Brief

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Smart metrics mean smart decisions: essential for speed, agility and resilience

How a mix of the right leading indicators, to match the business model, accelerates progress

Timely, relevant and frequent metrics and feedback are essential for ensuring pace and delivery. This becomes even more important during a recession, or unpredictable period, when you are less certain of what will happen next, and how your customers, employees, partners and stakeholders might behave.

There is a great deal of published material on measurement. Most of it is specialised, focusing on one particular issue or function. But there is also some very interesting research that looks at the overall need for metrics in running a business - beyond the statutory and obvious core financial data.

We looked a range of recent material including work by consultancies Deloitte, Bain and Marakon, as well as later thinking by former MIT professor Michael Hammer.

This distills the best ideas from each of them and summarises the key themes.

Metrics: part of a whole approach to pace, delivery and growth

Organisations that use metrics and feedback effectively do so because they approach them in a systemic way. They understand what is driving their growth and delivery. They have a clear understanding of their business model and know exactly what the key drivers of value are in their business. The metrics they choose are designed around that business model. They make their most important decisions based on these metrics. The business model, metrics and decision-making are all part of one system. For example, UK supermarket retailer Tesco has been well-known over decades of growth for the way the right metrics are integrated into how the business is run, from daily sales data to the analysis of customer loyalty cards.

During a fast-changing environment, or period of increased unpredictability, the role of metrics becomes even more important. Otherwise, how will you know when 'business as usual' assumptions are no longer holding, when the standard market behaviour has changed, or when a 'blip' becomes a major detour or a hard 90° turn? Metrics enable you to quickly pick up the early 'weak signals' of significant change.

Metrics are not good enough in most organisations – two core problems

A joined-up approach between the business model, metrics and management decisions sounds straightforward. However most metrics used by organisations are not produced with this in mind.

In one recent survey by Deloitte and the Economist Intelligence Unit, 78% of CEOs say that they need more than the standard financial indicators, but that their ability to monitor these remains inadequate. Why is this? The research suggests two core problems

Problem 1: metrics remain focused on statutory and retrospective reporting

Over the years, custom and regulation have resulted in a core, consistent set of financial metrics being required for regular reporting of results to shareholders. As a result these are used for measuring all sorts of other aspects of organisation performance - from business planning to target setting and reward. These are metrics that were originally designed for reporting retrospectively, not for managing forward. As Michael Hammer said: "If I know that sales are down and costs are up, that's useful, but it doesn't give me any clues about what to do about it."

Problem 2: additional metrics are owned by functions, not by the top team

While 80% of CEOs say that the core, traditional financial metrics should be the responsibility of the top team, when it comes to other indicators, they should be the responsibility of senior functional managers. The challenge with most metrics designed and owned by marketing, or HR, or IT, or the supply chain, is that they tend to be designed to test the performance of the function (and, if you are cynical, help them justify their budgets and roles). They are not designed as useful measures for managing the business as a whole.

The poor outcomes

This is why the final outcome is, as one of the CEO-based studies suggests:

- *Underdeveloped measurement tools* (“I don’t trust this data”, or “this data is too complex to use easily”)
- *Organisational scepticism* ("your metrics are just about self-justification")
- *Unclear accountability* (“Whose job is it to take action or decisions prompted by the data?”)
- *Concern that useful data will be misused*: it will be revealed to competitors, customers, or regulators so is best not gathered, not used, or not widely known or understood (“we already know what is going on anyway and we must keep it to ourselves”).

The prize: metrics that help deliver, not a self-protecting vicious circle

Research shows that over many years, most organisations fail to meet their strategic goals. On average there is a 63% gap between multi-year strategic intent and delivery. And when looking for causes, it is clear that the performance bottlenecks (where they are and how they work) are often invisible to leaders, due to insufficient processes for tracking and reporting progress. Without such information it is difficult to take corrective action in time to make a difference.

If you mainly rely on historic financial reporting measures, by the time you find out that there is a problem it is too late to close the gap. This in turn leads to a vicious cultural circle where middle and senior managers learn that strategic plans do not get fulfilled, and metrics become the rationale for explaining this failure, and of course a means to justify it.

The prize is clear: the majority of CEOs say that forward looking information, including non-financial measures, is of greater value than historical information.

Recent research makes the point. The best performing 20% of companies are twice as likely to use a range of non-financial key performance indicators to help manage the business, compared to the remaining 80%. Through a range of dashboards, scorecards and auto-reporting processes, they use a small number of regular and frequent metrics to inform decisions.

Proof of success

In particular, one study shows that when looking at these organisations as they strive to improve delivery, those companies that are using a mixture of financial and non financial measures with 'lead indicators', deliver:

- 2 x the improvement rate in "time to decision" compared to the industry average (10% vs 5%)
- 9% improvement in profitability (compared to 7% industry average)
- 9% improvement in net-new customers (compared to 6% industry average)
- 9% improvement in customer satisfaction (compared to 7% industry average).

The research concludes that "the faster and more accurately key metrics can be accessed, reviewed, analysed and acted upon, the better the chance for success".

What is a good measurement system?

A good measurement system is one that can be used effectively to improve business performance. It needs to be an easy to use, practical system that focuses only on what can be controlled or influenced. It should provide regular and timely guidance about what to do.

Example 1: an electric energy supply and distribution company finds the leading indicators that will drive its growth plan: The CEO used to focus on "revenue growth" as the key metric. After years of average performance, the company analysed what the key drivers in the business model were and identified customer retention as key to revenue growth. With further causal analysis, they found that the most important thing to customers was "hassle-free service" - especially that things are done when promised.

The company started measuring how long it took to do an electrical installation and whether it was done when promised. Installation 'as promised' happened 45% of the time and this was an average hiding wide variations. They used the data (identifying where best practice was and transferring it quickly) to improve the average to 75% in one year and 98% in two. Customer retention increased significantly, and so did revenue growth. They had discovered a leading indicator.

Example 2: an insurance company uses leading indicators to drive profits and sales. The leadership team commissioned analysis that identified that a key driver of customer retention was the cycle time to turn around an application for insurance. Performance was measured, good practice identified and radical improvements made. In three years, cycle time was drastically reduced, operating costs were cut by hundreds of millions and their customer service ranking rose from 37 to number 4 in its sector, which in turn led to much more profitable, and higher sales.

Example 3: a global consumer goods company tracks speed to market to drive long-term growth. Looking to improve their long-term growth compared to competitors, the executive team determined that the two key drivers of value in their business model were speed to market of new innovations, and speed to market of existing products to new markets. By tracking these rigorously, reviewing them at executive team level, and making regular interventions to speed up progress, they drove up growth in profit and sales. In parts of the company where this was fully applied, sales doubled over five years.

To quote Michael Hammer: "measurement is not an accounting activity, it's a management activity".

Six steps to creating smart metrics in your business

According to the range of research and published studies, there are six steps to developing an approach to metrics that fully supports the business:

1. ***Understand your business model:*** research shows that while nearly all high-growth, high-delivery companies have a clearly articulated and well understood business model, only about half of ‘non-growth’ companies do. Metrics should be built

on this clear understanding of how the company makes money, and of the drivers of growth and successful delivery. In particular, focus on those aspects which are time-critical: such as: speed of innovation, product roll-out and response to consumer spending patterns.

2. ***Understand the value drivers in the model:*** look at what underpins the business model - at the features which drive long-term success. The sophisticated way to do this is to conduct a statistical analysis of leading and lagging indicators of financial performance - which is much more accurate than depending on assumptions. Xerox spent years, and millions of dollars, measuring and making decisions on the basis of customer satisfaction, believing it was a driver of sales growth. Analysis showed this to be a false assumption and that a true driver was customer loyalty. So they switched to a customer loyalty measure which was found to be a leading indicator of financial performance.
3. ***Identify and design measures to track the key value drivers:*** these should be practical, easy to use and produced regularly and fast (so that the data is current).
4. ***Integrate metrics into the leadership of the business:*** the key measures should be owned by individual members of the executive team on behalf of the organisation, regardless of who has gathered them. They should be regularly monitored and routinely used as an input to key decisions. Some businesses ensure that key metrics are not owned by the person closest to relevant operational delivery to ensure maximum objectivity – so for example in a retailer, it is marketing that report on customer satisfaction (rather than the retail operations team).
5. ***Ensure focus:*** an effective executive team should have fewer than 20 metrics (ideally far fewer – it all depends on the breadth of the business), based on the 'root cause' drivers of value in the business model. Most should be leading indicators and each should have an owner accountable for understanding and applying them. 'Course' corrections should be in the hands of a clearly accountable team member.
6. ***Metrics do not predict the future – and don't forget experience and instinct:*** even the best leading indicators will not tell us what will happen next. We also need anecdotal evidence, intuition and instinct from leaders included in the decision-making process. This, ultimately, is the leaders' role: use the metrics to inform our own judgement and common sense.

An effective organisation will have a clear long-term ambition that does not change often. At any one time, its current priorities may change, depending on what it takes to meet the longer-term goals - and the metrics should be adjusted to reflect this.

What success looks like

A study referenced by Bain looked at the ability of non-financial indicators of intangible assets to explain differences in stock market values. It found that measures including innovation, management capability, employee relations, quality, reputation and brand all explain a significant proportion of a company's value.

Organisations that do not measure and track these cannot fully manage their value. With the right measures, including the leading indicators, it is also possible to anticipate and respond to inevitable external changes. In our current economic environment, this has never been more important.

Sources

Sources used for this article include: *Best-in-Class: Improve Performance Through Use of Key Performance Indicators* (Aberdeen - technology research company; *Why it Matters to Measure what Matters* (Bain in the FT's Mastering Management series); *In the Dark* (Deloitte); Hammer: *The process Audit;* Haspeslagh, Noda, Boulos: Managing for value: it's not just about the numbers (Bain, Harvard Business Review); *Closing the Strategy-to-Performance Gap* (Marakon); *Measure Like You Mean It: Q&A with Michael Hammer* (Financial Executive).

