

Improving Financial Performance With ISO 9001

By Willie L. Carter

Summary

The establishment and integration of ISO 9001 into ongoing corporate management processes was addressed by the 2000 revision of the standard. There remain tremendous additional opportunities for improvement in the use of economics-of-quality approaches.

It is important that the effectiveness of ISO 9001 be measured in financial terms. Quality is widely recognized as a critical success factor in long-term business performance. However, many organizations that have implemented ISO 9001 see little return on their investment in terms of performance improvement because managers generally remain unaware of the tremendous opportunities for improvement that yet exist.

Let's examine how an economics-of-quality approach can be integrated with ISO 9001 implementation in order to optimize return on investment and begin long-term continual improvement.

Total Quality Management or Quality Management System

The key to understanding this issue is to recognize the difference between total *quality management* (TQM) and a quality management system. TQM is a philosophy under which a business or organization operates. The philosophy is pervasive applying to everything, hence *total*. Its aim is to satisfy all customers—internal and external, hence *quality*. And it focuses on the example set and reinforced by every area of the organization, hence *management*. TQM is supported by a culture of continuous improvement and it is a never-ending journey.

A quality management system is one of the building blocks for this process. It is a tool through which management structures the organization's processes. It ensures that all team members understand the activities required to achieve quality the first time. The quality system establishes a process for identifying non-compliance from this goal and a process for analyzing the root causes so that the organization can take long-term corrective action.

Quality is an Organizational Issue

Quality systems have evolved from their traditional "little q" emphasis on engineering and manufacturing operations. At one time, most quality practitioners came out of a technical background (the writer not withstanding), emphasizing quality in physical activity. In these areas, losses from scrap, rework, and other product costs were clearly visible. Thus the evolution of quality thinking tends to

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relate to systems that pertain only to direct costs, not administrative support activity. For many organizations that implement ISO 9001, this is still the case.

With the 2000 and the 2008 version of ISO 9001—management must demonstrate greater interest in implementing quality systems and not just justify the implementation on the basis that “customers demand that suppliers be registered.” The feeling that this is simply the right area to address for the sake of the customer often drives organizations that do implement a quality system. The opportunity to vastly improve business performance is often overlooked.

Measuring the Economics-of-Quality

“Total quality costs represent the difference between the actual cost of a product or service, and what the reduced cost would be if there was no possibility of substandard service, waste, failure of products, or defects in their manufacture.”—Doing it right the first time.

The above statement is alarmingly simplistic: it recognizes quality costs as the total opportunity. Most quality systems address only some of the areas that affect an organizations cost structure. If the organization applies ISO 9001 only to engineering and manufacturing, then it ignores the intent of the standard and the significant impact on cost structure, long-term competitive advantage, and internal and external customer satisfaction.

Examples

- In creating ISO 9000 documentation a distributor of electronic products and services totally ignored the process control sections of the standard in the misguided belief that a non-manufacturing business was exempt from process control. This company lacked understanding of the management of process in determining customer satisfaction or the consumption of resources and, therefore, costs. A benchmarking study of the distribution industry revealed that up to 25% of the actual operating costs stem from failure of internal processes. A well-run distribution company should earn a pre-tax return of two to four percent of sales. Its operating expenses should run 16-20% of sales. Thus, focusing on process quality was the company’s single greatest opportunity for improving profitability—a connection that management had failed to consider.
- A large tier I automotive manufacturing company began implementing ISO 9001/TS 16949 because customers were demanding that it be certified. Initially, management believed that costs of quality—including rework, scrap, seconds, and other items related to product cost—were about seven to ten percent of the cost of business. However, when the company developed an economics-of quality system that addressed the total costs of poor quality (as defined by the American Society for Quality), management realized that the true costs of quality—pertaining to wasted administrative and sales expenses,

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lost customers, warranty claims, penalty clauses for late delivery, late product development costs, and other “hidden” quality costs—exceeded 25% of the overall costs of business.

The Hidden Quality Costs

How can an organization address this wide gap between known quality costs and real quality cost? The answer lies in an economics-of-quality cost system. An economics-of-quality system identifies costs of poor quality in three major categories: prevention, appraisal, and failure costs.

An economics-of-quality system must include all costs of sub-optimized processes. This concept extends far beyond the traditional costs that are reported by costing systems. ISO 9001 with its emphasis on continual process improvement forces an organization to finally break away from this traditional mindset.

Examples

- In an effort to reduce costs, a hand tool manufacturer’s purchasing department had been buying iron castings at the lowest price available from several suppliers. A cost of poor quality analysis revealed that the price savings gained from this approach were actually outweighed by additional costs in several areas. These costs included additional expediting and problem analysis activity by the purchasing department and more receipts, more accounts payable invoices being processed, and more errors. The company was able to reduce its purchasing, receiving, and accounting costs only when it decided to work exclusively with suppliers who delivered quality products.
- A retail catalog house discovered that only a few of the credits it issued were related to product failure problems that had been identified by its traditional quality system. Instead, a quality cost driver analysis traced more than 80% of the credits to administrative quality problems. Addressing this issue allowed the company to reduce its overhead costs by eliminating the root causes, including inaccurate pricing data, ineffective communication between sales and administration, and inaccurate customer master file data.

In both of these examples, management was unaware of the costs of poor quality incurred through process failure. Worse yet, these items would not have been uncovered by simply implementing a traditional quality system. They were buried in overhead costs and handled on a responsibility basis rather than an activity or process basis. In such cases, efforts to reduce administrative costs only increase customer dissatisfaction, as the problems remain unresolved and errors accumulate. Employee dissatisfaction is at an all time high because of employee layoffs and attrition. Management fails to redesign processes leading to yet more work and more dissatisfaction—precisely the wrong kind of environment in which to implement total quality management.

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Conclusion

Integrating ISO 9001:2000 throughout the organization allows management to align top-level goals with internal processes and process measures. With greater visibility into processes, managers will be able to translate the initial quality goals of better, faster, and cheaper into continual process improvement and also improve their financial performance.

The opinions expressed in this article are those of the author only and do not represent the views of the Techman/Kanata or of any of its directors, officers or employees. The author, Willie L. Carter, can be reached at wcarter@quantumassocinc.com or by phone at 847-919-6127.

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