Aligning Strategic Performance Measures and Results

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Principal Researcher
The Conference Board

Balanced Scorecard Interest Group
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Agenda

- Study design and definitions
- Reasons for an SPM system
- SPM system implementation
- Challenges
- Lessons Learned
Study Design and Definitions

• Input:
  – TCB finance and strategy councils; A. T. Kearney
  – Interviews with CFOs and corporate strategists
  – Review of current business literature

• Survey of 113 companies
  – Size: 49% under $5bn in revenues; 51% over $5bn
  – 46% US; 12% UK; 27% European; 14% Asia
  – 53% CFO; 14% controller; 33% corporate strategist
  – 22% voting control with government, family or foundation
Key Terms & Definitions

- **Strategic Performance Measurement (SPM) System:** Translates business strategies into deliverable results. Combines financial, strategic and operating measures to gauge how well a company meets its targets.

- **Value-based Management (VBM) or Economic Value Added (EVA) System:** Performance measurement system that emphasizes the cost of capital in measuring value created for shareholders.

- **Balanced Scorecard System:** Performance measurement system that emphasizes the key business drivers (e.g., customer and employee satisfaction, operational excellence, new product development, etc.).
SPM Systems Approaches

• **Value-based (EVA):**
  – Focus is on measuring *value* created for shareholders
  – Oriented toward capital markets
  – Helps in developing strategy (less useful in setting direction).

• **Balanced Scorecard:**
  – Focus on measuring *key business drivers* (e.g., customer satisfaction, operational excellence, and new product development)
  – Oriented toward process and key success factors (e.g., market position, product quality, process cycles, etc.)
  – Helps in setting direction in execution.
Key Terms & Definitions

SPM system characterization:

- 41% Value-based Management
- 40% Balanced Scorecard
- 6% Strategy Deployment
- 13% Other
Reasons for a SPM system (percent respondents)

Organization lacked focus  44%
Strategy and incentives not aligned  34%
Strategy implementation frustrated  30%
Employees confused about strategy actions  28%
Other  21%
SPM System
Forces Driving Change

Any Specific Force Behind Change in SPM System?

<table>
<thead>
<tr>
<th>Force</th>
<th>Over past three years</th>
<th>Over next three years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>72%</td>
<td>36%</td>
</tr>
<tr>
<td>New Strategies</td>
<td>23%</td>
<td>33%</td>
</tr>
<tr>
<td>Major Shift in Business Environment</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>New Executive Team</td>
<td>21%</td>
<td>6%</td>
</tr>
<tr>
<td>New IT System</td>
<td>10%</td>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
<td>10%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Over past three years: 23% Yes, 33% New Strategies, 21% Major Shift in Business Environment, 10% New Executive Team, 10% New IT System, 17% Other.

Over next three years: 36% Yes, 36% New Strategies, 33% Major Shift in Business Environment, 6% New Executive Team, 6% New IT System, 17% Other.
Measurement-Managed Companies

Four key characteristics

• Closer agreement on strategy
  – creating measurable objectives requires specificity
  – forces issues out into the open

• Better alignment of business units with strategy

• Greater clarity of communication

• Builds corporate culture for teamwork and risk-taking
## Companies with a Formal SPM System

Stock Price Performance Relative to Competitors

<table>
<thead>
<tr>
<th>SPM System</th>
<th>Better</th>
<th>Equal</th>
<th>Below</th>
</tr>
</thead>
<tbody>
<tr>
<td>YES</td>
<td>52%</td>
<td>30%</td>
<td>18%</td>
</tr>
<tr>
<td>NO</td>
<td>26%</td>
<td>43%</td>
<td>31%</td>
</tr>
</tbody>
</table>

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**SPM system implementation**

**SPM system leadership in...**

<table>
<thead>
<tr>
<th>Developing</th>
<th>Maintaining</th>
</tr>
</thead>
<tbody>
<tr>
<td>50% CEO</td>
<td>26%</td>
</tr>
<tr>
<td>50% CFO</td>
<td>47%</td>
</tr>
<tr>
<td>47% Corporate Strategy/ Business Development Directors</td>
<td>43%</td>
</tr>
<tr>
<td>12% Division Managers</td>
<td>19%</td>
</tr>
<tr>
<td>44% Other</td>
<td>27%</td>
</tr>
</tbody>
</table>
SPM System

Four Critical Development Stages

- **Identify and select the right measures** by using strategic and value maps to *analyze* the company’s vision and financial drivers of performance (e.g., may involve **mapping key business processes**, analyzing historical financial results)

- **Develop plans** for core strategic, operational, and capital activities; implement plans with operating measures; review progress; and adjust feedback.

- **Set individual targets** from among comprehensive group of strategic performance measures and **link to compensation**.

- Optimize the SPM system by **designing an appropriate information system** to gather, store and support the process.
Strategic Performance Measurement

Percent Companies that First Introduced SPM System to:

- Entire Corporation: 58%
- Selected Divisions: 17%
- Selected Business Units: 25%
## Cascading the SPM System
*(Lowest Level to which SPM system is applied)*

<table>
<thead>
<tr>
<th>Level</th>
<th>Over past three years</th>
<th>Over next three years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>19%</td>
<td>0%</td>
</tr>
<tr>
<td>Division</td>
<td>23</td>
<td>18</td>
</tr>
<tr>
<td>Business Unit</td>
<td>58</td>
<td>82</td>
</tr>
</tbody>
</table>
Linkage Between SPM System and Incentive Performance-Based Compensation Satisfaction Level

- Completely: 4%
- Mostly: 49%
- Somewhat: 41%
- Minimally: 6%
- Not at all: 0%
# Strategic Performance Measurement Systems

## Considerations During Development and Implementation

(Percent considering completely or to a great extent)

<table>
<thead>
<tr>
<th>Consideration</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determining links between strategies and related performance measures</td>
<td>69%</td>
</tr>
<tr>
<td>Communicating the business drivers, game plan, and intended results</td>
<td>60%</td>
</tr>
<tr>
<td>Cascading performance measures from high level strategies</td>
<td>51%</td>
</tr>
<tr>
<td>Linking individual performance and compensation plans to business strategies</td>
<td>46%</td>
</tr>
<tr>
<td>Assessing the alignment of performance measures between key operating units</td>
<td>45%</td>
</tr>
<tr>
<td>Implementing behavioral/monetary consequences when units/managers perform below target level</td>
<td>37%</td>
</tr>
<tr>
<td>Modifying IT systems to support reporting and analysis of measures</td>
<td>29%</td>
</tr>
<tr>
<td>Assessing links between strategies and performance measures rigorously</td>
<td>22%</td>
</tr>
<tr>
<td>Identifying key stakeholders’ potential reasons for resisting the SPM effort</td>
<td>9%</td>
</tr>
</tbody>
</table>
Assessing the Alignment of Performance Measures Between Operating Units or Functions

Stock Price Performance Relative to Competitors

<table>
<thead>
<tr>
<th>Completely</th>
<th>Better</th>
<th>Equal</th>
<th>Below</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>43%</td>
<td>40%</td>
<td>17%</td>
</tr>
</tbody>
</table>
Implementing Behavior/ Monetary Consequences When Units/Managers Perform Below Target Level

Stock Price Performance Relative to Competitors

<table>
<thead>
<tr>
<th></th>
<th>Better</th>
<th>Equal</th>
<th>Below</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completely</td>
<td>45%</td>
<td>41%</td>
<td>14%</td>
</tr>
</tbody>
</table>
Information Technology Systems
Avoidance of SPM Measures Due to IT System Limitations

- To some extent: 49%
- Minimally: 22%
- Not at all: 21%
- Mostly: 8%
- Completely: 0%
Manual Capture of Strategic Performance Measures

Manual Capture of SPMs?

Yes

57%

No

43%

Percent SPMs Captured at:

Company-wide Level

32%

Division Level

48%

Business Level

48%
Corporate Culture Resistance to Changes in SPM Systems

- Completely: 1%
- Mostly: 23%
- To Some Extent: 54%
- Minimally: 19%
- Not at All: 3%
Benchmarking Measures
What Do Companies Compare Performance Against?

<table>
<thead>
<tr>
<th>Performance Standard</th>
<th>% Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Budget</td>
<td>64</td>
</tr>
<tr>
<td>Peer competitors</td>
<td>52</td>
</tr>
<tr>
<td>Absolute Standard</td>
<td>49</td>
</tr>
<tr>
<td>Strategic Milestones</td>
<td>36</td>
</tr>
</tbody>
</table>
Financial Value-based SPM

Top Measures Over Next Three Years

<table>
<thead>
<tr>
<th>Measure</th>
<th>% Respondents Ranking It Among Top 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Flow</td>
<td>27</td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>26</td>
</tr>
<tr>
<td>Total Shareholder Return</td>
<td>23</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>21</td>
</tr>
<tr>
<td>Revenue</td>
<td>19</td>
</tr>
<tr>
<td>Earnings Per Share</td>
<td>16</td>
</tr>
<tr>
<td>Other</td>
<td>10</td>
</tr>
<tr>
<td>Share Price</td>
<td>9</td>
</tr>
<tr>
<td>Dividend Yield</td>
<td>1</td>
</tr>
</tbody>
</table>

Measure: % of respondents ranking it among top 3 measures over the next three years.
Balanced Scorecard SPM
Top Non-Financial Measures Over Next Three Years

Measure: % Respondents Ranking It Among Top 3

- Customer Satisfaction: 50
- Market Share: 35
- New Product Development: 32
- Quality: 28
- Other: 12
- Environment: 8
- Ethics: 6
Presence of SPM Targets and Results in Annual Reports

Currently

- Yes: 36%
- No: 64%

Over Next Three Years

- Yes: 58%
- No: 42%
CHALLENGES:

Barriers To SPM Implementation

<table>
<thead>
<tr>
<th>Barrier</th>
<th>% Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not measuring “difficult-to-measure” activities</td>
<td>55</td>
</tr>
<tr>
<td>Measuring the right things wrong</td>
<td>29</td>
</tr>
<tr>
<td>Measuring the wrong things right</td>
<td>29</td>
</tr>
<tr>
<td>Antagonisms among managers</td>
<td>27</td>
</tr>
<tr>
<td>Breakdown of the SPM implementation process</td>
<td>21</td>
</tr>
<tr>
<td>Nobody is accountable for the SPM process</td>
<td>20</td>
</tr>
</tbody>
</table>
Strategic Performance Measure Design

- Both Quantitative and Qualitative: 48%
- Cost and Non-cost Based: 45%
- Process-based: 31%
Major Challenges

- SPM systems not strategic enough
- Difficulty translating strategy into *performance measures that are relevant to activities at the business unit level*
- IT capabilities are often deficient
- Cultural and political resistance
• Expect Cultural Resistance:
  – “…people have mindset that this is about controlling people, instead of empowering people”

  – “…have to demonstrate that the SPM system can help the …local organization reach their objectives…”

  – “The biggest challenge in implementing an SPM system is to get people to think at the enterprise level in a standard way”
SPM System Development

Lessons Learned

- Establish clear accountability
- Bring in appropriate people at the beginning of the effort when measures are being defined
- IT must be able to support SPM needs
- Cascade SPM System From Corporate to Business Level:
  - Assess validity of the strategy-measure links
  - Secure buy-in from business unit managers and employee
- Tie performance to incentive compensation
SPM System Development

Lessons Learned

- “Corporate must ensure changes by business units are not made simply to avoid reporting on the most important targets set in the prior year.”

- Difficult-to-measure activities are biggest roadblock to implementing an SPM System (e.g., employee performance, customer satisfaction, brands, R&D, time-to-market, etc…)

- “Fuzzy objectives” also major barrier to an effective SPM system.
Linkage To Compensation

*Case Study Example: Siemens*

- Top 500 managers linked to EVA performance
- For Board members, heads of divisions, and heads of corporate offices:
  - 40% fixed salary
  - 30% annual bonus based on EVA-derived annual targets
  - 30% long-term bonus contingent on reaching three-year EVA targets
- Supported by new planning system:
  - Business goals, especially budgets, are linked to EVA targets
  - No longer two separate planning cycle for strategy and budget planning
  - Strategic planning examines: competitive position in technology, pricing, sales, service, etc...