

# Performance Measures: The Most Critical Component

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Performance measures are the most important element in the design of a variable pay program. They communicate what is important and what will be rewarded. If desired performance is achieved, they can create the funding for the variable pay plan PLUS a return on investment back to the company.

Perhaps one of the most popular concepts in performance measures is the Balanced Scorecard. This was popularized by a Harvard Business Review article and a book by Robert Kaplan and Dave Norton. In essence, both argue that organizations take a holistic view of their business and include measures that relate to financial, customer, operational and capability or learning performance. Further, measures were made even more important when companies like Sears demonstrated the linkage between three key measures—*Financial performance* is a function of *customer satisfaction* which in turn is a function of *employee satisfaction*. Finally, the market valuation or capitalization of a company has increased in importance as more companies use stock options as a primary reward vehicle.

The problems most companies have with performance measures lie in three areas:

**1. Selecting measures that reflect their strategy.** If a firm is focused on being a low cost producer, what are the key indicators of performance? If the firm is focused on providing innovative services or high quality, what should they measure? To work effectively, measures must directly reflect the strategy and key success factors of the organization.

**2. Translating measures into meaningful actions.** Selection of measures is only half of the story. To work, people need know what is expected of them. Therefore, people need to understand their roles and desired actions in the context of the measure used by the corporation. This goes for



the CEO down to the most basic level employee.

### 3. Setting meaningful, challenging and achievable performance levels or goals.

Once one selects and defines the measures, what is the desired level of performance or how much is needed to improve? No one ever believes their goals are set correctly, research has clearly shown that when people are involved in setting their goals, they are more committed and achieve higher performance. A key task is to identify the reference point for the goals—historical performance, competitive benchmarking or strategic important (“we just must do this”). Set poorly, people become discouraged and become targets for competitors recruiting efforts. Set effectively, people become committed, engaged and excited about what they do. In other words, be careful what you measure and reward, you will surely get more of it.

Below is a brief list of the measures that we have found are highly effective to many organizations. Hopefully, they will provide some assistance to your critical task of assessing and selecting the measures for a variable pay plan:

Financially focused:

- Revenue growth
- Net income
- Contribution margin
- Economic value added (EVA)
- Earnings per share (EPS)

Customer focused:

- Customer satisfaction
- Share of customer purchases
- Repeat sales from same customer
- On-time delivery
- Cycle time from order to receipt

Operationally focused:

- Budget to actual expenses
- Scrap rate/rework rates
- Accuracy/error rates
- Product/process quality
- Safety

Capabilities focused:

- Employee satisfaction
- Turnover
- Project implementation

In short, measures are easy to understand at a general level, but can be difficult to put into operation at a specific level. Consider the following criteria in the selection and application of the effective performance measure:

**Positive**—People are excited by seeing the numbers move “up.”

**Reliable**—People can trust the measurement process and accuracy of the data

**Objective**—The measures and data are based on fact, not subjective judgement

**Achievable**—The goals are perceived as challenging but reachable

**Control**—The results are within the person’s sphere of influence or control

**Timely**—The feedback on the measures can be tracked and monitored as performance progress

There are no magic measures that will focus a group on what is important. The answer is found in the organization’s strategy and ability to track, understand and respond to performance data. The inspiration to work towards effective goals and measures is to change and improve individual groups and company performance. “If you always do what you’ve always done, you’ll always get what you’ve always gotten.”