# STRATEGIC PERFORMANCE MEASUREMENT

by Bob Kali, RK Business Development LLC

Can the small or medium sized business use management techniques more typically used by larger companies? In the opinion of this writer, the answer is a resounding YES!

This paper will introduce to the small to medium sized business (SMB) a “big company” management method known as strategic performance measurement (SPM). It is also sometimes referred to as the “balanced scorecard” approach to strategic planning.

A quick way to introduce the concept of SPM is to compare it to the more familiar tool for managing a business, the company budget process. Most SMBs use a budget to plan and control their business. This very familiar tool is used to communicate to various constituencies, e.g., employees, functional managers, bankers, or board of directors, what’s expected of the business and what activities the company will undertake in the upcoming 12 month period. It is usually broken down in excruciating line item detail of revenue and expenses for each department in the company. This gives everyone a good idea of what the company is expecting of them whether as revenue producers (e.g., the sales department) or as a cost center (e.g., the production department). It also provides a basis for managers to monitor whether the company’s activities are performing at the level necessary to produce the profitability expected for the year. It also can alert everyone to where some problems may lie so action can be taken to address these shortfalls to the plan.

## What is Strategic Performance Measurement?

Now we can move to describing what strategic planning and SPM is all about and why it is just as important (if not more important) to making a business successful as the budget process. Just as with setting near-term direction for the company with a budget, management has the responsibility for setting longer term strategic direction and goals for the company. Examples of strategic management activities are deciding what markets the company will target and determining what is required of the company to compete in these markets. What specific products or services will be offered customers and why? How will a competitive advantage be achieved and sustained with these products and services? How are employees best trained to be most effective in handling the needs of customers? What internal processes are most critical to improve in order to reduce cost or increase level of service?

Simply put, SPM focuses the company on those goals and activities that will make a difference 2, 3, or even 5 years down the road. The lead-lag relationship between strategic activities undertaken in the present is enormous, so the decisions made and direction set is critical the long-term success of the company. Even more important is ensuring the strategic success drivers are being achieved. This is why all employees should be concerned, aware, and knowledgeable of how their day to day jobs are involved with these strategic activities. SPM is a formal way of focusing not only managers but each employee in the company in each department or function on these critical activities.

## The Four Perspectives

SPM and the balanced scorecard provides a very structured set of processes for focusing, measuring, and communicating the company’s progress against its strategic goals. But what guidance do the creators and other proponents of the tool offer about the particular strategic goals a business should set for itself? The developers and other SPM consultants do not necessarily engage in developing strategic plans for their clients. They leave that work largely to the leaders of the company. However, they do offer valuable guidance by suggesting four major business perspectives that a *balanced* set of strategic goals would comprise.

The four strategic goal perspectives are *financial, customer, internal process, and learning and growth*. All successful strategic plans should cover at least the four critical perspectives listed above to be effective in driving the company towards long term success. Some may have more than these four or slightly modified ones depending on the nature of the business, but these four have proven to be the best in terms of a *balanced* set of strategic goals.

## The Lagging Financial Perspective

The goals from the financial perspective tend to be the ones that are the most *lagged* in a *cause and effect* relationship amongst the four perspectives. If one were to monitor strategic goal performance only by evaluating progress against financial goals, it would be too late in the game. The *drivers* of financial goal achievement are actually the goals from the other three perspectives. Financial goal achievement maybe the ultimate desired outcome, but it is critical a *balanced* set of SPM goals is developed that are *linke*d to each other and ultimately the financial goals. Ideally, one should be able to state how each

Written by Bob Kali. (c) 2002-2003 RK Business Development LLC

*customer, internal process or learning and growth goal* will lead, directly or indirectly, to achieving a financial goal.

SPM goal development typically begins with the financial perspective by asking the fundamental question: What financial performance must be delivered to investors or the owners to meet their expectations and to survive as going concern? A set of financial goals would typically begin by targeting rates of revenue growth in the company's product or service lines of business. They would also include long term improvement in profit margins or cost related areas for the lines of business. Financial perspective goals may also target improved asset utilization or reduced cash-to-cash cycle goals such as those related to reducing inventory or speeding the collection of receivables.

Establishing and achieving goals in the remaining perspectives (*customer, internal process, learning and growth*) is where the business game is really won or lost. Again, achieving these goals should *lead* or *cause* the achievement of the *lagged* financial goals. For example, a company may determine that in order to grow its revenue by 20% (a financial perspective goal), it must improve three specific customer satisfaction measures ( *customer* perspective goals). Or to meet that revenue goal *and* increase the gross margin to 50% of revenues, it must improve two critical quality measures in its manufacturing process (an *internal process* goal). In this simple example, customer satisfaction goals and product quality goals will drive future revenue growth and improved profitability. A valid SPM goal system is demonstrated by the *cause and effect linkage* that is established amongst the *balanced* set of SPM goals.

**<u>The Leading Perspectives</u>**

The checklist for goals from the *customer* perspective includes those concerned with improving customer acquisition and retention, increasing market share, understanding customer needs, selling the optimum product mix, improving customer satisfaction and company reputation, and increasing customer profitability. Hopefully one can quickly realize how many of these are linked to each other and ultimately to the financial goals of growing revenue and profitability. The typical checklist for goals related to *internal process* includes improving employee productivity, reducing process cycle times, reducing product or service cost, reducing inventory levels, and increasing service response times. Goals established for the final perspective, *learning and growth*, are usually the most *leading* of the four perspectives and possibly the most effective drivers of long term results. Because they have largely intangible benefits that are not immediately apparent, these goals are the most difficult to justify investing time and money in achieving. These goals have to do with advancing the company's intellectual assets and may begin with simply better training to upgrade the competency of staff employees. Recognizing and rewarding employees for innovative contributions as well as retention and motivation of key contributors to making the company more competitive are all strategies in this perspective to be considered.

**<u>SPM as a Management System</u>**

Before discussing actual implementation of SPM, there is one additional key point to be made with respect to its benefits. As will become more clear in the implementation discussion, one of the benefits of a committed SPM implementation is that it can evolve to become an all encompassing *management system,* even in the small to medium sized business. SPM is not just another set of financial performance metrics nor should it suffer the fate of just another management fad. SPM has been successfully implemented by many large public companies and has evolved to become the management system used to implement and manage significant change in these organizations. The reason for this is that the components of a successful SPM implementation lead the company into examining and changing the way it builds top management consensus, communicates with employees and other company stakeholders, fosters employee and functional strategic alignment, fosters management leadership, and leads to new employee motivation and reward systems. In other words, it is used by many top leaders of companies as cornerstone of a comprehensive management system.

**<u>First Implementation Steps in the Small to Medium Sized Business</u>**

Implementation of a SPM initiative begins at the top. The business owner or top leader of the SMB must be 100% sold on and committed to leading and supporting the process. Often it is this person who is the sponsor of the need for a SPM system implementation as it fits perfectly with the responsibilities of the CEO or COO role. In some situations it may have been suggested by another staff member or outside consultant, but at the end of the day it will go nowhere if the CEO or COO is anything but an unwavering evangelist for the process. Good riddance to the well meaning staff member, e.g., the CFO or Sales VP who tries to launch an SPM implementation without the top leader's full involvement and support. Once the ultimate leader has "seen the light", he or she may delegate the process facilitation task to another company leader. But this will work only after the top person has completed his or her most important task i.e., gaining the buy-in and commitment of the entire functional leadership team. The CFO, the top sales or marketing executive, the top manufacturing or operations executive all need to be an integral part of the early SPM development and leadership process. This group needs to learn about SPM, understand and believe the process will add value, and commit to leading their functional teams through the process. Many times consultants are used to help build this consensus and commitment amongst the leadership team or function as facilitators of the entire implementation process. Once the required level of team commitment has been achieved, then the first major step has been completed and the team is ready to begin the long journey towards transforming the organization using SPM as the system to drive positive change.

The classic SPM implementation steps are: create the vision and strategy; build the top-level scorecard; educate and communicate to stakeholders; cascade the scorecard; create a linked reward system; continuously review progress; and refine the strategy. The steps described are actually a closed loop feedback system that cycle back to the jumping off point, i.e., create or refine the strategy. The closed loop feedback system means the process never ends, i.e., it is a continuous loop. Many companies integrate already existing periodic processes, like the annual budget and resource allocation process into this new continuously evolving process.

The first step listed above will not be discussed in this paper as SPM is not about developing the vision and strategy, rather its value is in ensuring execution of a strategy all ready in place. Before launching into SPM implementation, however, it would be very wise to use the initial management team consensus building process described above as an opportunity to clarify and re-state the organizational vision and strategy. Also, the closed feedback loop nature of a SPM system includes a periodic refinement of the strategy.

So what does the leader of an SMB do next to bring this tool to the company? After defining the vision and strategy for the company, the business leader needs to become an *evangelist* for using SPM to implement it. As previously discussed, one person alone cannot implement SPM nor can the leader "will it" to happen. It must be sold to the company's key managers as SPM implementation is no less a team effort than running the day-to-day business. It is recommended the leader become educated enough so he or she can at least present the case for using SPM to the other key players. Using an outside consultant to help with this selling process is something to consider as it can help overcome internal resistance to change. When ready, present your case along with the implementation plan and secure the necessary buy-in, consensus, and team commitment to go forward.

**Further Implementation – Rolling Up the Sleeves**

With the initial steps completed, the rolling up of the sleeves begins. That is, the team begins building the SPM "scorecard". These are the actual measurable goals that will drive the company toward long range success. As discussed above, these goals should cover the four perspectives: financial, customer, internal process, and learning/growth. Again, a consultant can help by studying your business and facilitating a team process to create the scorecard. However, it is important for the top management team to personally build the scorecard as a team rather then having it appear suddenly from "on-high' or worse yet from the outside consultant. It is recommended that team members drill down for ideas by involving their respective groups in making scorecard proposals. The consultant or company leader should take the responsibility to determine that the final scorecard is valid, i.e., that the goals are long term in nature and are linked to each other to create the desired cause and effect relationship discussed in an earlier article.

Next comes the fun part - finally communicating to the employees what is going on! For the SMB, an all company communication meeting to introduce what the management team has been working on is highly recommended. It is a chance for the CEO to shine by presenting the strategy and vision as well as presenting SPM as the management system to get there. The goal of this communication process is to convince every staff member that their work and responsibilities make a difference. They should see in the presentation of the scorecard examples of their day-to-day functional work being goaled and with progress to be monitored. Ultimately, they should make the connection that what they do is linked to the vision and long term goals of the company.

In larger more complex organizations, there would be a step of cascading scorecards down through the organization In the SMB though, the cascading process make not apply and the company level scorecard would probably suffice. Should the company be large or complex enough, cascading the scorecard involves functional teams taking the company level scorecard and breaking it down to goals relevant to more functional day-to-day work. This results in "mini-scorecards" for functional or departmental work groups and offers a larger meaning to their day-to-day work.

A key implementation step is to design and announce a reward and recognition system for the company and employees in achieving the scorecard measures. Getting creative here and sending the message that management is serious and employees can earn rewards for scorecard progress will give the process its due attention. These rewards should be frequent and low-cost to get the desired effect. More financially significant rewards that are aligned with the scorecard can be implemented by modifying already existing compensation schemes, e.g., changing annual bonuses to be based on meeting scorecard objectives.

Another key SPM implementation step is to continuously review and communicate progress towards the scorecard goals. This means developing a system to measure and report progress to management and for management to keep employees informed through regular employee meetings or written communications. This lets everyone know the leadership is serious about the strategic vision and that it will monitor the steps to get there.

The last step in SPM implementation is to realize there is no last step. The process is a continuous and improving feedback loop. This means every so often, e.g., several times a year or at least annually, the top management team goes back to the beginning of the process and update, refine, improve, change, and generally reflect new learning into the process, i.e., the strategy, goals, the scorecard, etc. Take the attitude that the SPM process is not static nor a one-timer. If you do, you will have achieved the level of using SPM as a management system and not just a measurement tool. If this is the case, SPM will not only have been important to your business; it may have been the key to survival or taking the SMB to the next level!

**Conclusion**

There is much more that can be discussed on SPM. Please refer to the landmark work on this subject for more information: "The Balanced Scorecard – Translating Strategy into Action", by Robert S. Kaplan and David P. Norton. The authors also have a web-site (www.bscol.com) which disseminates updated thinking based on their consulting work.

**About the Author**

Bob Kali is president of RK Business Development, LLC. As a business consultant , Bob provides CFO oriented consulting for early stage through middle market companies focusing on business planning, financial management, and financing strategy. Bob has over 20 years of management experience in corporate finance, general management, and financial services. Bob holds an MBA and is a certified management accountant. Feel free to contact him with any questions or comments you may have at 970-222-2810 or at rk-bd@msn.com.

grow.