The search for meaningful measures

Managers across the world – in both the public and private sectors – are grappling with the challenge of performance measurement.

By Professor Andy Neely

Surveys suggest that in the five years to 2000 around half of all companies attempted to transform their performance measurement systems, while more recent data indicate that 85% of organisations had performance measurement initiatives under way in 2004. What goes for organisations also goes for individuals. By 1998, workers were subject to formal performance appraisals in 79% of British workplace. For many, the individual performance management process is a key indicator of the way organisations establish employees' obligations and hence of how life in organisations is experienced. A sharp illustration of the spread of these ideas is provided by a study of a Norwegian hospital, where even the priest had performance measures that included not only calls made in and out of work hours, but also the number of last rites he performed.

The enduring challenges of measurement

Why is it that people designing measurement systems in organisations make such a mess of the task? Why are there so many reports of ill conceived measurement systems driving dysfunctional behaviour? And why, given all of the problems that measurement can cause do managers persist with their search for ever better measurement systems? To understand the difficulties of putting performance measurement into practice, companies and executives need to recognise three main challenges of performance management.

Desire to quantify

The desire to quantify remains. In 2004 the UK Government completed its last spending review. As part of this review the Treasury agreed 110 Public Service Agreements (PSAs) with some 20 central government departments. Effectively these 110 PSAs describe what the Treasury expects in return for its investment in different government departments. The PSAs are couched in rather generic language, so each department seeks to translate its PSAs into more specific targets. Consider the police force. The stated aim of the Home Office is to build a safe, just and tolerant society. In return for its budget allocation the Home Office agreed six PSAs and one value for money target with the Treasury in 2004. To enable the Treasury to measure the Home Office's progress against these targets the Home Office and the Treasury agreed 37 separate performance indicators (defined in publicly available 'technical notes'). 10 of these 37 indicators relate directly to the Police Force (the others relate to other Home Office responsibilities – eg the criminal justice system, etc).

These 10 indicators feed into a document called the national policing plan, which refers to the PPAF (police performance assessment framework). The PPAF has six domains and 18 separate indicators covering issues such as reducing crime; investigating crime; promoting public safety, etc. To respond to the PPAF, local police authority's are expected to develop strategic plans explaining how they will address the priorities identified in the national policing plan, as well as other local priorities. If you take a region like Cambridgeshire, for example, the local strategic plan proposes 78 performance indicators that can be used to assess the police's performance. If this was the end of the system it might be possible to argue that it makes sense. The performance management regime translates centrally agreed targets to local priorities. The problem lies in the fact that multiple other bodies also have an influence on police priorities and that these other bodies produce plans such as the National Policing Plan, the Local Policing Plan; the National Crime Reduction Strategy; the Best Value Plan, all of which contained targets and suggested performance indicators. The result is a plethora of performance measures for the police force that fail to communicate strategy or priorities. Recently I had the opportunity to raise this point with a Chief Constable, who replied very politely, saying that I had completely misunderstood the system.

The big advantage of having so many performance measures and targets was that he could always find a good news story for the media, because at any point in time something would be getting better! True, but hardly the intended use of the performance measures.

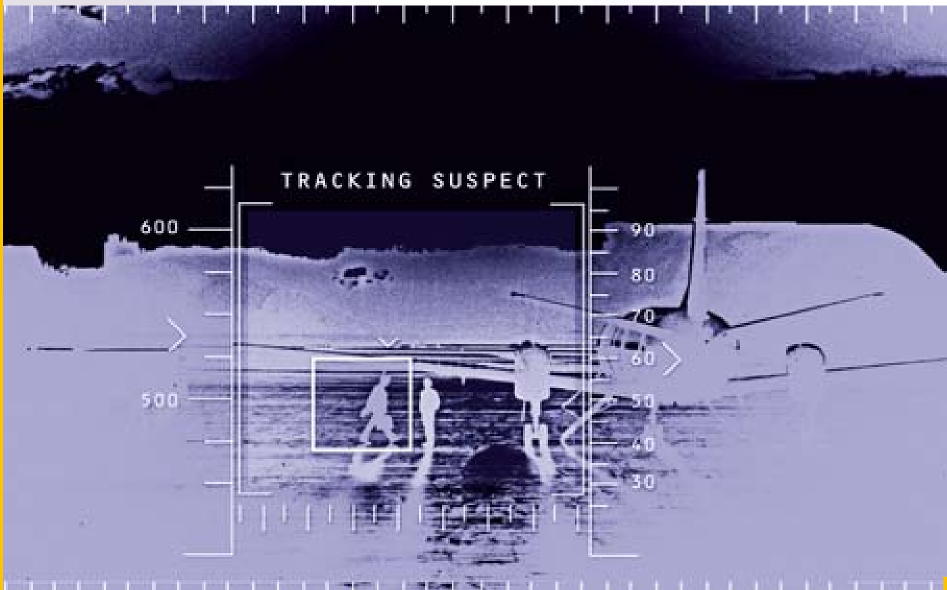
Unanticipated consequences

Although not a new phenomenon, management's desire to quantify has some significant consequences. At the same time that Ridgway wrote his article bemoaning the tendency of management to measure everything that walks and moves, Chris Argyris published some interesting work which highlighted a second challenge of measurement – namely the unanticipated consequences that result. Argyris uncovered a common practice of "stuffing machines at the end of the month to meet budget quotas". A fair question to ask is does this contrast with the behaviours that we see in organisations today? Not long ago I had the opportunity to work with a wholesaler of electrical components. The business, which consisted of around 140 separate branches, was struggling to solve the problem of inter-branch co-operation. While all of the branches were part of the same organisation, they used to compete with each other to win business.

Savvy customers knew that they could request a quote for 100 light bulbs from one branch and then phone a second branch to see if they were willing to undercut the first branch. If the second branch offered a lower quote the electrician would call the first branch again to tell them they would lose the order unless they were willing to beat the new 'best' price. In essence the branch managers in the business were trading away margin, competing with one another. Yet this behaviour, while completely illogical from the business perspective, was perfectly logical from the branch manager's perspective. Only the branch credited with a sale was credited with the profit resulting from that sale.

Each branch manager was measured and rewarded based on the profitability of their branch. So it was perfectly logical for the branch manager to do everything possible to maximise the profitability of their branch.

The problem with single or narrowly specified sets of performance measures is that they encourage local optimisation. It is well known that if performance measures are inappropriately specified then they will encourage people to take actions that improve the performance of one part of the system, but that this can sometimes be at the expense of the system as a whole. The electrical firm's measures of branch profitability encouraged optimisation at the branch level in terms of branch profitability, but simultaneously encouraged sub-optimisation at the firm level.



The search for balance

The way organisations can deal with this problem is encapsulated in the third challenge of measurement – the search for balance. This is not new. More than 50 years ago, that doyenne of management thinking, Peter Drucker, made the case for balance in measurement systems in the *Practice of Management*. He suggested that appropriate performance criteria for organisations were 'market standing, innovation, productivity, physical and financial resources, profitability, manager performance and development, worker performance and attitude, and public responsibility'. It is interesting to note how the performance criteria suggested by Drucker not only encompass everything included in one of the most popular measurement frameworks of the moment – Kaplan and Norton's balanced scorecard – but also extend this framework by foreshadowing interest in the corporate social responsibility agenda.

Today managers are using frameworks such as the balanced scorecard and the performance prism to achieve balance in their measurement systems. These frameworks are designed to encourage managers to think broadly about what success constitutes for their organisation and hence what should be measured. The performance prism, for example, asks five fundamental questions:

- Who are our key stakeholders and what do they want and need from us?
- What strategies are we pursuing to satisfy these sets of wants and needs?
- What processes do we need to have in place to enable us to achieve these strategies?
- What capabilities do we require if we are to operate these processes successfully?
- What do we want and need from our stakeholders too?

By emphasising these multiple dimensions of organisational performance, the performance prism seeks to encourage managers to think more broadly about which measures they should introduce. Importantly, the performance prism makes a distinction between what the organisation wants of its stakeholders and what the stakeholders want from the organisation. Too often this distinction is missed in discussions about measurement. Some organisations appear to assume that customers want to be loyal and profitable. In reality customers want great service and excellent value for money. It is the organisation that wants its customers to be loyal and profitable.

Clearly both sets of wants – those of the organisation and those of the customer – are valid. The important point is to recognise that they are different wants. If the organisation fails to manage the delivery of value to customers, it is somewhat unrealistic to expect those customers to be loyal and profitable.

Addressing the enduring challenges: Learning not control

How might these three enduring challenges of measurement – the desire to quantify, the unanticipated consequences that result and the search for balance – be addressed? Part of the problem is that many people regard performance measurement systems simply as a method of control. Targets are set, performance is monitored and corrective action is taken when performance appears to fall short of expectations. Another way of approaching performance measurement is to think of them as learning systems rather than control systems. Measurement systems provide data that can be used to challenge the assumptions people hold about how their organisation operates.

Learning through measurement: The British Airways experience

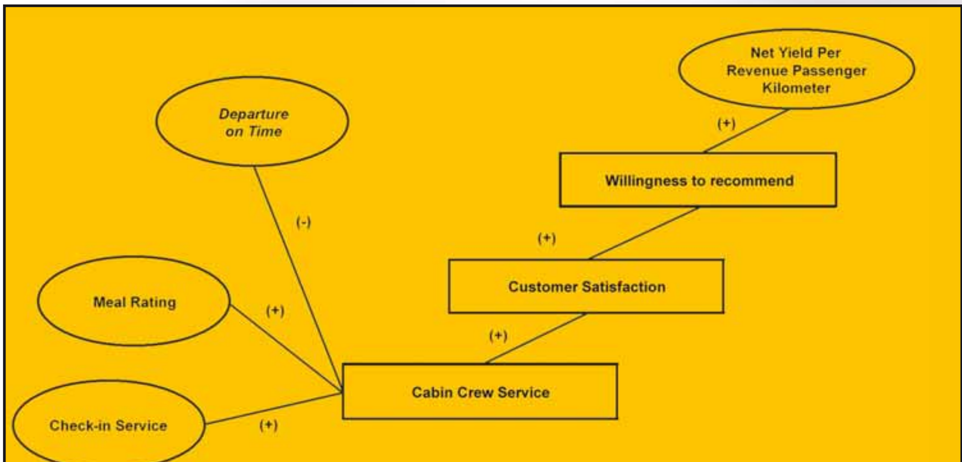
British Airways have one of the most sophisticated customer satisfaction measurement systems in the world. Surveying over 1,000,000 passengers per annum, the firm collects data on every 'moment of truth' – every interaction between the firm and its customers. Research shows how this customer satisfaction data can be used to identify the key drivers of firm performance. Through a combination of statistical analyses the researchers identified correlations between specific dimensions of customer service and firm financial performance.

The most surprising finding was a negative correlation between on time departure of aircraft and cabin crew service. When planes leave late, customers tend to report that cabin crew service is better and when they report that cabin crew service is better they tend to report higher levels of customer satisfaction.

Clearly this somewhat counter-intuitive finding – customer satisfaction is associated with late departure of planes – would cause some debate in any airline. But when thinking about the finding it becomes less counter-intuitive. Consider the service recovery process. When planes leave late the pilot often passes the blame to air traffic control – "I am terribly sorry to have to tell you ladies and gentlemen that air-traffic control have delayed our take-off". A few minutes later the pilot will often announce – "I am delighted to tell you ladies and gentlemen that I have been negotiating with air traffic control and we have agreed a reduced delay" – hence recovering the situation somewhat in the eyes of the passengers. Additionally there is an incentive for cabin crew to try harder when delays have been announced. They do not want to have to look after frustrated passengers for the duration of the flight, so when delays are announced they will offer people extra drinks, newspapers and blankets simply to damp down frustration levels.

The shift from measurement as a system of control to measurement as a system of learning requires some subtle organisational changes. Too often the performance review processes that exist in organisations are set up as interrogations. Senior managers visit particular sites or facilities to review performance. Team leaders gather their troops to explore whether or not they are likely to meet their budgets.

But such reviews simply encourage defensive behaviour. People come to the performance reviews armed with reasons and excuses that justify why performance is not as good as it should be. A much more productive approach is to focus on the future – exploring issues such as how do we get to where we want to be.



Testing British Airway's Success Map

Creating an organisational culture that focuses on the future.

Creating an organisational culture that enables such conversations is far from trivial. All of the language that surrounds performance measurement – performance reviews, performance assessments, performance appraisals – suggests a defensive organisational routine. Even subtle changes, such as talking about 'performance planning' rather than 'performance reviews' can be a valuable first step.

Of course a simple change of language and tone is insufficient. Many organisations are now creating performance management teams to support their efforts to extract insight from performance data. These teams are not simply expected to support the performance measurement. Increasingly they are being asked to play an active role in the performance analysis process. Indeed a core role for performance management teams is to extract insight from data that can subsequently be used to make informed decisions.

The creation of performance measurement teams is a challenge in itself. Clearly the technological infrastructures that many organisations have developed provide access to enormous volumes of performance data. These data have to be analysed and interpreted if insights are to be extracted. Performance analysts need to be able to analyse the company's data using valid statistical approaches. Having done so, they need the intuitive skills necessary to explain what these data mean and then they need the social skills to be able to persuade others of the validity of their analyses.

This combination of skills – the ability to analyse data, intuitively extract insight and sensitively communicate these insights – is in relatively short supply in many organisations, yet it is essential to develop it if the value of performance measurement is to be fully extracted.

The issue becomes ever more important when one considers how much organisations are spending to capture and analyse data. It is almost impossible to find an accurate response to the question: "How much are you spending on performance measurement?" The most common answer from senior managers is an exasperated: "too much". Efforts to reduce the cost of measurement, while maximising the value it delivers have to continue. Measurement is not going to go away, but neither are the enduring challenges of doing it well. What is needed is careful and reflective thought, so that organisations introduce measures that are beneficial rather than problematic.

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