'Show me the money!' How quality management systems affect the bottom line

by **Tommie J. Johansson** and **Paul C. Palmes**

The new ISO 10014, *Quality management – Guidelines for realizing financial and economic benefits*, aims at providing top management with financial arguments for introducing or updating a quality management system. It should also help to bridge the gap that separates top management perspectives from those of quality professionals

Top management expects value-added activities from and within each department of the organization. The requirement to demonstrate financial return has increasingly manifested itself in areas such as human resources, engineering, maintenance and most administrative positions as companies trim excess from operations for the sake of the bottom line.

To be competitive in a world class setting includes the requirement that cost considerations drive decisions devoted to maximizing shareholder return. In turn, each department is expected to contribute to achieving that goal.

Within every organization, quality is not immune from the same constraints, demands and potential opportunities facing other departments. In fact, quality has a unique and distinct advantage in demonstrating value to top management.

Quality programmes, viewed as an investment, can be assessed in financial terms during each phase of their life cycle. For every dollar spent in training, calibration, process development and documentation, non-conformity management, and auditing, there should be a measurable payback in increased customer orders and expressed satisfaction from the market-place – in addition to internal efficiency improvements. The " bottom line " for quality – profits should increase with investment in quality management.

Unique

Quality occupies a unique place in its ability to guide thought and planning for advancement. The results-driven character of the quality discipline inherently seeks to understand the current state of affairs prior to investment in new tools and methods.

Quality data functions as a platform for decisions, a gathering point for discussion and analysis that is initially strategic and eventually tactical when the time comes to implement planned improvements. And, unlike other departments that are more or less defined by their function, quality has the unique expectation and ability to transform itself into a resource applicable to a myriad of functions.

As stated above, all functions can be measured in financial terms and expected to show a rate of return for the invested resources. The only real discussion point remaining is what type of financial reporting structure would be most effective or desired by management.

There are many. In fact, there are vastly more opportunities for collecting and reporting in financial terms than were ever possible in the pre-computer age. For example, data, once expressed simply as units of scrap or rework, can just as easily be converted to monetary losses and measured from month to month.

So too can a host of other previously accepted quality baselines and measurements be converted into the language of top management for their use in making fact-based decisions. That conversion is the central subject of this article.

Differing perspectives

A lack of appreciation for each other's differing perspectives often separates top management and quality professionals. Top management's view of operations is highly compressed and expressed in financial terms. Quality expresses itself using data and details supporting reduction of variation and improvement that too often simply implies financial gain.

Not conversant with financial terminology and tools, the quality professional is routinely unable to translate improvement efforts into financial terminology. Naturally, everyone claims to be looking at the same end result: improvement. However, the inability of quality professionals to make the required translation from advancement to wealth, waste reduction to added profit, or the expression

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of improvement into the language of finance continues to stress the working relationship between these two allies-in-waiting.

Never has each side needed the other more, yet consistently failed to get to know each better than in today's competitive world. There is a lack of knowledge by both parties.

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Top managers – often after years of grappling with arcane quality reports and terminology like " SPC " and " CpK "[1] – are wary of further investments in " culture," expensive measurement tools and compliance with various standards.

Quality managers – often after years of grappling with arcane financial terminology such as ROI, EVA[2], and jumping through hoops trying to understand concepts like " due diligence", "depreciation schedule of capital investments" – are weary of justifying what to them appear to be obviously advantageous purchasing decisions.

But each side needs the other – one to supply the possible tools and data, the other to assess the price of risk by inaction against containment of those risks according to the proposed cost of improvement. Quality's tools and data without the financial value of risk management are incomplete for communicating effectively to top management. And the lack of appreciation of risk lies at the heart of the discussion of who needs what to make the best decision.

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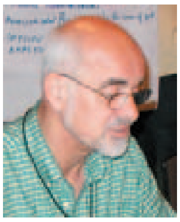

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Financial benefit is the single most compelling indicator to top management for counterbalancing risk. Financial benefit is the incentive that opens the ears and minds of top management to consider the acquisition of new tools and training, conformity to quality standards and other improvement efforts.

Especially important in the current competitive climate is finding financial benefit in all the "soft ", but culturally significant programmes without which all the quality tools on earth will only achieve limited success. Communication, team development, employee empowerment and a multitude of others are ready targets for red pens and disappointment as elusive and ill-defined financial returns characterize the exchange between quality professionals and top management – that is, until now.

ASQ's 2003 *Future Study*[3] often referred to in different articles on the subject, includes attention to seven key forces for defining quality in the next decade, two of them containing strong financial requirements:

- Quality must deliver bottom-line results i.e. achieved benefits must be shown in monetary units.

1) SPC – Statistical Process Control, CpK – Costs of Poor Quality

2) ROI – Return On Investment, EVA – Economic Value Added

3) http://www.asq.org/pub/qualityprogress/past/1102/qp1102case.pdf

Hard at work on the draft ISO 10014 at the last ISO/TC 176 meeting, in Kuala Lumpur : ***Paul Palmes*** *at the computer, while* ***Tommie Johansson*** *(right) and Mexican delegate* ***Héctor Gascón*** *do the checking.*

- The economic case for a broader application of quality will need to be proven i.e. different cost / benefit tools must b used to provide a factual base for decision-making.

ASQ's realization that quality must also utilize ROI as well as CpK is a giant step in redefining the profession in much the same manner as the ISO 9001:2000 revision connects the classic quality approach to top management through attention to customers and a process approach designed to create mutual value.

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The framers of the US Constitution claimed that certain truths are self-evident. The same manner of truth is evident in ISO 9001:2000's application of solid business practices to achieve mutual success in fulfilling customer's needs.

Presently, a guideline explaining these issues is under development within ISO technical committee ISO/176, *Quality management and quality assurance*, by a select working group of 20 experts from all over the globe. Launched in late 2002, the project work has passed the halfway mark and produced a draft standard at the last international meeting in Kuala Lumpur in 2004.

The current draft international standard is entitled ISO/DIS 10014, *Quality management – guidelines for realizing financial and economic benefits*. The new document will replace the previous technical report, ISO/TR 10014, *Guidelines for managing the economics of quality*.

Realizing financial and economic benefits

The new ISO 10014 draft standard affirms the relationship between effective management and realization of financial and economic benefits. Tactical deployment of appropriate tools fosters the development of a consistent, systematic approach for addressing financial and economic objectives. A self-assessment is included in the standard as a gap analysis tool.

Successful integration of the management principles relies on the application of the process approach and the PDCA (Plan-Do-Check-Act) model. This approach enables top management to assess requirements, plan activities, allocate appropriate resources, implement continual improvement actions and measure results in order to determine effectiveness.

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The core part of the guideline examines each of the eight quality management principles defined in ISO 9000:2000 in a PDCA model and describes the benefits that can be achieved by their application. A forthcoming article in *ISO Management Systems* will examine the content of the standard in more detail.

Why is ISO 10014 important ?

From many different perspectives and in any organization, the achievement of financial and economic benefit from organizational assets and resources is the key factor for survival and sustainability.

The new age requires every organization to develop customer relationships, introduce innovative products/services, customize high quality products / services, lower costs and shorten lead times, create mutually beneficial relationships with suppliers, mobilize employee skills and motivation, deploy information technology and a lot more.

The success of all these issues depends on your company's management system, regardless if it is based on quality or any other discipline. And to be able to use different tools in different situations increases the prospect for success.

The new ISO 10014 guideline will also improve the way quality is perceived in the new competitive world and help top management in acknowledging quality as a profession.