THE ART OF MEASURING WHAT MATTERS

To keep measurement systems up to date, managers should conduct annual reviews to ensure they are tracking the right metrics

BY THOMAS BERTELS

> *"Ensure that every measure of performance is pertinent to the achievement of a goal or value of your organization. Otherwise, you risk misdirecting the organization."*
> –Peter Drucker, *Management: Tasks, Responsibilities, Practices* (Harper & Row, 1974)

Even in well-managed, global companies, the failure to measure what matters can lead to unintended consequences. Consider the following real-world scenarios:

- The manager of a pharmaceutical packaging operation proudly announces another record-high production month. Unfortunately, the efforts from that month also resulted in excess inventory of a product about to go off patent.
- The performance quality indicators for a logistics services provider show dramatic improvements over the last two years – yet a third-party loyalty study indicates that share of wallet (the amount of business the company receives from a customer) has dropped substantially over the same time period.

In a perfect world, an effective measurement system aligns the entire organization with its objectives, enables executives to make good decisions and facilitates organizational learning. In the real world, however, the rate of change is ever-increasing. The balanced scorecard metrics defined two years ago often are no longer able to measure what really matters to the business today. The failure to measure the right variables creates unproductive conflict, wastes scarce resources, hinders strategy execution and rewards the wrong behaviors. To help companies avoid these problems without losing the investment put into creating the measurement system, Six Sigma professionals need to be part of a regular review process that ensures the right metrics are being tracked.

Auditing the Measurement System

An annual audit of an organization's entire system of measurement is an effective approach to maintain effectiveness. Depending on complexity and scope, such an audit can take from as few as two days for a department or function to as many as two weeks for a complex business unit.

The first step is to take an inventory of all the current metrics used and review the strategic plan. Interviews with a cross-section of managers provide user perspectives and context. The emphasis of the audit is:

- To test whether the metrics are aligned with the organization's goals.
- To ensure a balance between efficiency and effectiveness measures, as well as leading (predictive) and lagging (confirming) indicators.
- To highlight measurement gaps, blind spots and potential conflicts.

At the individual measurement level, the audit is concerned with whether the metric is still relevant, who owns it, whether it can be validated, who needs to have access to this information and how to make the information more useful. The outcome of the audit is a list of key findings and specific recommendations, which should be reviewed with the respective leadership team.

Ideally, the responsibility for the measurement system should rest with the finance department. The CFO is a logical candidate to own not only financial but also non-financial metrics and to serve as the overall measurement champion. Tactical responsibility for conducting the measurement system audit can be assigned to the comptroller. With respect to timing, the ideal point at which to review the current metrics would be during the annual planning and budgeting cycle.

Keeping Metrics Current

An audit of the current measurement structure, both at the system level as well as the individual metric level, should address the following questions:

1

What Matters Most?

Over the last couple of decades, the rapid adoption of information technology has dramatically increased the ability of organizations to measure virtually every aspect of their business. More information, however, is not always better. Simply because you can measure something does not mean you should. Instead, what are the vital few measures that reflect performance for the entire organization? For example, retail companies are known for measuring sales per square foot, an overarching metric that touches many aspects of a retailer's business.

Leaders would be well-advised to establish and communicate a clear hierarchy of metrics. Other important questions to ask include:

- How well aligned are local metrics with the overall objectives?
- Does everybody in the organization understand how their performance impacts the entire organization?
- Because financial metrics are always lagging indicators, what are the critical few, non-financial measures that your leadership team needs to manage well?
- Do you have leading indicators of performance? How reliable and predictive are these indicators?

Failure to measure the right variables hinders strategy execution.

2

What Has Changed? What Is Missing?

If you are still using the same set of non-financial measures you defined five years ago, you probably shouldn't be. Answering the following questions will help your leadership team review the current inventory of metrics to identify gaps and revise priorities.

- Assuming you review your measurement system annually, what has changed over the course of the last 12 months?
- What have you learned during this period? What assumptions have been proven wrong?
- What changes do you anticipate in the near or distant future? Has the strategy changed?

3

What Should We Stop Measuring?

Keeping a measurement system healthy requires frequent pruning. Given the abundance of information available to executives, the guiding principle is: "If it does not help, it probably hurts." Often, one-time requests from senior executives turn into comprehensive monthly reports that do little to improve processes.

Far too many metrics end up serving the same purpose as the "door close" button in most modern elevators. For the most part, these buttons don't work at all, but give the illusion of control. The effort required to collect, review, analyze, present and discuss measures that have outlived their usefulness should be invested elsewhere.

With each metric, the team should consider:

- What happens if we stop measuring?
- Where have we made enough progress to declare victory and move on to the next challenge?

4

How Do We Resolve Conflicts and Contradictions?

Often, functional or departmental performance indicators are the root cause of friction within an organization. Customer service is measured against perfect order rates and short lead times, but the pressure on the supply chain function to keep inventories low may result in constant fire-fighting and fuel interpersonal tensions.

Mapping the departmental metrics against the overall key business objectives is a good way to highlight, understand and resolve apparent conflicts between departments. Questions to ask when considering how to resolve conflicts include:

- What percentage of your organization's momentum gets lost as a result of avoidable friction among groups just trying to "make the numbers"?
- Does your measurement system align with the needs and requirements of your customers?

5 What Should We Reward?

The failure to align the reward and compensation system with the metrics used to drive the business is a frequent root cause of failed initiatives. For example, say a new supply-chain initiative is focused on reducing inventories, but the management board refuses to change the way sales reps are compensated; as a result, the reps continue to stuff the retail channel, and the leadership is forced to pull the plug on the project.

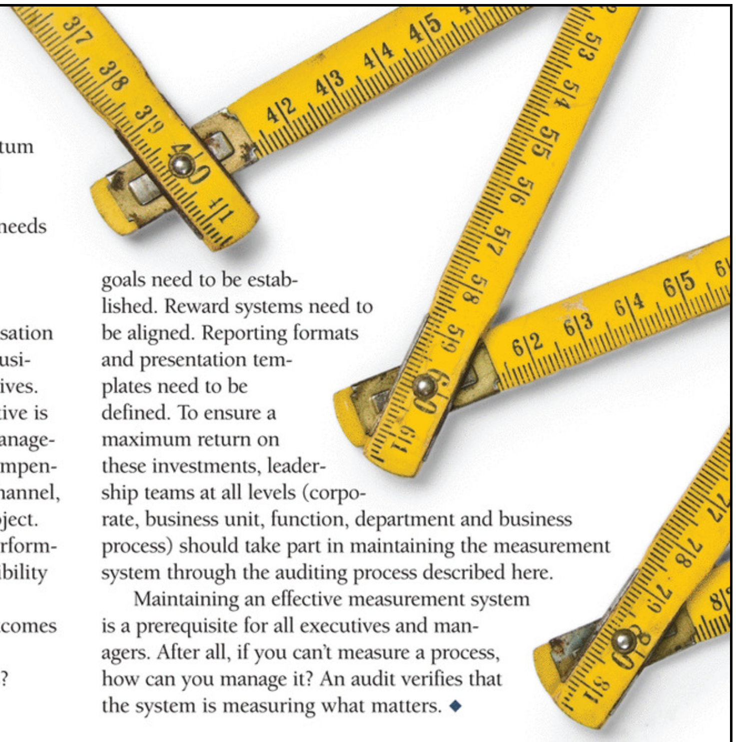
Ensuring individual compensation and business performance are well-aligned is a critical management responsibility that cannot be delegated. Ask your leadership team:

- How do you ensure the right behaviors and outcomes get rewarded?
- Have you considered unintended consequences?
- How do you prevent abuse and manipulation?

Improving Management

Developing and deploying a new system of metrics is typically a significant investment and a time-consuming effort: Leaders need to be involved in every step along the way. Baselines and goals need to be established. Reward systems need to be aligned. Reporting formats and presentation templates need to be defined. To ensure a maximum return on these investments, leadership teams at all levels (corporate, business unit, function, department and business process) should take part in maintaining the measurement system through the auditing process described here.

Maintaining an effective measurement system is a prerequisite for all executives and managers. After all, if you can't measure a process, how can you manage it? An audit verifies that the system is measuring what matters. ◆



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