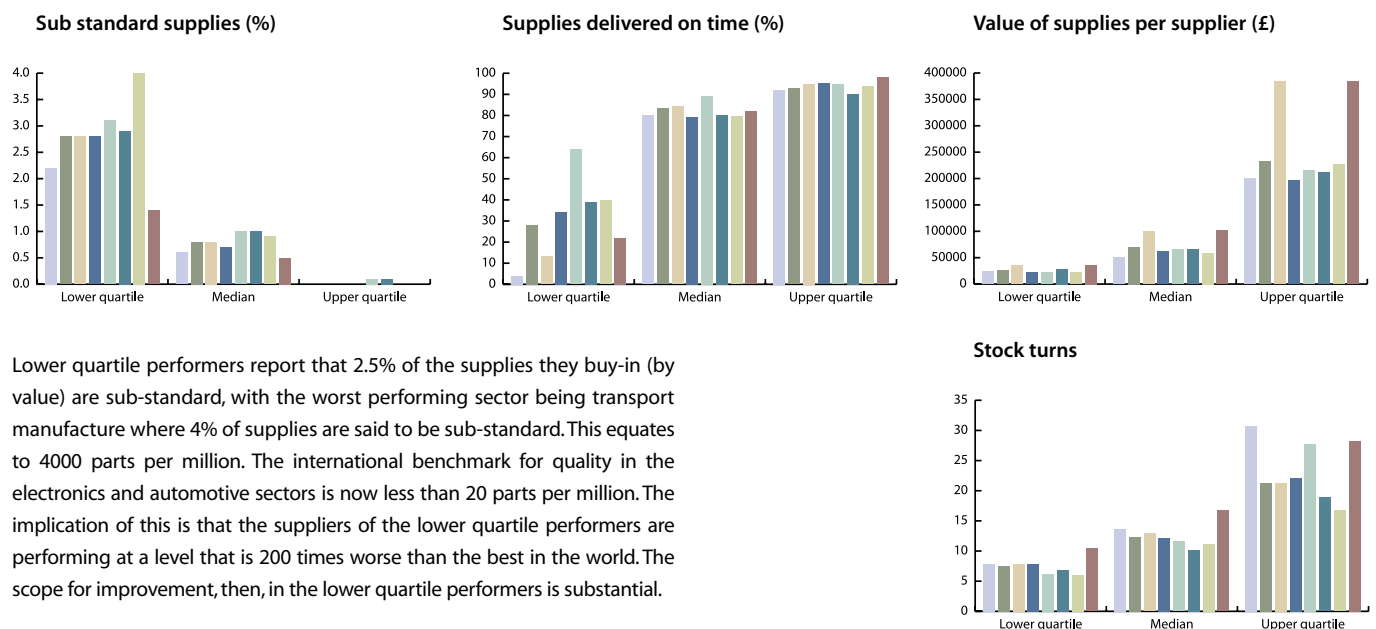
motivation is absenteeism. Lower quartile companies lose 6 days a year per employee through absenteeism. To put this in perspective this is equivalent to a 500 person business losing 12 person years through absenteeism for every year worked!

Unsurprisingly, absenteeism is worst in the lower quartile performers in the food and drink sector, probably because of the seasonal nature of employment in many food and drink companies. However, absenteeism in the upper quartile companies in the food and drink sector is only 1%, the same as the service and general machinery sectors, and better than all of the other sectors. The question this raises, of course, is how are companies in the upper quartile in the food and drink sector managing absenteeism?

An alternative measure of employee motivation is provided by accidents per employee. It is assumed that motivated employees are more likely to be engaged in their jobs. Hence they will be paying more attention while at work and are therefore less likely to suffer accidents. It is concerning to see the high level of accidents per employee in lower quartile companies. The data suggests that each year one employee in five, regardless of sector, will suffer a reportable accident. Performance in the upper quartile is far better, with several companies reporting a very small number of accidents per employee.

## Are suppliers performing for SMEs?

In recent years there has been an increasing trend for firms to outsource non-core activities, which results in them becoming ever more reliant upon their suppliers. This, coupled with the growing recognition that significant cost can be taken out of supply chains, has resulted in significant interest in improving supplier performance. The Benchmark Index captures data about supplier performance using several different measures, most notably - % of sub standard supplies by value, % supplies delivered on time by value, turnover/number of suppliers and stock turns. Unfortunately, the data suggests that, despite the significant efforts that have been exerted to date, supplier performance across all sectors leaves much to be desired.



Lower quartile performers report that 2.5% of the supplies they buy-in (by value) are sub-standard, with the worst performing sector being transport manufacture where 4% of supplies are said to be sub-standard. This equates to 4000 parts per million. The international benchmark for quality in the electronics and automotive sectors is now less than 20 parts per million. The implication of this is that the suppliers of the lower quartile performers are performing at a level that is 200 times worse than the best in the world. The scope for improvement, then, in the lower quartile performers is substantial.

The supplies that many companies receive are not only sub-standard, but they are also often late. The lower quartile reports that 84% of the supplies they receive (by value) arrive after they were due. In contrast, the upper quartile claims to receive 92.5% of supplies on time. Interestingly, this is one of the few measures where there are large variations across the sectors, especially among the lower quartile performers. The worst sector is service, where only 3.9% of supplies are delivered on time to lower quartile performers. This contrasts with the general machinery sector, where the lower quartile performers report that 63.9% of supplies are delivered on time.

So, why do so many companies have such problems with their suppliers? One possible reason is that they simply have too many suppliers to deal with. The ratio sales turnover to number of suppliers provides an indication of how many suppliers a company requires to support it achieving its turnover.

The variation from lower quartile to upper quartile performers is massive, and suggests that upper quartile performers use one tenth of the number of suppliers than lower quartile performers use. Of course, using less suppliers means that the organisation requires less overhead and can focus resources on building relationships with a limited number of suppliers. This, in turn, should lead to improved supplier performance.

For this particular measure, it is important to compare performance within sectors. Companies that operate in sectors that make products with a limited number of components – such as chemicals or food and drink – appear to have far fewer suppliers than companies that produce complex products with multiple sub-assemblies and components – such as metal products, transport manufacture and general machinery.

It is not only external control in the supply chain that is a problem for many companies in the data set. Lower quartile performers report that they achieve 7.7 stock turns per year, which contrasts with the 26 stock turns per year achieved by the upper quartile performers.

Companies that are able to achieve high stock turns tend to be those that have control over their manufacturing processes, that have reduced set-up times so that it is economical to manufacture in small batches and have good stock management systems in place. Given that the upper quartile achieves four times as many stock turns per year as the lower quartile, it is clear, once again, that there is much the lower quartile companies can learn from the upper quartile ones.

Managers are generally involved in making incremental changes to improve their business. 'The Benchmark Index has been a superb tool for measuring the cumulative effects of such changes,' says Gary Pollard, Business Manager of VTP, a subsidiary of British Vita plc, employing 60 people in Middleton, Manchester.



- 50% reduction in complaints per order
- 40% reduction in absenteeism
- 60% fall in material re-processing
- 15% reduction in set-up times
- 22% reduction in scrap rates
- 5% cut in energy costs

VTP produces rubber compounds which have all the processing advantages of thermoplastics combined with the physical properties of rubber. They achieve high levels of 'right-first-time' and are easily recycled. VTP's products have found multiple applications in the automotive and construction industries, creating a business with a current turnover of £10M.

In 1997, Gary Pollard had a gut feeling about where the strengths and weaknesses of the business lay but wanted to check and quantify this against the Benchmark Index. John Gerrard, Project Adviser for the British Rubber Manufacturers' Association used the Benchmark Index to measure VTP's performance against other rubber businesses and against plastics and processing industries. The results showed that VTP was top of the class in its levels of capital expenditure. It was less good at interacting with its market.

Automotive customers were clearly impressed with the company's technology and were coming back requesting further adaptations and hybrids. Too often, however, R & D efforts were not being fully exploited, despite a good work force and strong management.

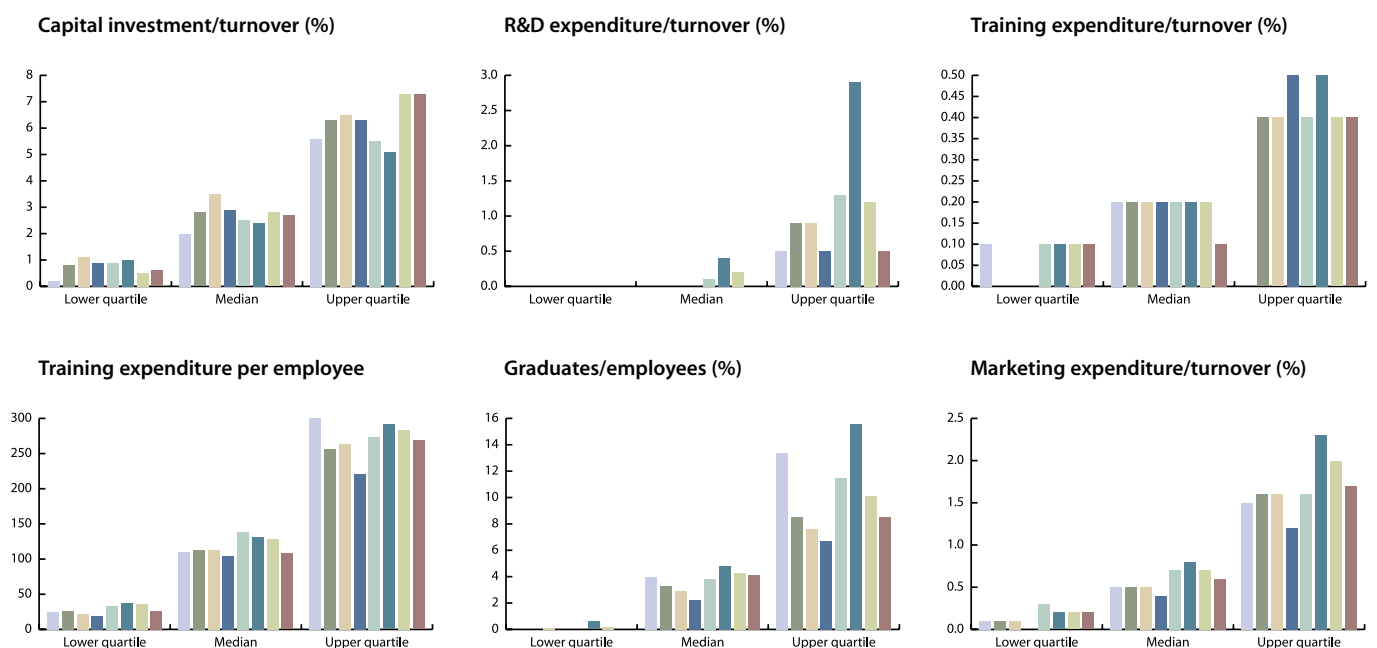
The organisational structure has now been flattened with a clear emphasis on accountability. 'In improving innovation within the company,' says Gary Pollard, 'managers are encouraged to support and facilitate their teams'. Talent is also being promoted through increased graduate recruitment, which is up 22% since 1997. These efforts are starting to be rewarded. Income from new products has nearly doubled, rising from 3.6% of the total to 6.5%.

In 1997, VTP was also weak in its branding and marketing, as measured by the strategic policies that it had in place. 'Our products may have been good,' says Gary, 'but we weren't telling the market about them'. Two policies were introduced. VTP registered for a generic trademark, Vitaprene, which acted as a master for subsequent launches and a PR agency was also engaged to communicate new developments to the market.

VTP has just received its 1999 Benchmark Index results, which, taken together have helped push VTP's growth rate to **22%**.

The results have provoked much thought and discussion throughout the company. 'It has been very helpful in getting people to think outside the box,' comments Gary Pollard. As new targets are drawn up, there is one certainty in Gary Pollard's mind - he will definitely undertake the Benchmark Index again in 2001.

Satisfying customers and employees today is all very well, but for a business to survive and prosper in the long term it is essential that appropriate investments in new products, processes and ways of working are made continually. The Benchmark Index data set contains significant information about the investments made by UK SMEs, using the measures – capital investment, marketing expenditure, training expenditure, training days/employees, training expenditure/employees, ratio of graduates to employees and R&D expenditure.



Upper quartile companies invest 12 times as much of their turnover in capital equipment as lower quartile companies do. The biggest difference between the upper and lower quartile is in the service sector. Here upper quartile companies invest 28 times as much of their turnover as the lower quartile. Even in highly capital intensive industries, such as chemical and electrical, there is still a difference of 6:1 between upper and lower quartile companies.

Well over half of the sample spend nothing on R&D. Even the upper quartile performers spend on average a mere 0.7% of their turnover on R&D. The figures for training expenditure are even more disturbing. The average spend for upper quartile performers is 0.5% of turnover. The average for the sample as a whole is 0.2%.

Similar figures can be seen when reviewing training expenditure per employee, which ranges from £28 per annum for the lower quartile to £278 per annum for the upper quartile performers. Coupling these figures with the average number of training days per employee suggests that the lower quartile engages in courses that cost on average £50 per day, while the upper quartile participates in courses that cost £100 per day. Given that many professionally run courses now retail at £4-500 per person per day, it is hard

to believe that these companies are engaging in high quality training. Of course, one option would be to employ highly trained people, rather than build their skills once they have joined the companies. If the companies included in the database are pursuing this strategy then it would be reasonable to expect that they would employ a high number of graduates. In fact, even in upper quartile companies, fewer than one employee in 10 has a degree while in lower quartile companies in some sectors (metal, general machinery, food & drink) nobody has a degree.

The contrast between marketing expenditure as a percentage of turnover and R&D and training expenditure as a percentage of turnover is fascinating. On average companies in the sample spend 0.7% of their turnover on marketing. This contrasts with the 0.4% of turnover they spend on R&D and training put together.

Why do business's spend so little on the fundamentals – developing skilled people and designing great products – and, comparatively, so much, on marketing. If they have not made the investment in the fundamentals then what are they marketing? Is it anything more than smoke and mirrors?

In the two years since undertaking the Benchmark Index, Carmelcrest has moved from a turnover of £2 million to over £5 million.

The Benchmark Index was instrumental in turning Carmelcrest from a £2m company into a £5m one. Ray Spooner, the company's managing director, is now in the market for ideas to get into the £10m-£20m bracket. He certainly envisages using the Benchmark Index again. The first set of results were 'really useful', he thinks, and generated 'some great information'.

In an industry as traditional as building, Carmelcrest tries to do things a bit differently. Set up 17 years ago, it has always looked to develop an edge and now specialises in refurbishments for offices, schools and hospitals. From working on £15,000 contracts, the company is currently discussing a £1.2m deal to look after Reuters' estate of 28 offices in London.

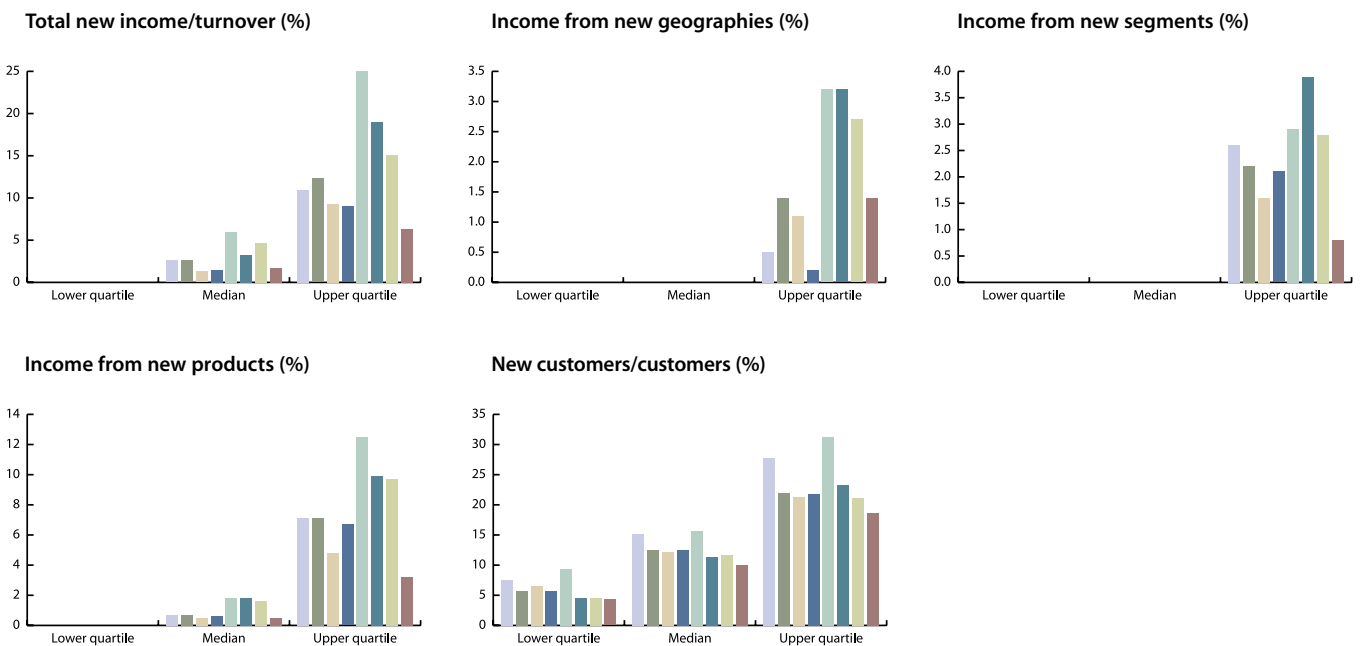
In reaching a position to contemplate taking on a deal of that size, the Benchmark Index was invaluable in prompting Ray Spooner to analyse Carmelcrest's competition in depth for the first time. As well as identifying the three companies he was most likely to be pitching against, he also took comfort from the relative strength of Carmelcrest's financial ratios.

The Benchmark Index was also helpful in suggesting that customer service is as important as technical ability in developing the business. Ray Spooner feels that his foremen should handle clients with tact and diplomacy and always be reassuring. The benchmarking process suggested that was not always the case in practice. To ensure sites were managed properly in future, he called his foremen together for two hours every Tuesday for 15 weeks to work through the assumptions behind any project - an exercise that is repeated with every new foreman.

The commentary from the Business Link also highlighted potential changes in working practices. Carmelcrest has adopted a system of employing a core team of 35, supplemented by staff from smaller builders where necessary. By assuming the role of managing agent, downtime is kept to a minimum. Ray Spooner is now actively looking for the next model to take Carmelcrest forward.

## Market growth and penetration

In today's increasingly global market place it is becoming ever more important for companies of all sizes to take their place on the world stage. Sadly, the companies featured in the data set do not appear to be taking this message to heart. While they are reasonably successful in raising new income, little of this income comes from new markets or geographic regions.



25% of the companies benchmarked did not generate any new income from new customers, products or markets. On the other hand, upper quartile companies achieved new income of 11.6% of sales turnover.

Of course, more is not necessarily good. The key issue is - why do companies need new customers? Is it because demand for their products is growing, or is it because they keep losing their existing customers?

Few companies are attempting to generate new income by accessing new geographic regions. Even the upper quartile companies are, on average, generating only 1% of their sales turnover from pastures new.

50% of companies do not generate any income by accessing new sectors. Even in the upper quartile, only 2.4% of sales turnover comes from income from new sectors.

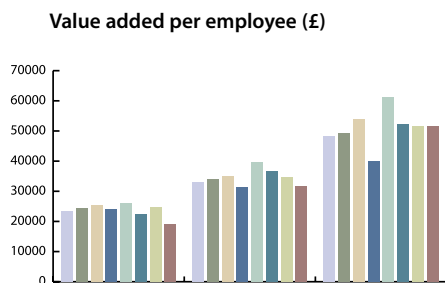
Around 50% of the companies received less than 1% income from new products. The top quartile companies received just over 7% of their income from new products.

All companies report a high percentage of new customers as a percentage of total customers. Lower quartile performers claim that 7% of their customers are new, while upper quartile performers suggest that 25% of their customers are new.

**“The Benchmark Index showed us in graphic detail just how much untapped potential there was within our company”**

new markets, geographical areas and product opportunities remain untapped by companies who continue to operate purely from the narrow parameters of their current state

An extremely powerful measure of financial performance is value added per employee. Value added is defined as the difference between sales turnover and total materials spend. Value added per employee provides an indication of how many employees the organisation requires to create value. The chart below shows the value added per employee data for the companies in the Benchmark Index data set. Once again the variation in performance within sectors can be seen, with the upper quartile companies achieving twice the value added per employee of the lower quartile ones.



Interrogating the data further, it is possible to identify several statistically significant differences between the upper and lower quartile companies when classified according to value added per employee. First, those in the upper quartile have better pre-tax profit as a percentage of turnover (8.4% against 5.3%) and better return on capital employed (24.3% against 16.3%). Second, the upper quartile has far lower overheads as a percentage of turnover (4.1% against 8.4%). Third, they have a far greater spend per supplier than the lower quartile companies (over £800,000 against just over £80,000). Fourth, the upper quartile has one more employee per manager on average. Fifth, the upper quartile has far lower employee turnover (16.9% against 22.5%) and far fewer early leavers (3.5% against 6.3%) than the lower quartile companies.

It is interesting to note how these observations echo many of the points raised earlier in the report. The importance of managing overhead in SMEs shines through the Benchmark Index data set. Dealing with multiple suppliers and failing to appoint the right people, for example, both add cost without creating value, and their impact is clearly reflected in the value added per employee figures. To improve the financial performance of SMEs, then, there appear to be three levers that are particularly critical at this stage:


1. **Overhead management** – ensuring that SMEs do not allow overhead costs to grow unnecessarily
2. **Supplier management** – searching for ways in which the supply base of SMEs can be rationalised
3. **People management** – identifying means that will help managers in SMEs enhance their employee recruitment and retention processes

One of the most surprising issues is that customers do not feature in this list, but there are several reasons why this might be the case. According to the Benchmark Index data the companies that are achieving the highest levels of value added per employee are those that have put their own house in order. They are controlling overhead. They are looking after their people. They are managing their supply network. Of course they will be focusing on delivering value to customers, but then so are the firms that are achieving low value added per employee. In both cases, customers appear to be receiving a similar level of service. Those companies that are achieving high levels of value added per employee, however, have found ways of delivering this level of service that are far cheaper than those companies that are achieving low levels of value added per employee.

### The Key Message

**So what does this mean for the manager of a SME? Well, the key message is simple. Keep delivering great service to your customers, but continually look for ways of reducing the cost of delivering this service through the three key levers – overhead management, supplier management and people management.**

Leisure no longer offers any free runs in Leeds. When a 100,000 sq.ft. David Lloyd Leisure Club opened two years ago it was the first health club of that size in the city. There are now several other facilities competing for the attention of its 3800 members.



...if you are a market leader, then you need to be continuously coming up with something new...

Although Becky Wellman, David Lloyd Leisure's Training Manager knew the Club had a strong team of c.70 employees; the SBS's Benchmark Index could only assist in continuously driving the business further forward.

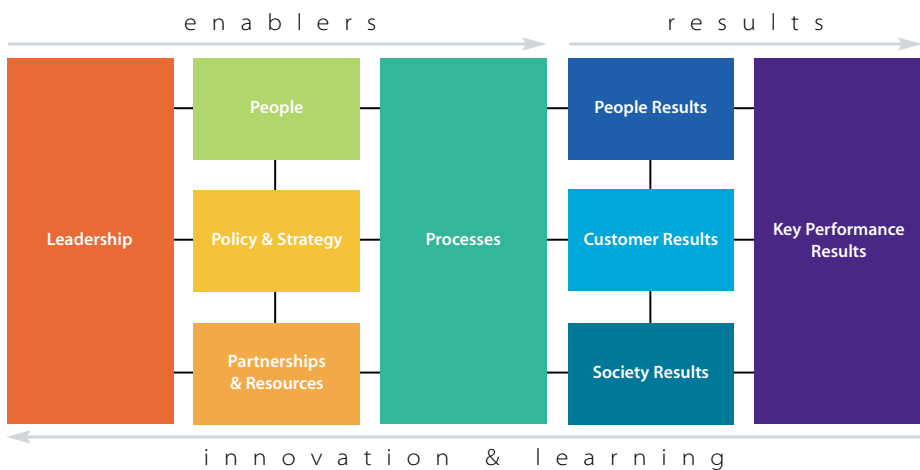
As is often the case, several areas could be developed further within the Club. As well as tightening up its financial management, remaining innovative could be quite a challenge. 'That's not always easy for a local Club in a national chain of 44,' says Becky Wellman, 'but if you are a market leader, then you need to be continuously coming come up with something new to keep encouraging members to come back. Running on a treadmill is not very exciting in itself.'

She continued, 'One of the great benefits of the Benchmark Index was that it enabled us to develop and devise a new process to positively handle and negate complaints and encourage our staff to be more positive and proactive when facing challenges.'

The Club in Leeds was the first in the group to undergo the Benchmark Index which assisted in the successful achievement of Investors in People status. A follow-up benchmarking exercise is planned for summer 2000 and a view will then be taken as to whether or not to roll the success of this programme to the rest of the group.

The benefits of the Benchmark Index are already being felt in Leeds. Renewals are up and an aggressive sales target of 4300 members is well on the way to being met,

The Business Excellence Model is an outstanding business tool, capable of improving any business or organisation. It has been used for a number of years by those organisations seeking to achieve world class performance.



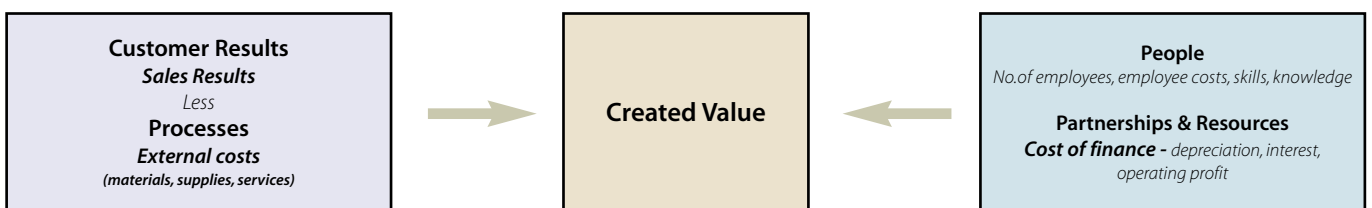
- Excellence in Customer Results**  
will help to sustain or *grow sales revenue* and provides customer value through better...
- Processes**  
which will help increase *created value as a percentage of sales* by reducing the cost of management processes and develop staff competencies through excellence in...
- People and People Results**  
which improve *created value per employee and per £ of payroll* resulting in better productivity through application of knowledge to improve...
- Partnerships & Resources**  
with *low cost invested capital* to create value to improve...
- Key Performance Results**  
through *profitability, cash flow, economic created value, shareholder value* through excellence in...
- Leadership**  
and the development of a continuous review of management driving...
- Policy & Strategy**  
to deliver results, all of which are the key to overall success and will have beneficial...
- Society Results**

The Government White Paper, Our Competitive Future - building the knowledge driven economy, sets out the Government's support of the Business Excellence Model (the EFQM Excellence Model) as a means of learning from best practice and describes how 'the Government is supporting the use of the Business Excellence Model as a framework for businesses to adopt a systematic approach'.

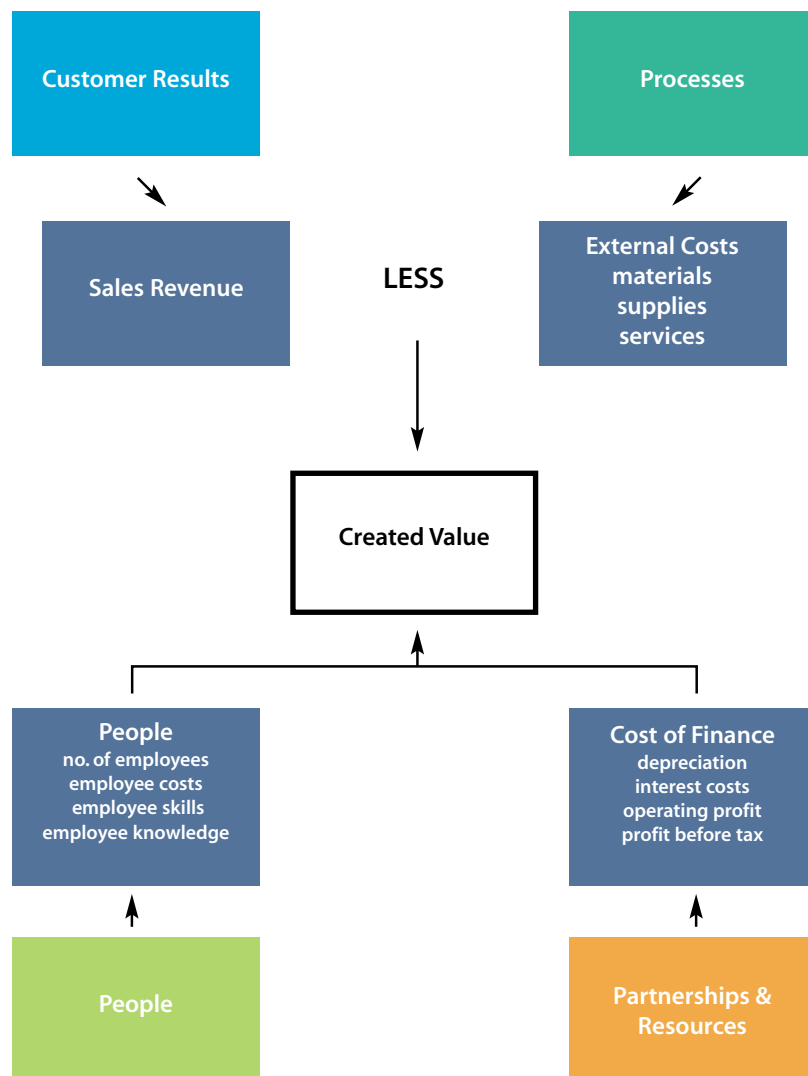
Against this background, national and regional Excellence organisations across the UK have established the UK Excellence Federation with the aim of more effectively encouraging the understanding and use of Business Excellence disciplines. The Federation, supported by the DTI, is an alliance which is devoted to the promotion and support of many initiatives leading to excellence and good practice in all walks of life throughout the UK.

But many businesses have yet to be convinced of the benefits the Business Excellence Model can bring - they assert that such effort is only of value if it evidently affects the 'bottom line', namely their financial performance.

This annex describes how application of the Business Excellence criteria to an organisation can readily demonstrate improved productivity and business performance. The drivers for shareholder value have a logical link to the Business Excellence criteria as the diagram opposite demonstrates.



The practical application of Business Excellence to the created value a business generates is shown below. Created Value is seen as the key measure in business success and is, essentially, determined from the business sales revenue less the costs of the business. The sensitivity analysis earlier in this report shows how variations in these factors dramatically affect business performance. The diagram shows how Customer Results, Processes, People and Partnerships & Resources criteria of the Business Excellence model drive the key areas that go to make up Created Value.



The Benchmark Index has the unique advantage of providing an assessment against 'hard' financial/management data and an introduction to the Business Excellence Model. This can be used to identify the links between the Model and actual financial results and stimulate a business to adopt the Business Excellence Model as part of their organisational culture by undertaking further in-depth assessment.

# TheBenchmarkIndex

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The recent launch of the Benchmark Index website now means that it is easier than ever to see for yourself how the Index can help to identify areas for improvement within your company.

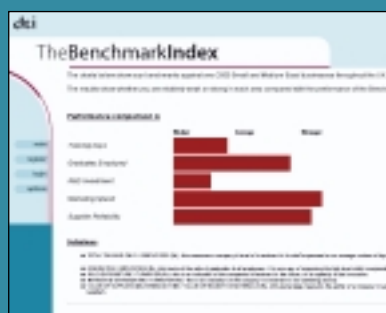
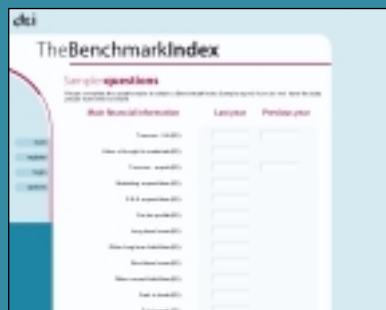
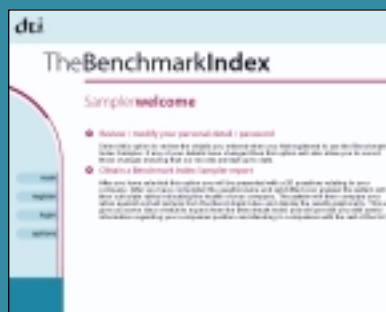
In addition to the vast amount of news and information available on the site, there is now a FREE and simple to use Sampler that allows you to receive an instant snapshot of your company's performance against other companies held on the Benchmark Index's database.

Simply enter your company's performance data into the short questionnaire and submit for an instant result.

At the end of the Sampler you will find all the details you require to register for a full benchmark of your company

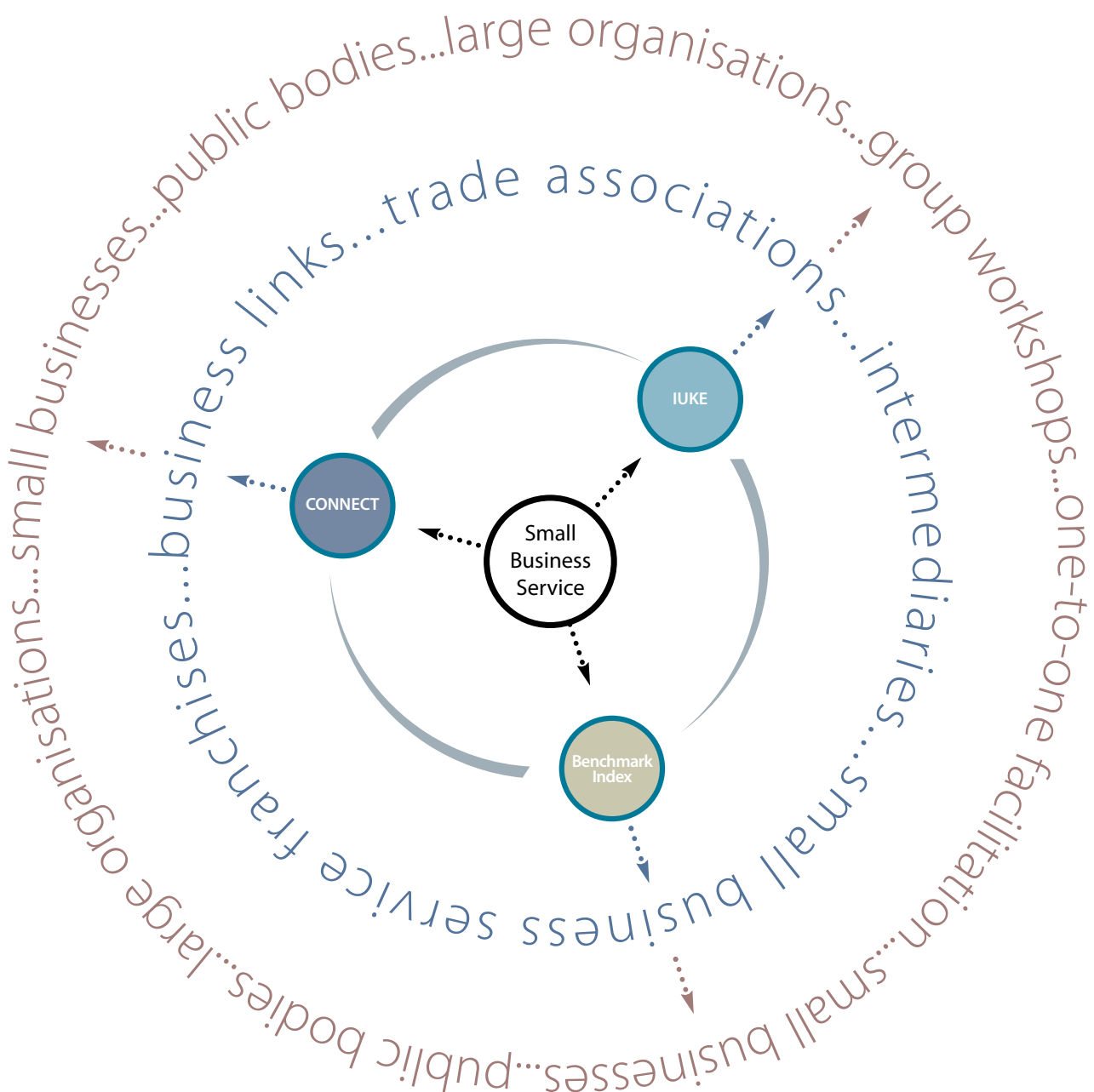
*"The Sampler on the web site is a perfect introduction to the power of benchmarking. I defy anyone to see their results and not want to go on to a full analysis"*

www.benchmarkindex.com



CBI research shows that if British companies adopted only average best practice levels then annual GDP would increase by £300bn.

The Benchmark Index is just one of three tools in the SBS's portfolio of best practice programmes that are helping businesses across the country to improve and compete.



# Benchmarkindex

Do you know how your company compares against your competition? Are you ahead of the field or lagging behind? The Benchmark Index can help you to establish your position and plan for improvement.

Over 2,000 companies have already been benchmarked across the UK and the Index also carries the records of a further 156,000 companies, making it the world's most comprehensive benchmarking resource.

It operates through a facilitated process of gathering information across a comprehensive range of 80 performance measures which are then transmitted back to a central database for comparison either locally, nationally or by sector. Results can be dramatic and surprising leading to positive and controlled change within your company.

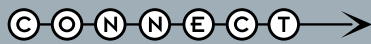
The launch of a free on-line benchmarking sampler service last October means that you can now sample the benefits of benchmarking before you commit to a full analysis.

Patricia Hewitt, Minister for Small Firms and E-commerce, explains, 'It provides a fully interactive facility for companies to assess their performance against a selection of hard data from the Index's core database of over 2,000 benchmarks...I am sure that the results will motivate users to progress to using the full Benchmark Index service.'

[www.benchmarkindex.com](http://www.benchmarkindex.com)

a powerful insight into the comparative strengths and weaknesses of our company followed by a strategic approach to improvement

Les Jones  
Outside the Square Ltd



Of the three SBS management best practice programmes, CONNECT acts as the starting point. Not only is it ideal to use as a wake up call, but it also helps organisations to promote other SBS or Business Link services, all aimed at providing the SME with ways of improving their business and implementing change.

The simplicity of the programme is that it is not based on academic theory but on the real experiences of business people which gives it integrity and relevance that other organisations can understand and copy.

Once companies have woken up to the latent potential within their business, they are encouraged to move on and try the other programmes available from the SBS.

[www.connectbestpractice.com](http://www.connectbestpractice.com)

a practical demonstration of what is possible in a way which everyone could relate to

Roy Clark  
PBA, Shropshire Business Link



Inside UK Enterprise is a programme which takes groups of UK business managers into the heart of top-performing companies.

500 visits are organised a year covering a wide number of best practice disciplines from business excellence to customer focus, leadership to manufacturing assembly.

The programme provides a unique opportunity to get under the skin of some of the country's top performing companies and hear about and learn from their best practice initiatives first hand.

'Over 180 host companies open their doors,' says Terry Pilcher, Assistant Director of the SBS's Management Best Practice Services, 'with the goal of sharing their experiences with visitors on a similar route to change.'

[www.iuke.co.uk](http://www.iuke.co.uk)

The level and breadth of information shared can advance your day to day business performance, productivity and achievement

Lilian Mains  
MD, Zodiac Training

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Dr Marek Szwajczewski is Senior Research Fellow in Operations Management at Cranfield School of Management and is responsible for the administration of the Management Today Best Factory Awards programme. Prior to joining Cranfield he held the position of marketing manager with Motorola. Marek has carried out extensive research into manufacturing focus, manufacturing plant performance, and supplier management. He is author and co-author of numerous papers on manufacturing performance and strategy.

### **Geoff Smith**, FIMgt, FINSTD, MCIM

Geoff Smith is an independent consultant who over the last 40 years has worked with created value structures for business performance measurement and analysis. Since 1972 this work has been carried out with a wide range of consultants, with particular reference to improving commercial awareness and performance. Geoff has concentrated on linking created value performance to a wide range of independent studies and non-financial criteria. In the late 1980's he sought to identify the links to shareholder and economic created value, whilst working as an Associate Director for 3I's consultancy. During the 1990's he has been trying to link created value performance to the excellence criteria included in the EFQM, Most Admired Companies and Mori/PA Quality of Management Studies. Currently he is seeking to identify the links between created value and shareholder performance.



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