

The case for balanced, structured, performance management. What difference can it make to an organisation?

Almost every organisation has introduced some form of non-financial measures and targets into its performance management approach. Calling them “Scorecards” after the Balanced Scorecard introduced by Norton & Kaplan, non-financial performance measures are used in many organisations.

Is there any evidence that such an approach improves performance? If so, what are the characteristics that contribute to that performance? Are all “Scorecards” equal, or are some better than others?

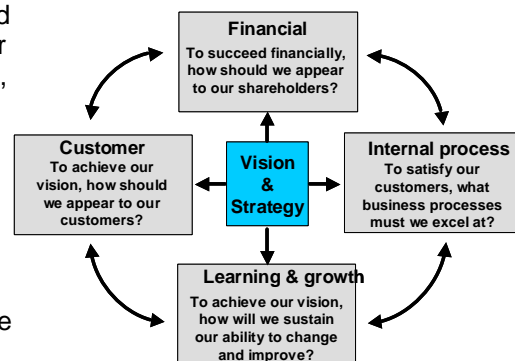
In this briefing paper we set out research that shows that companies that have balanced and structured performance management systems tend to have significantly higher performance (around 25% better) than their peers. Further, that this performance comes from having agreed strategic goals, setting out a clear path to achieve the goals and an improved quality of communication.

The paper concludes with a checklist of questions to assess how balanced and structured your performance management system is.

What is a balanced, structured performance management system?

The original Balanced Scorecard, developed by Norton & Kaplan in 1992⁽¹⁾, consisted of 4 quadrants with Financial, Customer, Process, and Learning and Growth measures. In the original version there was not a strong relationship between the measures (see diagram on right) and, as a consequence, the quadrants appeared arbitrary to many people.

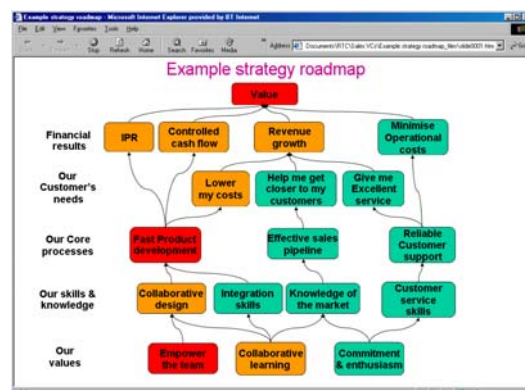
This led to two things happening: Early users added extra segments and renamed segments to suit their particular perspectives. Secondly, Norton & Kaplan, with the experience of many consultancy engagements, started to structure the segments so that there was a cause and effect relationship. Measures later became objectives (with measures attached) and a clear relationship between the objectives was created.



This cause and effect relationship was based on the premise that the capabilities of the organisation drove the quality of the delivery processes, which in turn affected the customer's perceptions that lead to financial value. A clear cause and effect relationship existed that drove financial performance.

By 1995 these were called “performance driver models” and well before their second book had come out, in 2001⁽²⁾, they had become rich pictures, called strategy maps (see example on right), of an organisation's strategy and how it would be driven.

As well as structuring the measures and ensuring coherence, Strategy maps have two valuable roles. Firstly, by explicitly setting out the strategy as a simple picture they help to achieve consensus amongst the players as to



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what the strategy is. Secondly, because they are a “one page” presentation, they enable the strategy to be told in as a simple story.

In parallel, the measurement system became first a performance management system, by cascading the measures and objectives through the organisation, through functions, all the way to individual's scorecards. Aligning initiatives meant that investment was also aligned against the strategy, and in many cases rationalised as a result. Later, learning from the feedback on the measures and targets, the approach evolved into a strategic learning and management approach.

At the same time the technology has evolved. The original Balanced Scorecards were created as spreadsheets, by hand, or built using early Internet technology. Manual input was vital as much of the data required was not in the existing systems. By 1999 package suppliers had emerged and there are now 18 suppliers accredited as supporting the Balanced Scorecard and many others that do as well that are not accredited. Manual input may still be required but much data is collected automatically.

So, for the purpose of this paper, by “Balanced”, we mean a set of objectives and measures that are not just financial but include the other perspectives as well. Typically we would expect less than 20-25% of the measures to be financial. Further, there is a clear cause and effect relationship between the measures in each perspective: “If I improve this measure, will lead to this positive effect in the higher perspective”. More importantly, the non-financial measures should act as leading indicators that the financial ones will be achieved.

By “Structured”, we mean that there is a structure in between the perspectives. Also, there is structure in the cascading through the organisation of the balanced objectives, measures and targets so that functions, and ultimately individuals, have balanced performance management. This ensures that the individual's objectives are linked to the organisation's strategic objectives.

Current use of the Balanced Scorecard

The use of scorecards and balanced performance systems is extremely prevalent. It is reported that up to 80% of organisations have some forms of non-financial scorecards in place, though many may be neither balanced nor structured by the above definitions.

The Hackett Group, in its latest analysis (2004) of over 2,400 companies⁽³⁾, found that more than 70% of US and European balanced scorecard implementations are failing their companies by not providing “concise, predictive and actionable information about how a company is performing and may perform in the future.” Why?

One reason is that there are far too many metrics out there. Hackett's research found that the average senior executive is inundated with 132 metrics (83 financial and 49 operational) every month. That's nearly nine times more than the number of measures landing on the desks of senior executives at best-practice companies. The “scorecards” are simply not concise enough. Too many measures confuse. John McMahon, a Hackett senior business adviser, says, “The reality is that even the most complex businesses have only around ten to 15 key elements driving performance.”

Another problem is that most balanced scorecards are not balanced. Hackett found that half the metrics in a typical balanced scorecard concern internal financial data with the rest divided between internal operating data and external financial and operating data. Another global survey⁽⁴⁾ suggested that 62% of scorecard indicators were financial and 76% lagging. Hardly balanced.

That leaves companies with far too much historical information and not enough forward-looking visibility. Also, where have the customer and learning & growth perspectives gone?

In other words they are using the term “Balanced Scorecard”, but not the key principles. They have lost the focus on strategic goals and underlying drivers of performance.

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According to The Hackett Group⁽³⁾, leading finance organisations (for example), operating best practice performance management:

- Spend 31 percent less money than their peers on operations
- Utilize nearly half the staff, enabling them to close their books more quickly and
- Provide more meaningful insights to successfully drive their companies' performance.

They say, "Several key strategies that world-class performers utilise to achieve exceptional results centre around improving access to information...through Business Performance Management". For example, world-class finance organisations are:

- Significantly more likely to have fully integrated budgeting and planning applications, and to use interactive tools, such as dashboards, enabling self-service for inquiries and financial reporting.
- 46 percent more likely than their median peers to use a central data repository to generate reports.
- 159 percent more likely to use mature balanced scorecards with a mix of financial and non-financial metrics to analyse performance."

Hackett report these Business Performance Management strategies add up to greater insight, and improved ability to predict and manage performance and ultimately a company's bottom line.

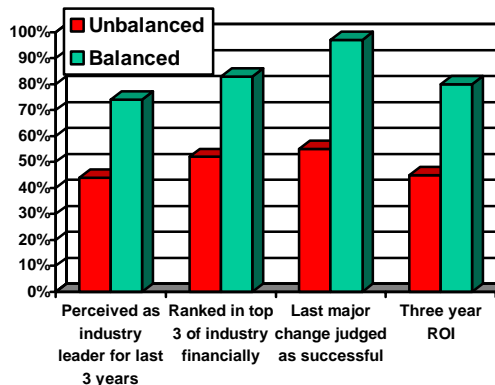
So best practice organisations use fewer measures. They also treat it as Strategic management not just performance management or merely performance measurement. An example of this is linking to the budgeting system. A survey of 300 UK companies suggested 60% failed to link their budgets and strategy. More recently, fully 66 percent of CFO readers surveyed believe their planning process is influenced more by politics than by strategy.

Some organisations do have well structured, balanced, performance management systems. So lets look in detail at what the potential is if it is done well.

The results of having a balanced structured performance management system

So, does having a structured, balanced performance management system improve organisational performance?

This first graph shows research into 220 companies, covering 1000 executives, with unbalanced and balanced performance management systems⁽⁵⁾.



Those with balanced performance management systems appear to perform around 25-33% better than those without.

The table below supports this. This comes from a separate study of 437 publicly traded companies⁽⁶⁾. It shows the comparative performance of companies before and after introducing structured, balanced, performance management systems.

Financial Ratio	Average Before	Average After	Average Change
Total Shareholder Return	-5.10%	19.70%	24.80%
Stock Return (relative to market)	-0.13%	0.18%	0.31%
Price/Book Value of Total Capital	0.03%	0.26%	0.23%
Real Value/Cost	-0.06	0.13	0.19
Sales per Employee (\$1000)	98.90	193.00	94.20

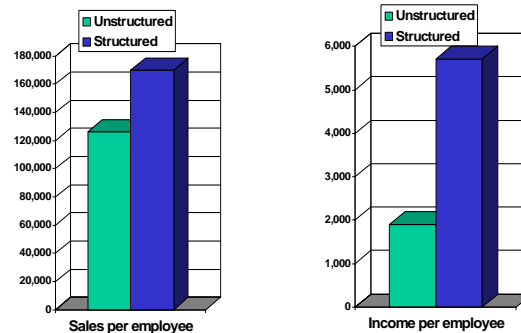
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Again the performance improvement is of the order of 25%. Overall improvement has accompanied by underlying productivity improvements as these two graphs from the same study show.

In fact there are deeper changes altogether going on. If we look at what sort of behaviour is being encouraged by the introduction and use of these approaches, some fascinating insights appear.

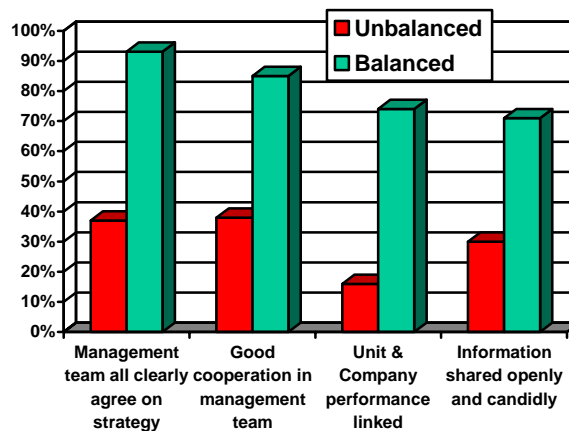
The effect on management style and employee behaviour

The graph below compares how the management team's perception of their



own behaviour differed between the companies with unbalanced and balanced performance management systems.

The most remarkable difference is in management team agreement. This rose from barely 35% to 90%. Can you imagine what a difference this made to the way the organisation was managed and performed?



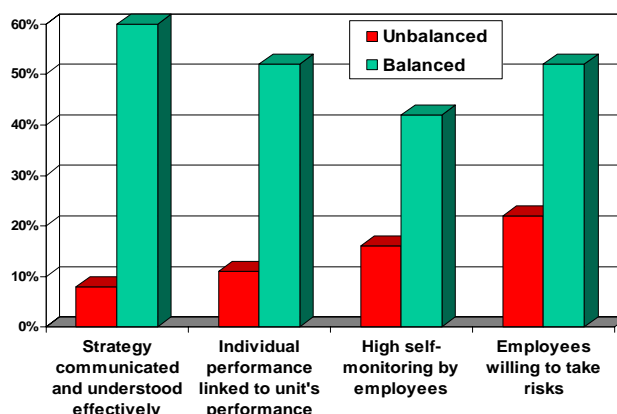
This was accompanied by an increase in the perception of cooperation, and the sharing of information openly and candidly amongst the team. Also unit and company performance were linked much more closely and explicitly.

In other words it suggests that a substantial change in the behaviour of the management team has occurred from the introduction of the performance management system.

In our work we have also found this to be true. Much of the early work in performance management engagements involves using various approaches to build a common map of the strategy amongst the management team. From this they can discuss where they agree and disagree on the strategy. Facilitating this discussion through to consensus amongst the team provide large rewards in itself.

But it's not only in the behaviour of the management team that changes have occurred. The perceptions and behaviour of the staff have also changed.

The number of staff that felt the strategy was communicated and understood increased from less than 10% to over 60%. (Interestingly enough a separate study also suggests that less than 5% of the staff in an organisation actually understand the strategy. Quite a scary statistic.)



Moreover there was a dramatic change in the way

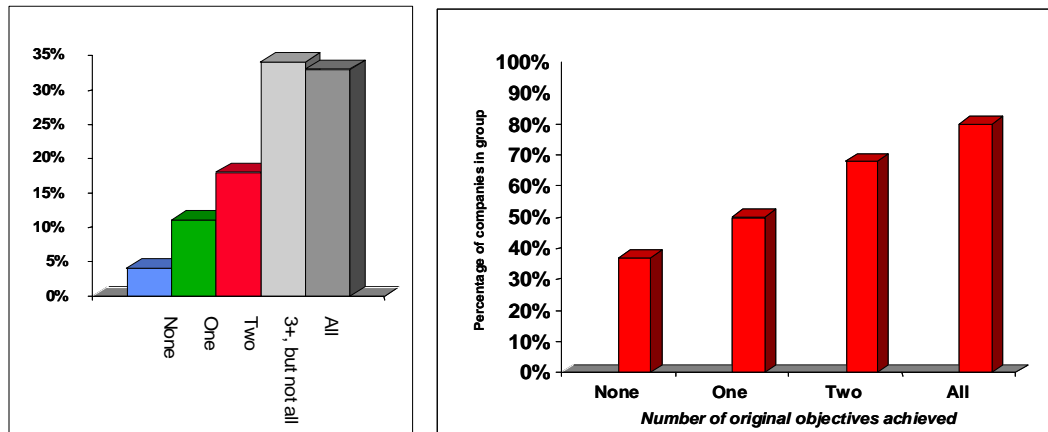
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they were managed. Individual's performance was linked to their units and they were given a high degree of self-monitoring and empowered. As a result there was much more sense of freedom to take risks and decisions for themselves.

Again our experience backs this up. Using the strategy maps and balanced scorecards makes it possible to communicate the strategy as a picture, and in words, and in figures and as a story. This means that people with different ways of thinking can all relate to the strategy and, in our experience, dramatically improves the extent of understanding of the strategy amongst the staff. From this can be built autonomy, and a sense that where you fit, and what you do, can make a contribution to the overall success of the organisation.

Clearly this is more than simply an appraisal system or a management information system being put in place. What is happening in these cases is a more holistic solution to manage the performance of the organisation and also to get the organisation to manage itself better as a result.

Finally we are saying this is more than just having balanced objectives and goals. The left hand graph below shows the number of objectives achieved in the execution of the strategy in a survey of more than 300 UK companies⁽⁷⁾. Only one third achieved all their objectives. Only another third achieved three objectives, but not all of them.



The second graph shows the percentage of these companies that set out a clear path to achieve those objectives. As can be seen nearly 80% of those that achieved all their objectives also set out a clear path to achieve them. In contrast those who failed to achieve their objectives frequently did not set out a clear path. Interestingly 80% of these companies cited "Executive support" as the most crucial contributor to success, with "Communication of objectives through the organisation" as the next highest with 60%. The most cited impediment was the existing management systems with 55% saying that was an impediment to the success of the strategy. This scored even higher than resources.

In Summary

Strategy is about establishing a unique position that will achieve sustainable competitive advantage. Getting a strategy to work is about achieving changes in organisational performance. So how do you manage that performance?

Managing performance is about far more than the technology of reporting or purely the financials of the business.

If a strategy is a belief about how you will achieve your aims, then performance management is about having a clear understanding of that belief. Understanding the drivers of financial performance in other dimensions of the business (Balance) and how those drivers relate to one another (structure). It is also about how the management team align behind that set of beliefs. What they believe as a team. It is about whether the rest of the organisation understands the strategy and is able to act to support the direction. It is about whether the management team can learn from their execution and refine the strategy as it evolves.

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If they can achieve this, then the rewards are there as we have seen in the case studies in this paper.

So what?

What are the implications for organisations? Well you can ask yourselves the following questions:

1. Do you manage the organisation with a balance of financial and non-financial objectives and measures? Are at least 80% non-financial?
2. Is there a structure to the set of measures? Is cause and effect clear? Is it clear which non-financial aspects drive financial performance?
3. Do the set of performance measures tell the story of the strategy? Do you feel that the story and the drivers of performance are understood?
4. Do you believe you can see the wood from the trees? Is there focus?
5. Do the measures look forward? Do they include sufficient leading indicators and predictors of organisational performance to make you confident of hitting your financial targets?
6. Does performance management focus on the organisation's cultural values as well as the financial value?
7. Are you able to evolve, refine and re-communicate your strategy, budgets, plans and targets as the strategy gets executed and you learn from it?
8. Are you delivering the results?

References

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3. Hackett research cited in CFO Europe, Swamped, Nov 2004
4. Answerthink: "Nearly half of companies unprepared", cited in Beyond Budgeting: Hope & Fraser 2002
5. Scheimann & Lingle: Bullseye! Hitting your strategic targets through high impact measurement (122 organisations and 1000 executives). (1999)
6. Gubman: The Talent Solution: Aligning strategy and people to achieve extraordinary results. Study of 437 publicly traded companies. (1998)
7. Independent research by Renaissance Worldwide.

About Excitant

For Executive teams, managing a business in a dynamic market and feeling frustrated with their existing management performance information, Excitant provides techniques and tools that allow you to anticipate problems and apply corrections, before they affect your financial results.

We put emphasis on the performance coming from the culture of the organisation and provide we provide a rich picture of the performance of the business. We also help you develop the thinking, techniques and approach, so that you can use the rich picture to react quickly, stay on your chosen course and reliably deliver your strategy and results.

- Want to improve your organisation?
- Want to introduce effective management of strategy and performance?
- Want to make your existing scorecards more effective?
- Want to change the culture and behaviours?
- Want to deliver results?

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