



Aligning Strategic Performance Measures and Results

Dr. Stephen Gates, CFA
Principal Researcher
The Conference Board

Balanced Scorecard Interest Group
November 14, 2001 Washington, DC



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



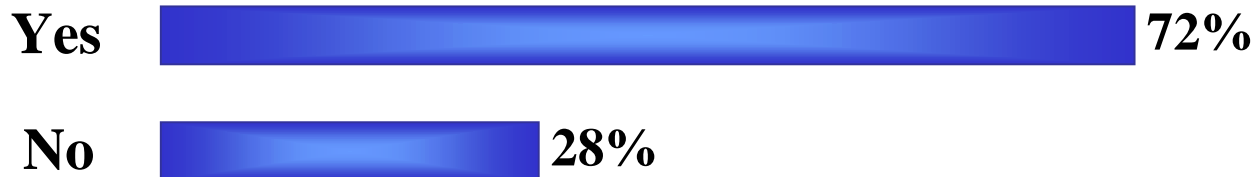
Reasons for a SPM system (percent respondents)

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



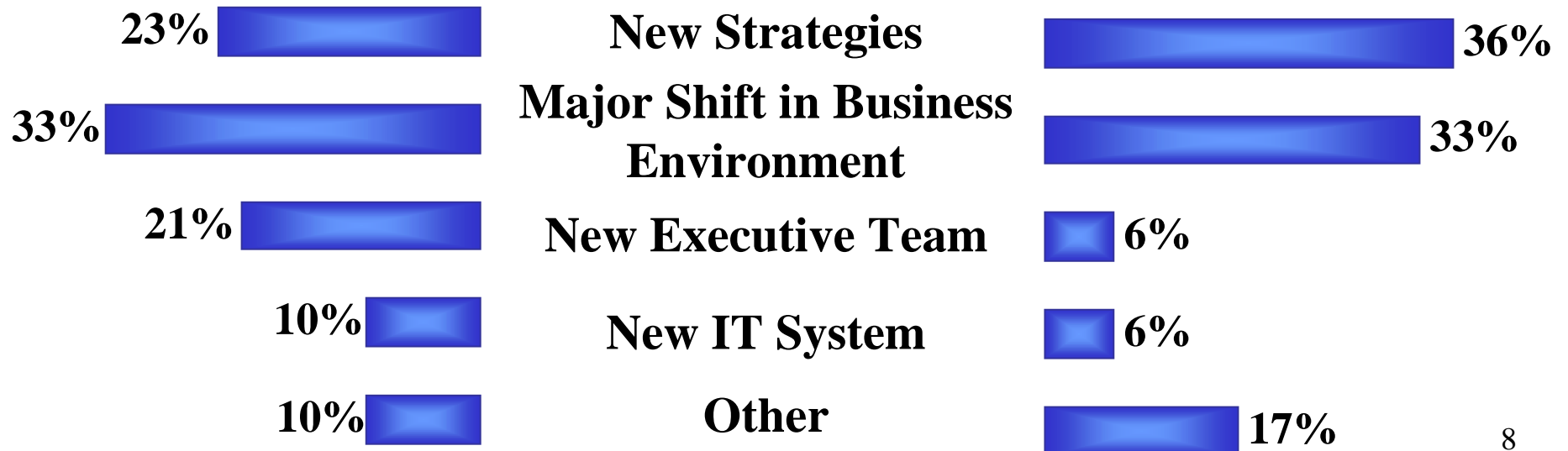
SPM System Forces Driving Change

Any Specific Force Behind Change in SPM System?



Over past three years

Over next three years





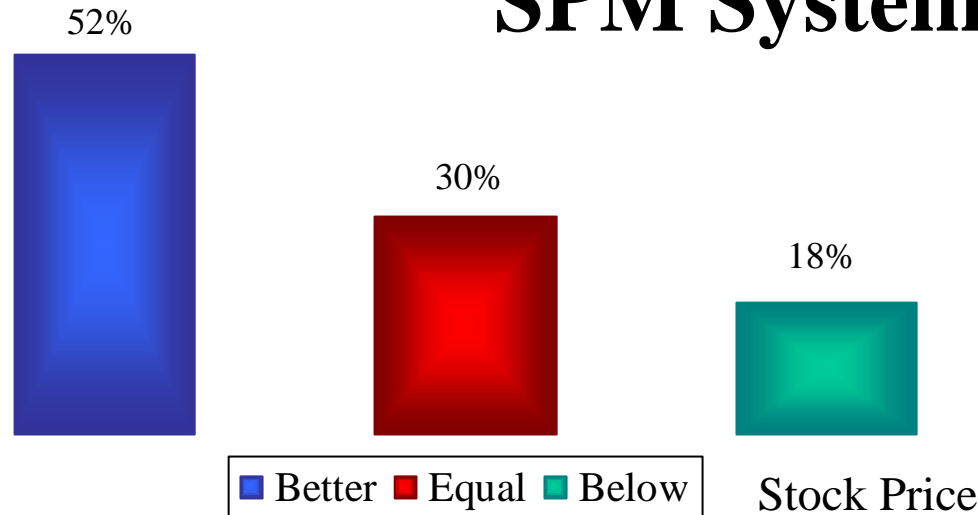
Measurement-Managed Companies

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

		Stock Price			Chi-square=6.0 p<.05
		Better	Equal	Below	
SPM System	YES	52%	30%	18%	
	NO	26%	43%	31%	



SPM system implementation SPM system leadership in...

Developing

Maintaining

50%

CEO

26%

50%

CFO

47%

47%

Corporate Strategy/
Business Development Directors

43%

12%

Division Managers

19%

44%

Other

27%



SPM System

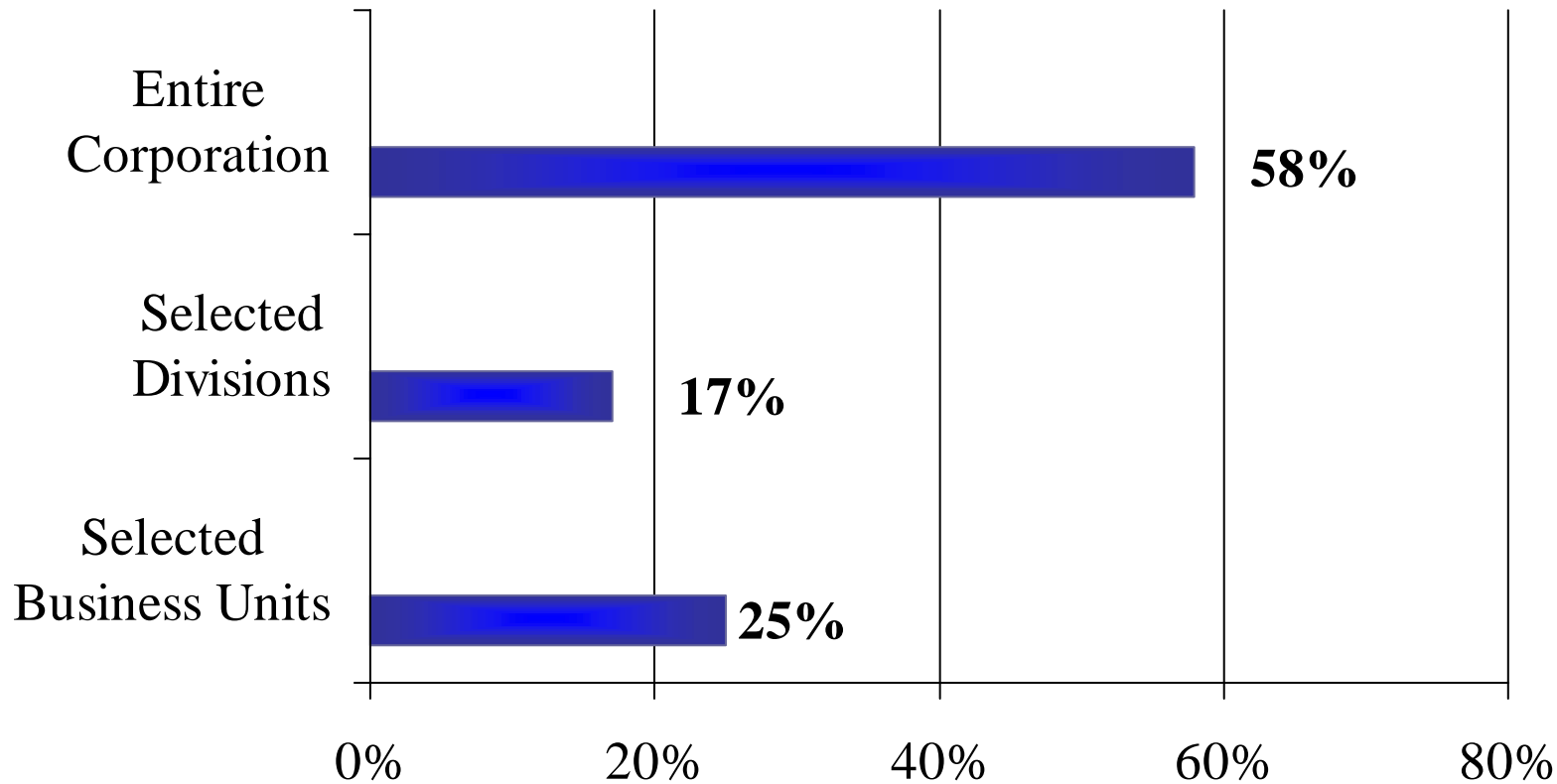
Four Critical Development Stages

- **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:





Cascading the SPM System (Lowest Level to which SPM system is applied)

Over past three years

Over next three years

19%

Corporate

0%

23

Division

18

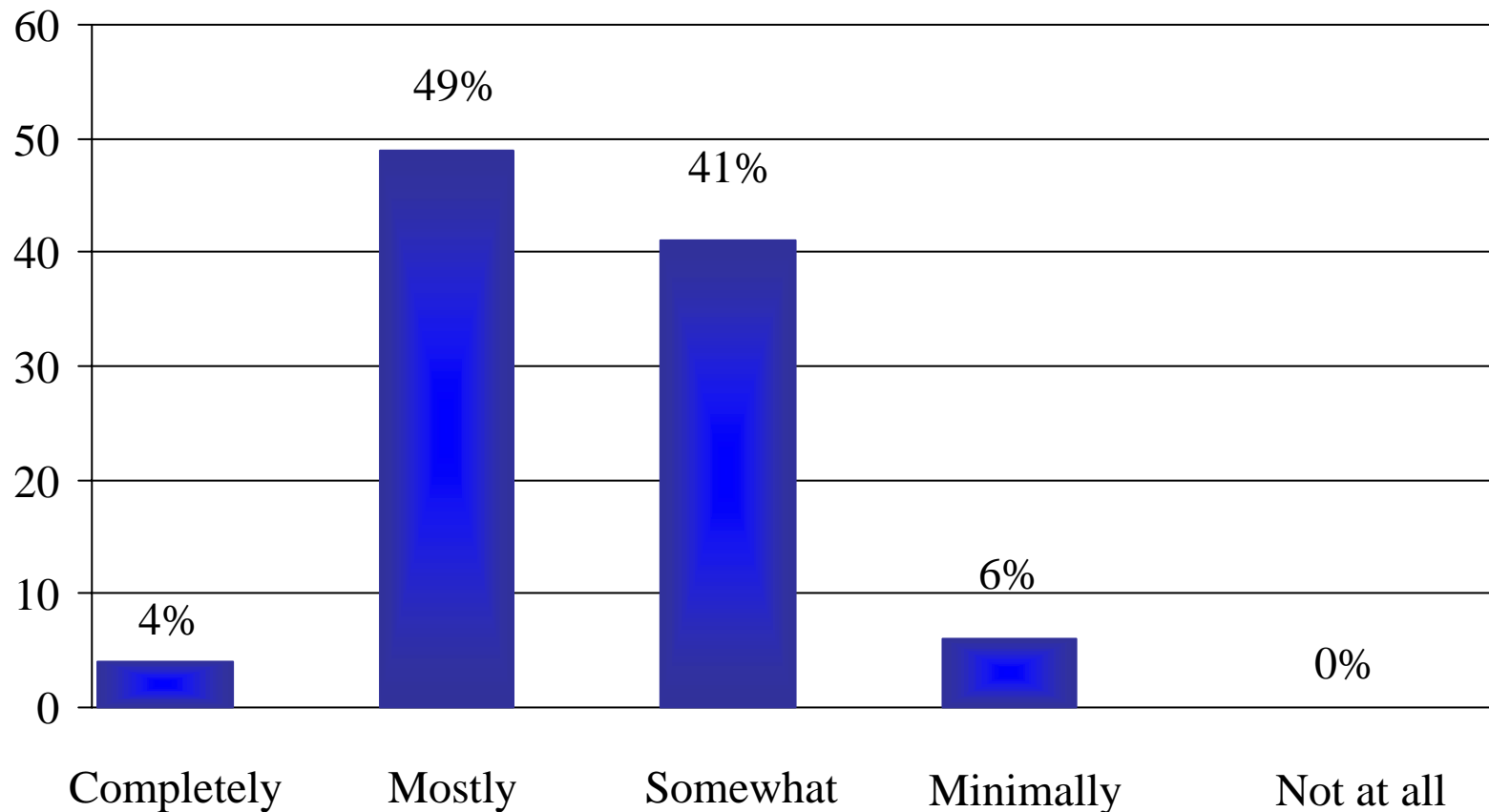
58

Business Unit

82



Linkage Between SPM System and Incentive Performance-Based Compensation Satisfaction Level





Strategic Performance Measurement Systems Considerations During Development and Implementation (percent considering completely or to a great extent)

Determining links between strategies and related performance measures	69%
Communicating the business drivers, game plan, and intended results	60%
Cascading performance measures from high level strategies	51%
Linking individual performance and compensation plans to business strategies	46%
Assessing the alignment of performance measures between key operating units	45%
Implementing behavioral/monetary consequences when units/managers perform below target level	37%
Modifying IT systems to support reporting and analysis of measures	29%
Assessing links between strategies and performance measures rigorously	22%
Identifying key stakeholders' potential reasons for resisting the SPM effort	9%



Assessing the Alignment of Performance Measures Between Operating Units or Functions

Stock Price Performance Relative to Competitors

	Better	Equal	Below
Completely	43%	40%	17%



Implementing Behavior/ Monetary Consequences When Units/Managers Perform Below Target Level

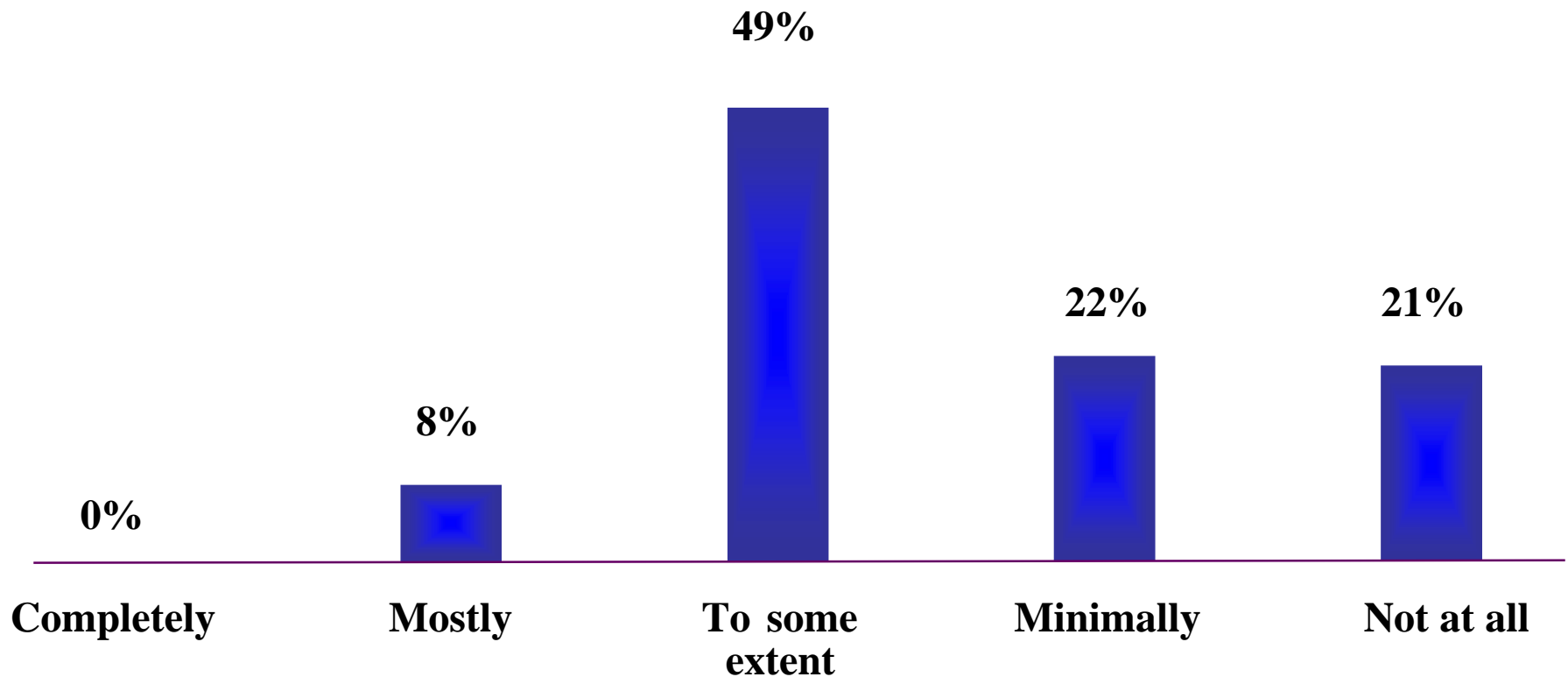
Stock Price Performance Relative to Competitors

	Better	Equal	Below
Completely	45%	41%	14%



Information Technology Systems

Avoidance of SPM Measures Due to IT System Limitations





Manual Capture of Strategic Performance Measures

Manual Capture of SPMs?

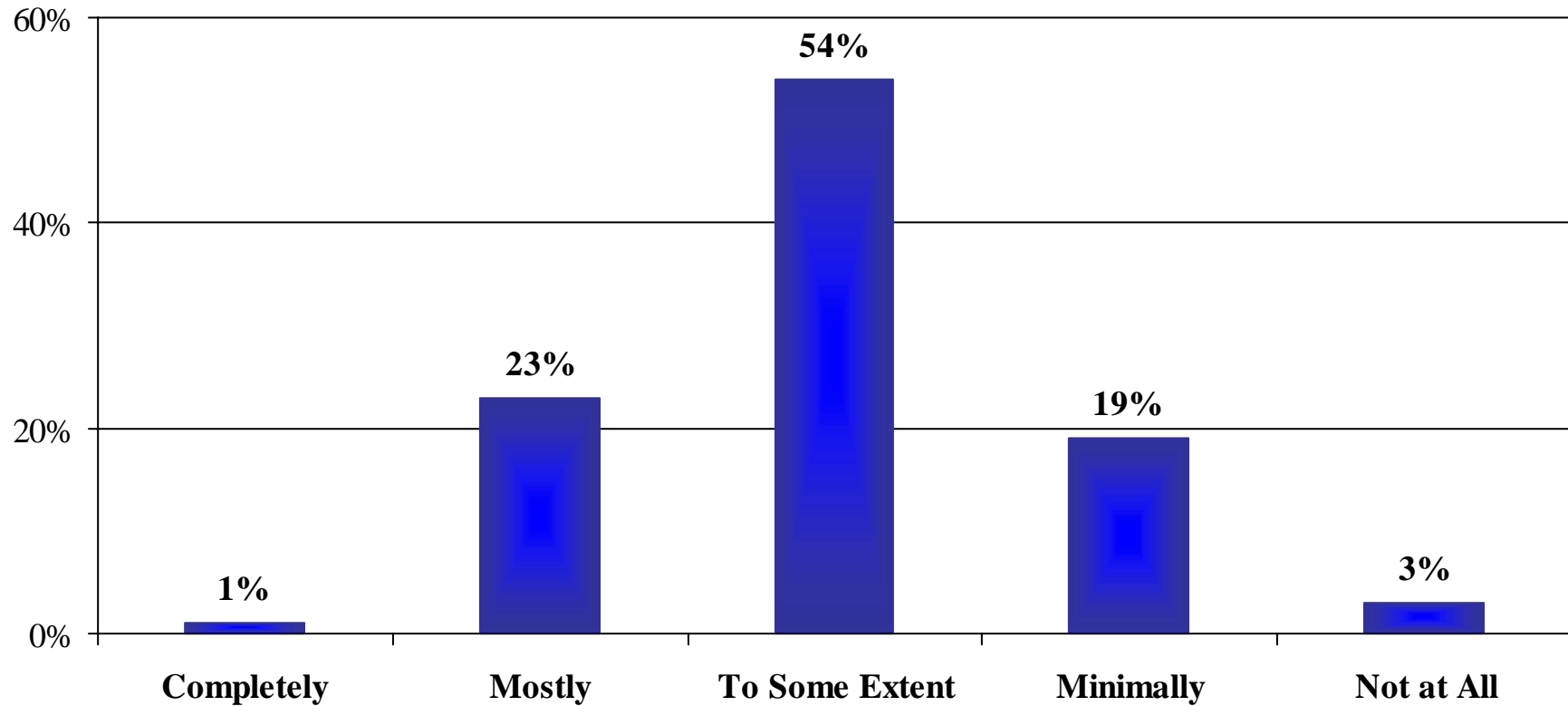


Percent SPMs Captured at:





Corporate Culture Resistance to Changes in SPM Systems



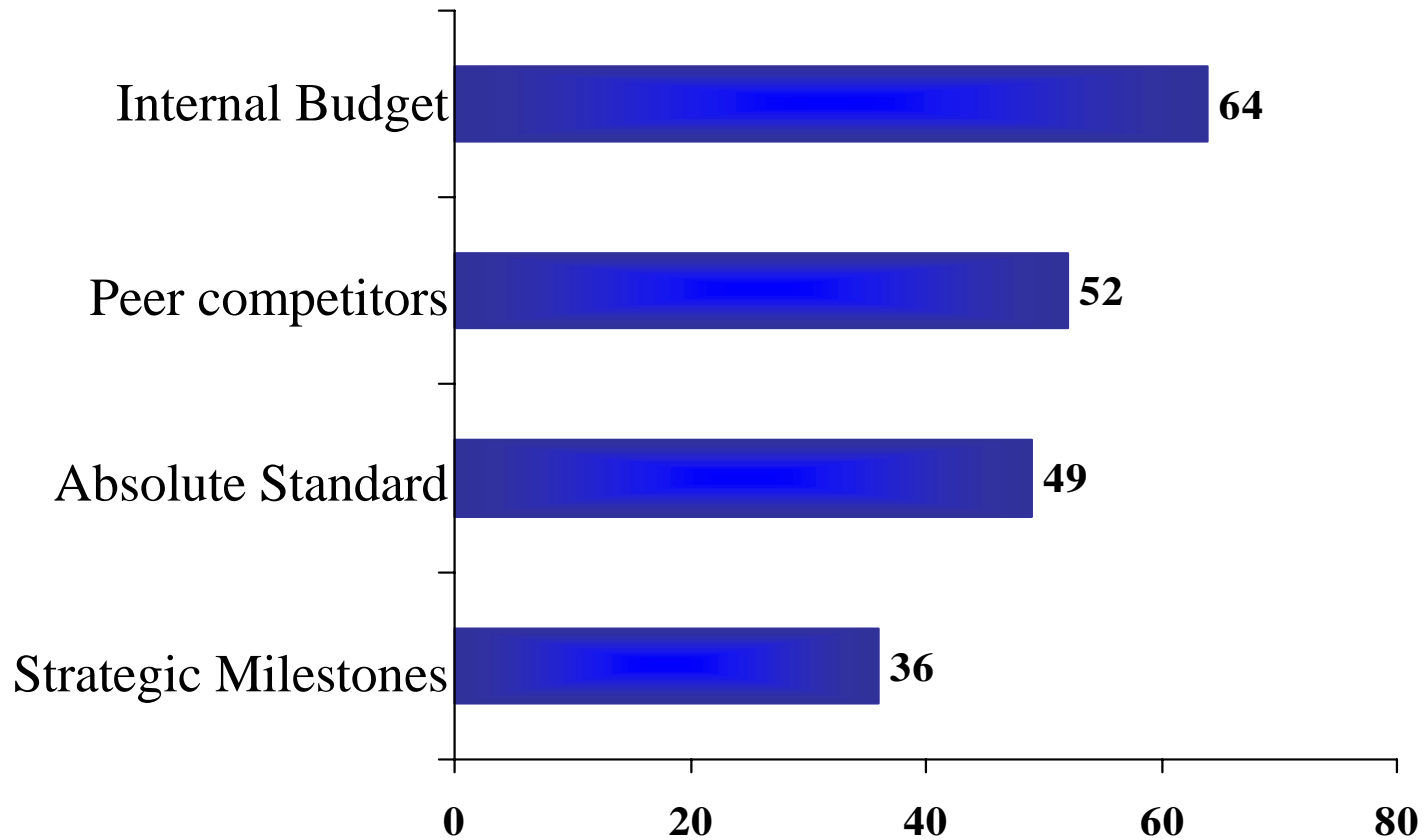


Benchmarking Measures

*What Do Companies
Compare Performance Against?*

Performance Standard

% Respondents





Financial Value-based SPM

Top Measures Over Next Three Years





Balanced Scorecard SPM

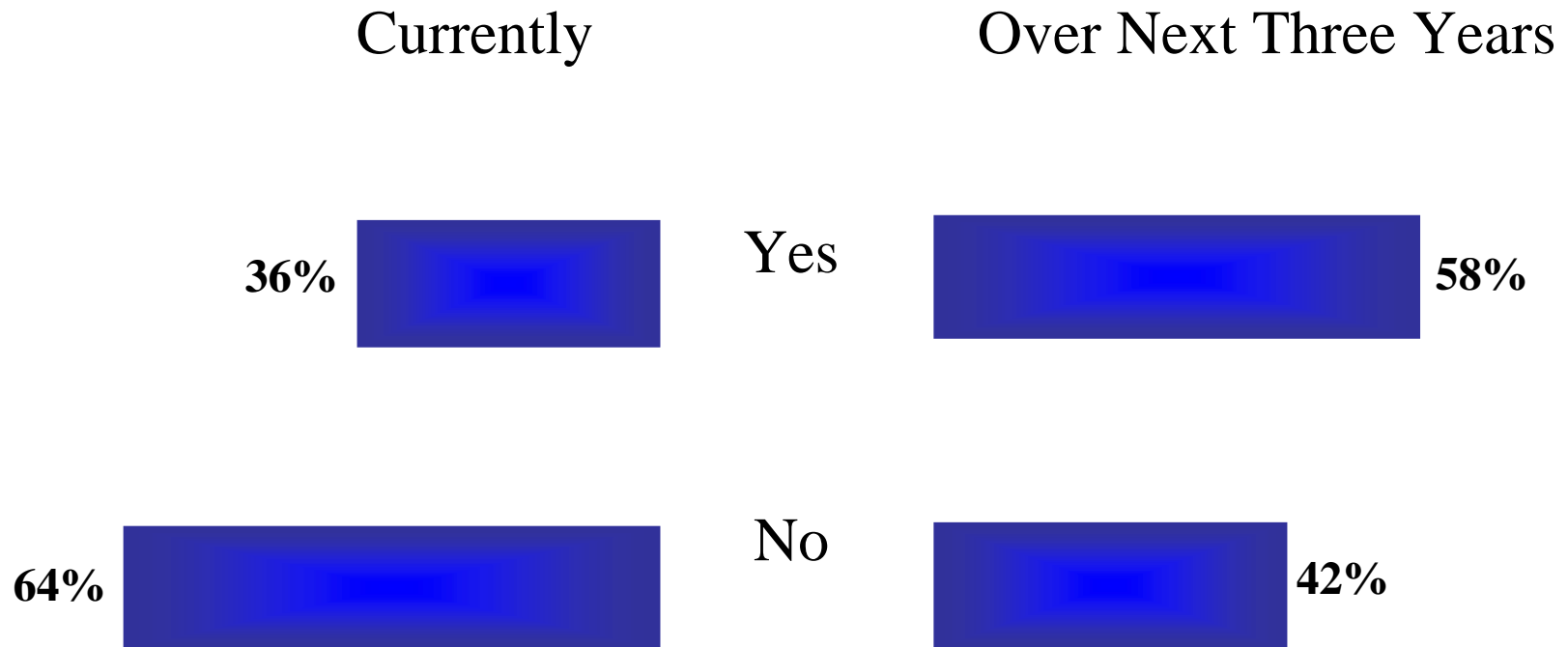
Top Non-Financial Measures Over Next

Three Years





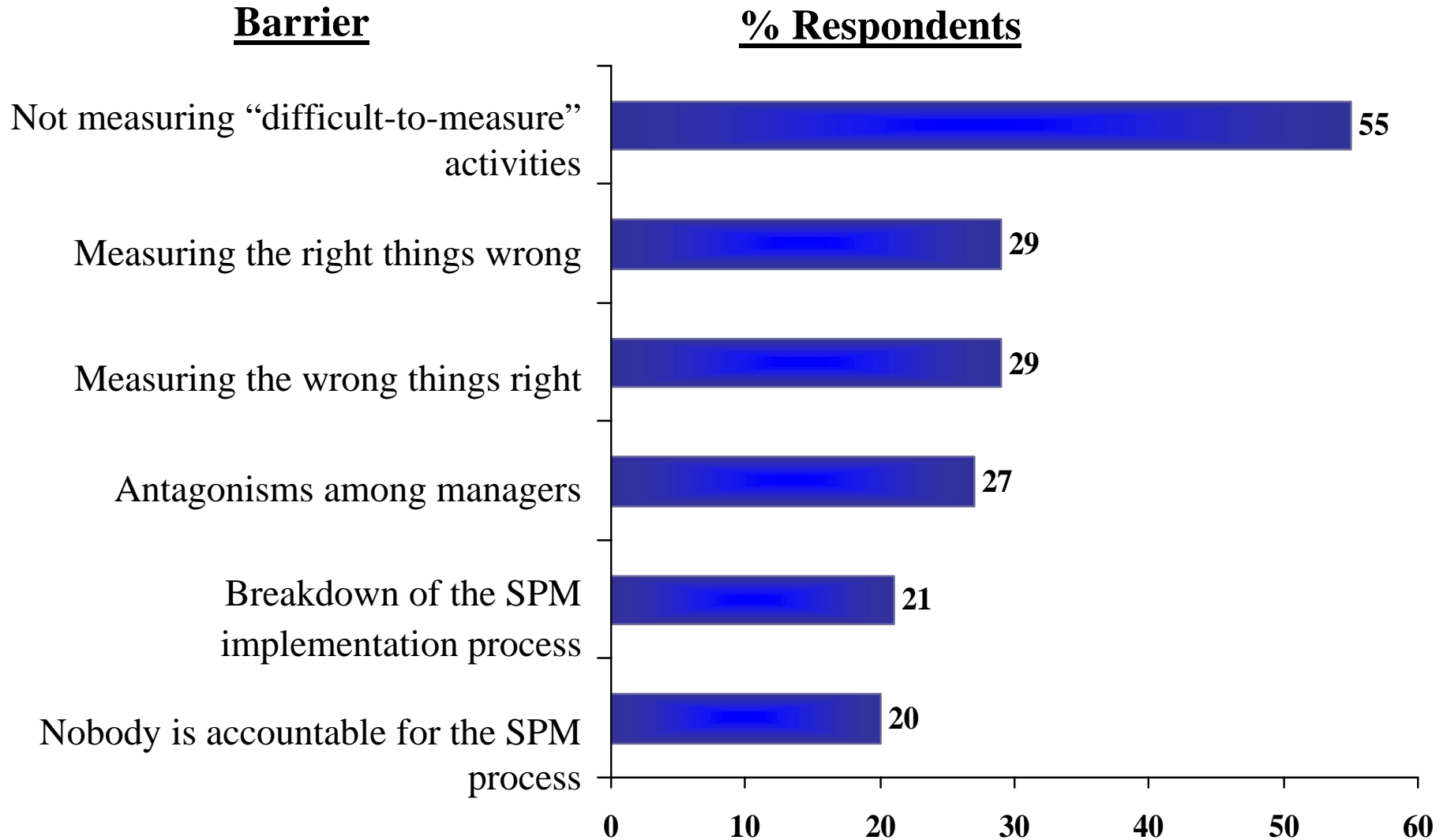
Presence of SPM Targets and Results in Annual Reports





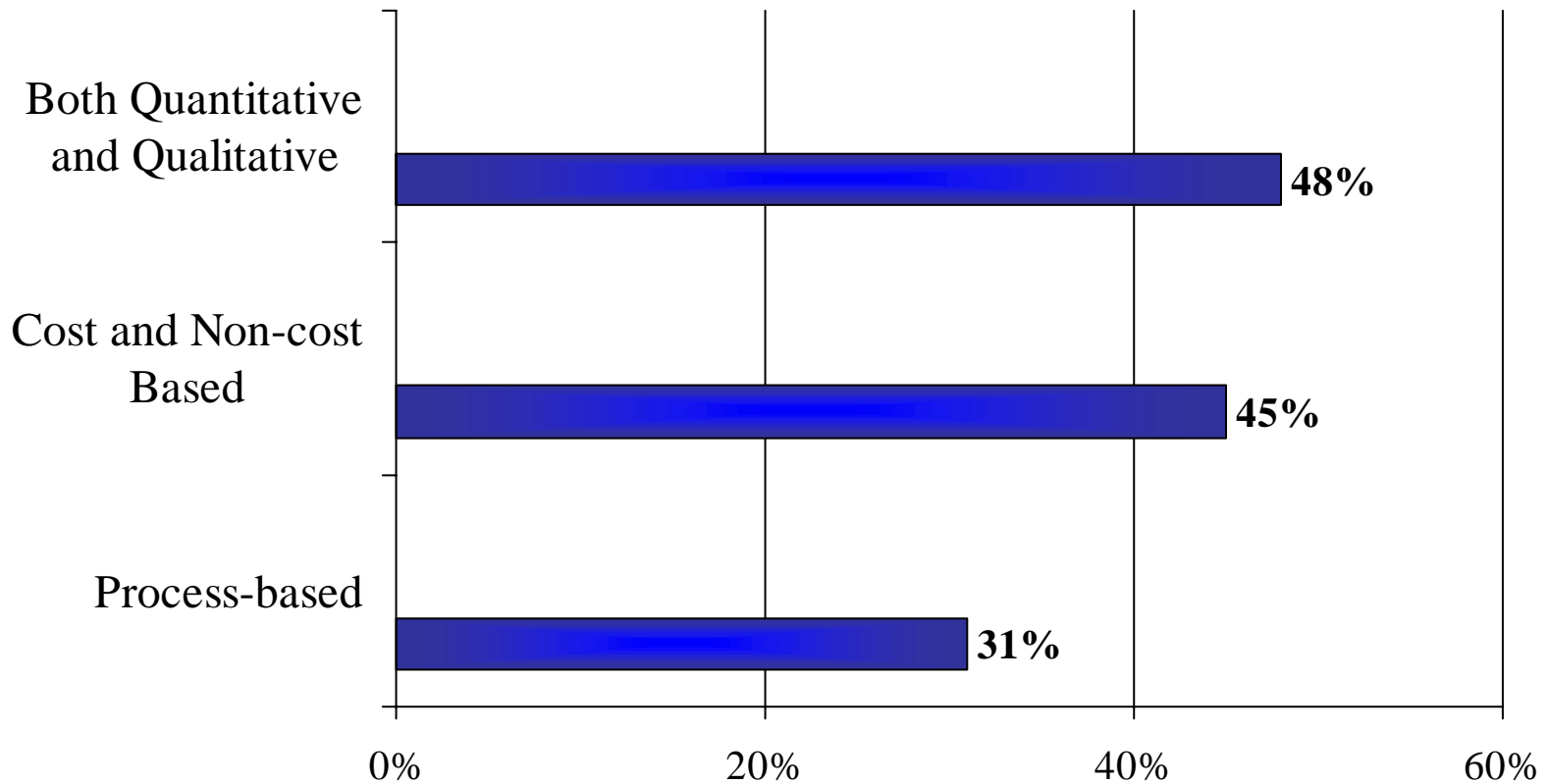
CHALLENGES:

Barriers To SPM Implementation





Strategic Performance Measure Design





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



SPM System Development

Lessons Learned

- 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...