

THE MEASURE NETWORK

IMPROVING CORPORATE PERFORMANCE MEASUREMENT

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"We have an excellent quality program, a sophisticated incentive compensation system and a reliable financial system. But why can't we have a single, complete system that provides a solitary focus and one version of the truth for all these measurement functions?"

—Human resources manager at a large automotive supplier

This statement captures the essence of a key performance measurement issue managers face in today's organizations. Why do firms build and maintain multiple performance measurement systems when a single integrated system would better serve their needs

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and help avoid so much of the confusion? To help us better understand, we asked managers how they feel about the systems they now use, why they feel as they do, and what must be done to improve performance measurement systems. This column lays out the research findings, comments on the forces driving current beliefs, and discusses the strengths and challenges of the most promising solutions for measurement system improvement.

HOW MANAGERS FEEL ABOUT PERFORMANCE MEASUREMENT

The methodology used to gather information on managers' feelings about their performance measurement systems is a questionnaire administered to attendees of various executive education courses at the University of Michigan Business School. Respondents are mostly general managers at large, global business firms. Almost half come from countries other than the United States. The number, form, and content of the questions

has varied somewhat over the years, but the following conclusions represent a reasonable consolidation of the results.

Questionnaire Feedback

Since 1998, 300 managers have been asked to complete the questionnaire and 175 respondents have complied.

Responding managers most strongly agreed with the following descriptions of their performance measurement systems:

- The company strategy includes measurable goals that the company is trying to achieve.
- The performance measures collected and communicated in the organization are useful to managers in running the business.
- Managers understand how effective measurement provides key support in the pursuit of corporate goals.
- An understanding of the consequences of performance results is communicated and understood.

- The current measurement system encourages behavior that is good for the organization.

Survey respondents tend to agree strongly with the most general kinds of statements about performance measurement: measures are seen as supportive of the business strategy; managers are positive about the firms' efforts to communicate measurement results, analysis, and significance; measurement systems are considered an important contributing factor to the success of the firm.

Responding managers most strongly disagreed with the following descriptions of their performance measurement systems:

- The complexity of the business is fully reflected in the detail and structure of the measurement system.
- The company understands and measures the specific aspects of value it creates for customers, investors, employees, suppliers, and other key stakeholders.
- The measurement system helps managers understand the interrelationships among business activities across all parts of the business.
- Managers at all levels of the business measure and understand the extent to which their process activities contribute to creating value for stakeholders.
- Performance standards are to a large extent determined from a comparison to external sources such as other divisions, competitors, or unrelated, world-class, benchmark companies.

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Interrelationships among measures are not made sufficiently explicit. The line of sight between measures of operating activities and the value-creation results for corporate stakeholders is unclear. Standards for measures are not modeled after external benchmarks.

WHY MANAGERS FEEL AS THEY DO

Although managers are generally satisfied with their company's measurement culture, level of measurement understanding, and communication of measures and their consequences, they are less enthusiastic about the structure, content, and connectivity of their measurement systems. Why might this be the case? Three reasons stand out.

First, managers support the concept of performance measurement because their experience has shown it to be a positive force in helping to achieve corporate success. The more a person knows about measurement, the more open he or she is to communicating results, and the more positive a person is about the role of measurement, the greater the chances of achieving the desired business outcomes. Ignorance, secrecy, and negativism regarding measurement are a sure recipe for failure.

Second, managers who use measures on a regular basis understand the difficulties inherent in the performance measurement process. Sometimes, the thing be-

ing measured and the measure itself are one and the same—cycle time, number of units produced, and number of errors are examples. More often, measures are an imperfect specification of the underlying idea. Return on assets is meant to comment on the efficiency of the use of capital, but assets are measured using the principles of accrual accounting and are thereby measured by historical cost, or perhaps, not at all.

Third, managers know the shortcomings of their own systems. They are aware of the distortions that can be introduced through cost and asset allocations. They know there is a tendency to measure the things that are easy to measure and to avoid measures that are more difficult. They have watched as others engage in activities that clearly hurt the firm but help a key measure, for example, avoiding value-creating investment because it would drive down Economic Value Added in the current period.

IMPROVING PERFORMANCE MEASUREMENT SYSTEMS

The key to improved performance measurement is the development of integrated performance measurement systems. Integrated systems are constructed around a unifying theme, such as business strategy or value creation, and measure the critical aspects of the structure that links the activities of the people and processes in the firm to the intended outcomes for the company's stakeholders. Integrated systems embody the quality concerns of production, the customer satisfaction focus of sales and marketing, and the monetary discipline of accounting, among other corporate subsystems. They use measures denominated by

money, units, time, feelings, and other expressions of actions and results but present all of these dimensions as parts of a single, overall representation of the aspects of company activity. When there is need for a subsystem, measures are taken from the whole and applied to the part. Measures used in pay-for-performance schemes are selected from the complete structure in recognition of their ability to drive the desired behaviors and outcomes and will probably be different for different parts of the company. Measures selected to represent the performance of a unit of the organization reflect the unit's performance, the link between the unit and other organizational units, and the link between the unit and the firm as a whole.

The sophisticated structure of integrated performance measurement systems is highly beneficial

to management, but it does not eliminate some of the basic difficulties of performance measurement. There is still the unavoidable disconnect between our desire to know the future and our ability to measure only in the past or present. Some of the things we measure today may have the power to give insight into the future, but future outcomes can only be predicted, not measured. It must also be recognized that businesses are highly complex organizations that offer far more opportunities for measurement than can effectively be employed by management. The challenge of reducing the required number of measures to a critical few will always be present. Finally, the relationships among measures denominated so differently defy mathematical representation. As a result, we must be satisfied with understanding rough approxima-

tions of the strength and direction of interactions among measures.

CONCLUSIONS

In spite of these difficulties, the benefits of measurement integration far outweigh the costs. A better measurement system helps align the actions of people in the organization to ensure they work together to accomplish the intended goals. A unified system facilitates the creation of a single version of the truth, which helps avoid conflicts and misunderstandings resulting from inconsistent data or inappropriate comparisons. Finally, an integrated system motivates individuals by conveying a sense of fairness and logic in the scorekeeping. Employees can seek to do their best knowing that the measurement system will accurately and impartially measure the contributions they make and the extent of their success. ■