Balanced Performance Measures: Tracking the Pathway to High Performance

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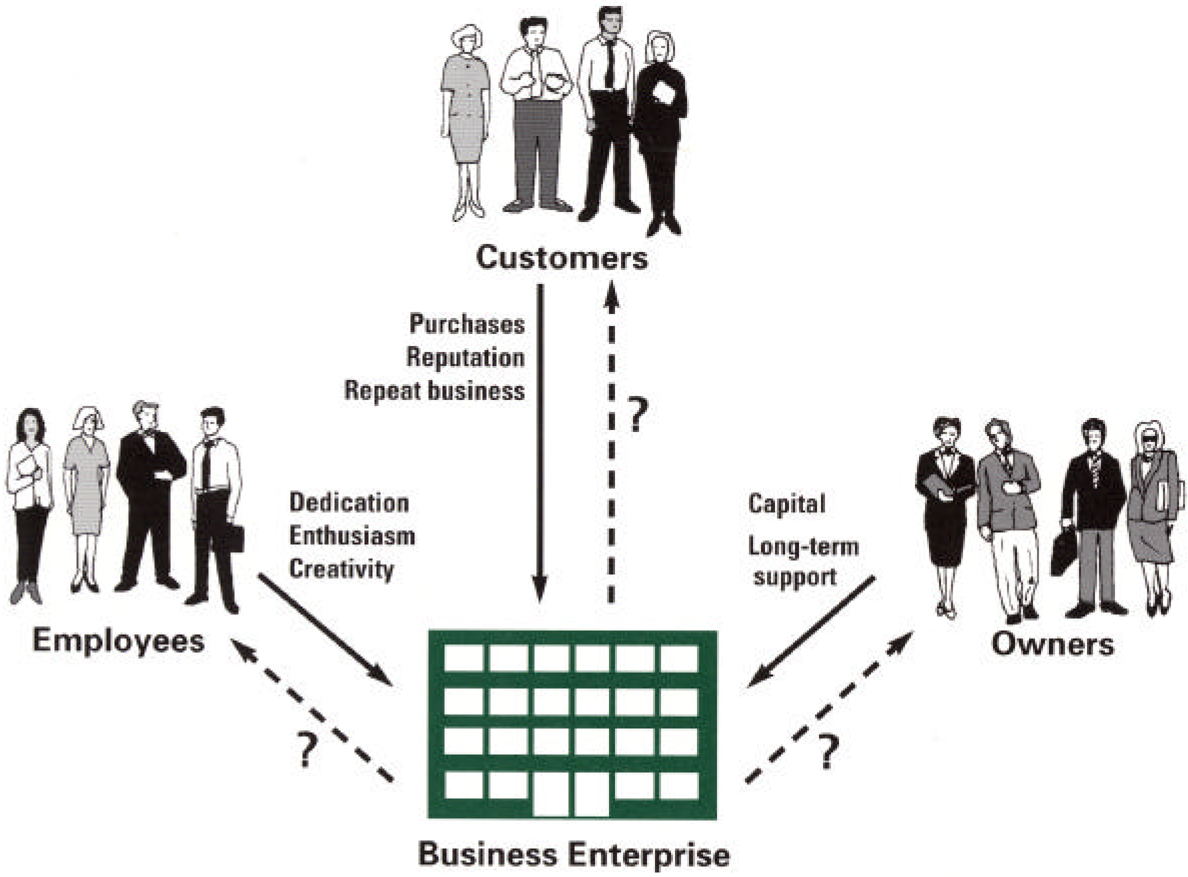
Traditional business performance measures, such as return on assets or earnings per share, reflect a company's overall financial results in a given period. While useful, they offer little insight into why or how the organization achieved any particular result, and they provide little guidance as to where or how to make improvements. To better assess the various factors contributing to overall performance, management needs additional „in process" measures.

Today, leading companies seek to measure the fundamental aspects of performance that give a more complete and balanced picture of the health of the enterprise than financial measures alone can provide. These metrics can then be tracked over time to complement financial measures and perhaps give some independent, early, and insightful signs of performance problems.'

A focus on financial measures reflects an ownership view of the company: the owners are concerned with the return on their investment. Interestingly, the owners themselves often have little direct impact on the performance of the company. A more balanced view would take into account the satisfaction of all the major constituents who directly influence the company's performance. We call these groups of constituents the stakeholders of die company; they include customers and employees, in addition to the owners, but may encompass other key groups as well.

The need for balance is central to the concept of the High Performance Business[2] (see Exhibit 1). At one level is the need to balance the give-and-take between the business and each stakeholder, recognizing that stakeholders expect things from the business just as the business expects things from them. If either party gives or receives too little, the relationship suffers. At another level, in order to sustain high performance, the business must meet the expectations of the various stakeholder groups in a balanced fashion. Satisfying owners at the expense of employees, or even satisfying customers at the expense of owners, will in the long run inhibit sustained high performance.



By measuring how well it is meeting the expectations of each stakeholder, a company gets a more accurate picture of its overall performance and gains critical insight and guidance for action. For example, a company with steadily rising earnings per share, but whose customer satisfaction has dropped three years in a row, is not performing at a healthy level.

Interestingly, the very process of establishing such a balanced measurement approach has often proven to be an opportunity for real organizational learning, yielding insights about the fundamental mission and vision of the company as it seeks answers to such questions as:

• Who are our customers?

• What do they want from us?

• How well do we really satisfy them?

• Who are our owners?

• What do they expect of us?

• How well do we meet their expectations?

• Who are our employees?

• What do they want from their work experience?

• What do they really think about working here?

Acme Electric: A Case Study

Acme Electric is a publicly owned utility, considered to be a successful private enterprise within its economic sphere. For many years the company focused on technical and engineering excellence and on early adoption of technological improvements. Like most utilities, it enjoyed a monopoly, and its rate of return was predictably steady. *Yet* management felt that the focus on financial measures alone was not providing a well-rounded picture of overall performance. It wanted to compare the company with other utilities as well as with less-regulated businesses and to understand how it was perceived by outsiders in comparison with other enterprises. Management also planned to embark on a performance improvement program for key business processes but had little idea where to begin; the current financially oriented measurement system provided no guidance as to what the priorities for improvement should be.

Acme decided that performance measures should reflect how well the company was satisfying the expectations of all its important stakeholders, not just the shareholders. Shortly after reaching this decision, management came to three critical realizations:

• There was basic, but not total, agreement on who the stakeholders of the business were.

• There was a wide disparity of views on what the stakeholders expected of the company.

• There was almost no agreement on how well the company was meeting these expectations.

Despite the disparity of views, simply articulating a shared level of understanding had a galvanizing effect on the senior management team and pointed the way to a fuller analysis.

A Process for Balanced Measurement

In working with the management team at Acme, Arthur D. Little consultants used concepts at the heart of the High Performance Business to define and put in place a balanced performance measurement system. High performance is attained when the company meets or exceeds all stakeholder expectations in a balanced fashion. The system was put in place at Acme in three stages.

Stage 1: Identifying Stakeholders and Their Expectations. As noted, a stakeholder is an individual or group that can heavily influence the performance of the business – i.e., whose support is necessary for success. Stakeholders almost always include the „big three“: customers, employees, and owners. For most commercial enterprises, these are by far the most important, and the scope of the performance measurement can be limited to them. In other situations (such as a publicly regulated company like Acme), the scope may need to be broadened.

A company must define its stakeholders clearly, particularly if there is any question about who is included in each group. Here is the list of stakeholders that Acme decided on:

• Customers (both users of electricity and land developers)

• Employees (both full- and part-time, at all levels)

• Owners (stockholders)

• Suppliers

• Regulators

• Local communities (specifically, mayors and city councils, as well as people who influence public opinion)

The process of deciding on the list of stakeholders proved to be an illuminating experience for Acme's management team. For example, it came to realize that suppliers (particularly the smaller local ones) were an important stakeholder. Understanding the interdependencies between Acme and its suppliers eventually led to significant policy changes.

The next step is to determine the expectations, or „satisfaction attributes," of each stakeholder. This analysis must be objective, based on facts, not on preconceptions. It should use tools like surveys and focus groups. Many organizations (including Acme, in the initial stages of the process) make the serious mistake of assuming that they already know and understand stakeholders' expectations. This is particularly true with regard to employees: senior management frequently assumes it knows what employees want from their jobs, and it is often quite mistaken. Complicating matters, as the world changes (e.g., competitors begin to satisfy more of customers' expectations, other companies in the area offer improved working conditions), stakeholder expectations change.

The relative importance of satisfaction attributes can reflect a company's strategic decisions. To take a highly simplified example: if price and quality are of equal importance to customers, a strategy that emphasizes competition on the basis of quality will raise the importance of quality in the eyes of the targeted customers. It is usually best to focus attention on three to five satisfaction attributes for each stakeholder; a scheme involving hundreds of performance measures will not work. A survey at Acme established the following expectations among the employees, together with the relative importance of each:

• Competitive compensation ....High

• Safe work conditions ....High

• Pleasant work environment.........Medium

• Career development....................High

Stage 2: Measuring Performance. How does a company measure how well it is meeting the expectations of its stakeholders? Here again, some managers assume too much: „Of course our customers are happy"; „Our benefits package is as good as any company's in the area"; „Our delivery service is second to none." A company should develop empirical performance measures for each stakeholder satisfaction attribute. In Acme's case, customer expectations for high-quality electric service are measured by two metrics:

• Maximum percentage voltage fluctuation (+ and -)

• Average outage time per customer during the month

The numbers generated by these metrics can be empirically determined and are not subject to interpretation.

Some satisfaction attributes – career development, for example – might appear difficult to measure, but a little thinking usually yields a solution. For career development one might measure the number or percentage of employees promoted from within and the number taking career development training. Another possibility is to quantify the results of surveys: determine, for example, the percentage of employees who rated their career development opportunities as above average or excellent on the annual employee survey.

By ensuring that each stakeholder expectation can be tracked over time with one or more quantifiable metrics, management can adequately measure the effect of performance improvement programs. Typically, a company will already have collected some relevant data, such as customer surveys, employee surveys, and the like, before developing a measurement system. These data can be particularly useful in identifying trends.

There are several possible methods for determining performance levels, depending on the type of metric:

• Empirical observation: e.g., counting the number of minutes of electric outage, or observing the actual voltage fluctuation

• Sampling: similar to empirical observation but for a sample of the entire population

• Questionnaires: taking a survey of stakeholder satisfaction

• Focus groups: a smaller sample than a survey, but often yielding more insight (particularly useful the first time around)

Remember that surveys and focus groups tend to be subjective; they measure the perception of performance against the expectation. Of course, the perception is often as important as the actual performance. A good practice is to incorporate both subjective and objective measures into the scheme. At Acme, Arthur D. Little used not just the number of minutes of electric outage but also the customer's opinions as to reliability. When these measures are moving in opposite directions, further investigation is necessary to determine the reasons (e.g., is the customer's definition of reliability different from the company's?).

Stage 3: Setting Targets and Assessing Performance. How are targets established for performance improvement? Certainly one way is to benchmark the company's performance against others. Industry or trade organizations frequently publish relevant statistics that can be used for comparison purposes. Acme might decide to aim to be in the top 10 percent of electric utilities in terms of voltage fluctuations. (The industry statistics show that this target translates into no more than 0.4 percent fluctuation over an entire year.)

Corporate strategy may also help set performance targets. Specific elements of the business strategy may well suggest an aggressive target for cost reduction or customer service, for example.

Once the basic elements of a balanced performance measurement scheme are established, the last step is to implement a periodic assessment and reporting process. A company can use this in various ways: as an informal report to the stakeholders themselves (e.g., printed in the company newsletter), as a report to the board of directors, or as part of the formal annual report. A formal report on the measurement scheme would typically be issued yearly. More frequent tracking of some measures might also be appropriate.

Similarly, if a company can set appropriate targets for several years in the future and then track them year by year, it can produce a useful trend line. Subtracting the current level of performance from the target set for improvement reveals the overall performance „gap." Some companies express the gap in terms of percent of target to be achieved. (Using a simple example, if the current performance level is 60 for a target of 100, the gap in percentage terms would be 40.) One of the benefits of expressing the gap in percentage terms is that an overall report card can then show which attributes are furthest from their targets on a comparable basis.

Acme now compiles and publishes a yearly balanced stakeholder performance report along the lines shown in Exhibit 2. Some measures are updated more frequently. As part of Acme's Executive Information System, senior management has access to the current measures, targets, and gaps, as well as to the underlying definitions of the stakeholders, their expectations, and the metrics.

The Acme team has used the report's analysis of gaps in meeting stakeholder expectations to focus business process redesign (reengineering) efforts on their high-priority opportunities (Exhibit 3). First, the team multiplied the relative importance of each attribute by the gap in actual performance to arrive at a weighting scheme reflecting need-for-improvement. Then it used a correlation matrix to reflect the degree to which each business process influences each stakeholder satisfaction attribute. For example: the process „Supply Electric Energy" might have a high influence on Quality of Electric Service and receive a base score of 3.4 in this cell of the matrix, while the same process has little influence on Career Development, resulting in a base score of O. Finally, they combined these base scores with the need-for-improvement weighting scheme and summarized the results for each business process. The bottom line of Exhibit 3 clearly shows which processes must be improved in order to close the gaps to meet stakeholder expectations.

Conclusion

Traditional financial measures do not provide a well-balanced picture of a company's performance, nor do they help a company identify where to focus performance improvements. A more balanced approach considers the expectations of all the important stakeholders of the enterprise and measures the degree to which these expectations are being met. We have reviewed here an approach to defining the stakeholders, identifying their expectations, and measuring the gaps that exist in actual versus targeted performance levels in meeting these expectations.

Perhaps the most important aspect in identifying stakeholder expectations and then measuring stakeholder satisfaction is objectivity. Balanced performance measures must be based on data compiled from empirical studies and surveys. Only then can they have real value in tracking company performance over time and in focusing performance improvement efforts.

Exhibit 2

The Stakeholders' Expectation Report Card

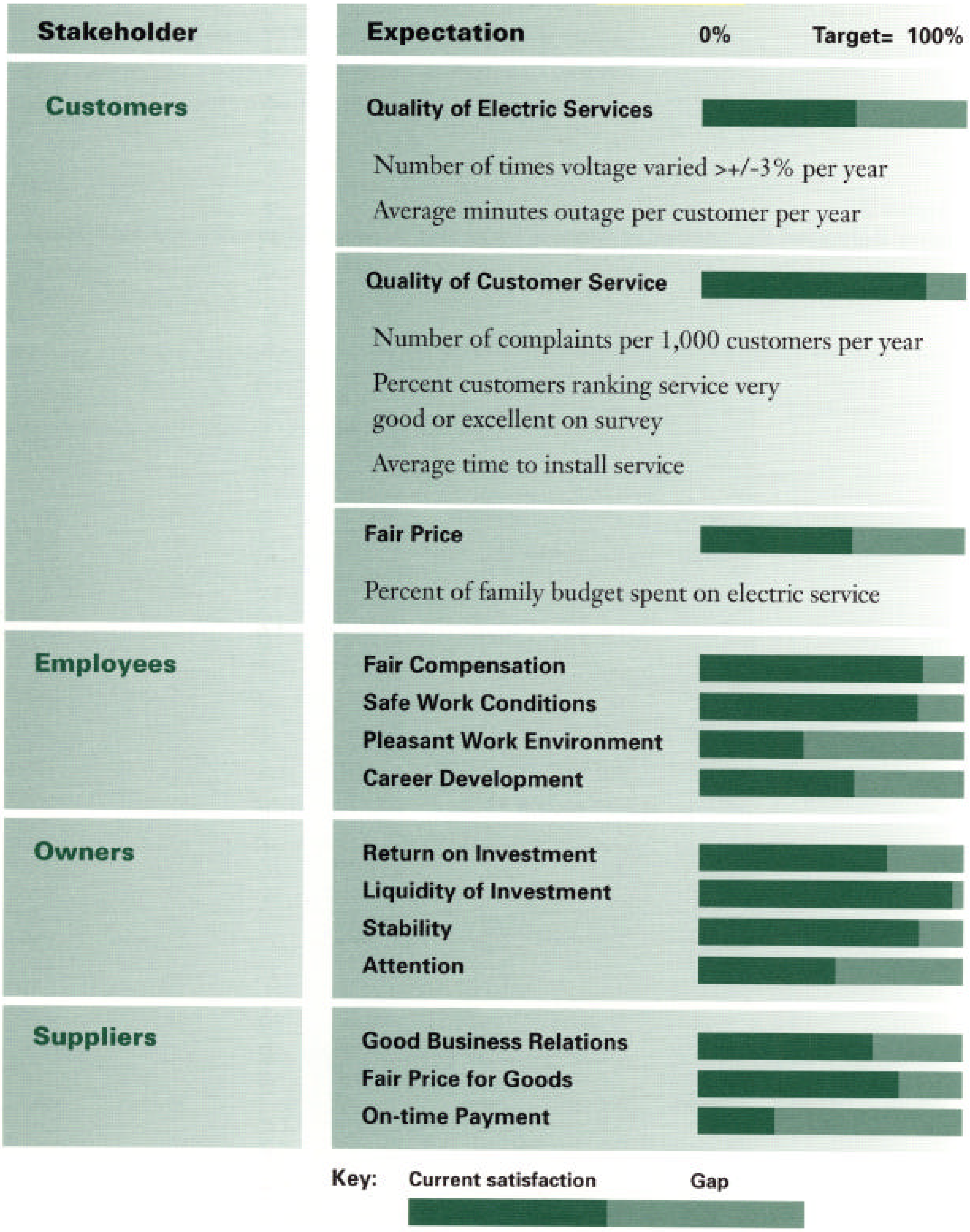


Exhibit 3

Using Balanced Performance Measures to Set Process Improvement Priorities

Stakeholder	Satisfaction Attribute	Relative Importance	Current Satisfaction Gap	Need for Improvement
Customers	Quality of Electric Services	3	60	180
	Quality of Customer Service	2	80	160
	Fair Price	2	40	80
Employees	Fair Compensation	3	60	180
	Safe Work Conditions	2	20	40
	Pleasant Work Environment	1	50	50
	Career Development	2	70	140
Owners	Return on Investment	3	20	60
	Liquidity of Investment	2	30	60
	Stability	2	40	80
	Attention	1	60	60
Suppliers	Good Business Relations	2	40	80
	Fair Price for Goods	3	50	150
	Early Involvement	2	80	160

Business Processes, Impact on Stakeholder Satisfaction

Supply Electric Energy	Serve the Customer	Manage Human Resources	Manage Financial Resources	Provide Materials Supplies	Provide Infrastructure
3.4	0.4	2.3	1.7	3.2	2.8
0.4	4.5	4.5	0.8	0.4	1
2.2	0.3	0	2	0.7	1
0	0	2.9	3.4	0	0
0.5	0.6	1.6	0.6	1.6	1.3
0	0.8	0.6	0	0.5	0.8
0	0	4.5	0.3	1	0
2.1	0.5	0.5	2.4	0.6	1.3
0	0	0	0.8	0	0
2	0.9	2.1	1.8	0.9	0
0	0	2.8	0	1	0.2
1	0	0.5	1.5	0.8	2
0	0	0	0.7	3.8	1.8
0.3	0	0.2	0.8	1.3	0.6
11.9	8	22.5	16.8	15.8	12.8

Density of color indicates priority for improvement = Significant opportunity = Modest opportunity = Little opportunity

[1] *Robert Kaplan and David Norton, „The Balanced Scorecard – Measures That Drive Performance,“* Harvard Business Review, *February 1992.*

[2] *See* Prism, *First Quarter 1992.*

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