



---

This essay is part of a series, *Controllers' Corner: Two-Minute Essays on Financial Management and Control*, which asks industry thought leaders for their opinions on critical issues facing today's finance organizations.

---

# Tracking Performance Trends to Drive Better Risk Management

*Robert Torok, IBM Global Business Services*

*Performance management systems not only provide a means of measuring success for current business activities and a view of planned activities for the future, they also act as a warning signal for risk.*

**Q** How can performance management initiatives support risk management portfolios within an organization? Are there specific finance processes that offer early returns for detecting and managing risk?

The objective of a performance management system – and its underlying management processes – is to enable managers and executives to understand what is going well, what is not, and what the future might look like, given data from the past.

Similarly, the objectives of a risk management process are to provide warning signals of impending or potential events that may impact the organization, and quantify those impacts, while enabling the organization to assess the efficacy of its mitigation strategies.

But there is frequently a gap between these two processes. This is because the performance management and risk management processes are not intertwined, with risks being assessed and managed without a complete understanding of the broader performance implications, while performance decisions are often made without regard for the risks they may inadvertently aggravate or mitigate. Both of these can be looked at through the metaphor of a rock being thrown into a pond: the first ripple is quite large and substantially disturbs the water around the point of impact, but each successive wave causes ever smaller ripples.

In bringing these two processes together, it is clear that strong performance management systems should incorporate measures of risk and be able to predict future results if risks materialize and/or risk mitigation actions are taken.



Consider the following example:

1. The organization starts with a traditional balanced scorecard, as shown in Figure 1. We will focus on customer metrics, shaded lightly in this figure. But there is a significant element missing here, namely, the risks associated with the customer metrics/targets and how the organization can get a warning signal that the risk might, in fact, materialize.

Area	Objectives	Measurements	Targets
<b>Financial</b>	<ol style="list-style-type: none"> <li>1. Exceed market growth</li> <li>2. Profitable growth</li> </ol>	<ol style="list-style-type: none"> <li>1. Sales growth</li> <li>2. Margin growth</li> </ol>	<ol style="list-style-type: none"> <li>1. + 2% / year</li> <li>2. + 5 % in 3 years</li> </ol>
<b>Customer</b>	<ol style="list-style-type: none"> <li>1. Perceived value for money</li> <li>2. Relationships at multiple levels</li> </ol>	<ol style="list-style-type: none"> <li>1. Customer survey</li> <li>2. # of contacts with targeted sponsors</li> </ol>	<ol style="list-style-type: none"> <li>1. Rated #1 by 75%</li> <li>2. 100%</li> </ol>
<b>Internal</b>	<ol style="list-style-type: none"> <li>1. Maximize customer retention</li> <li>2. Develop regional markets</li> <li>3. Identify profitable new markets</li> </ol>	<ol style="list-style-type: none"> <li>1. Win/loss rate</li> <li>2. Potential revenue in sales pipeline</li> <li>3. # of potential customers</li> </ol>	<ol style="list-style-type: none"> <li>1. 60% + in target segments</li> <li>2. Increase by 30%</li> <li>3. Double in 2 years</li> </ol>
<b>Learning</b>	<ol style="list-style-type: none"> <li>1. Develop marketing skills</li> <li>2. Develop customer database</li> </ol>	<ol style="list-style-type: none"> <li>1. % of strategic skills available</li> <li>2. % of customers with key attributes known</li> </ol>	<ol style="list-style-type: none"> <li>1. 100% in 2 years</li> <li>2. 80% in 2 years</li> </ol>

*Figure 1:* The Balanced Scorecard  
Source: Kaplan & Norton, *The Balanced Scorecard*, Figure 10.7

2. Periodically, let us say monthly, traditional performance measurement systems would report customer survey results and number of contacts, with those results analyzed by region, service area, business unit, etc. But these results are received weeks after the fact, and therefore any corrective action might be too late.
3. Hence, the first additional measurement: a warning signal every time a customer does not rate the organization #1 (the target or desired score). This is shown in Figure 2 under the column "Leading KRIs."

Area	Leading KRIs	Impact of Risk Event	Prevention / Mitigation Actions	Impact of Actions
<b>Customer</b>	<ol style="list-style-type: none"> <li>1. Incidence of rating other than #1</li> <li>2. # of contacts, new and/or renewed by month</li> </ol>	<ol style="list-style-type: none"> <li>1. For every 0.25% of shortfall in ratings, revenue loss is \$8 million</li> <li>2. Each new contact is worth \$500K/year in revenue</li> </ol>	<ol style="list-style-type: none"> <li>1. Wider authority to customer service to resolve issues</li> <li>2. Offer incentives to sales force to add &amp; renew contacts, with qualifying criteria</li> </ol>	<ol style="list-style-type: none"> <li>1. Additional customer service costs of \$1 million / year</li> <li>2. Incentives will cost \$400K / year, including allowance for 'contact loading'.</li> </ol>

Figure 2: The Extended Balanced Scorecard

4. A second key data element is also required, shown in the column "Impact of Risk Event," indicating the consequences of not meeting the desired target. Now, the performance management system is beginning to add value: the organization not only has a target and a set of actual results, but it also understands what will happen if the risk event or adverse trend materializes.
5. However, even that is not enough, as the organization seeks to counteract each risk event, in this case a negative customer rating. One common solution is to offer something to compensate a dissatisfied customer at the point where the customer interacts with the organization, such as a hotel check-out desk or during a visit by a sales representative—and before the customer formally evaluates the organization. If the organization's representative identifies a potential problem, they may be given the authority to act immediately, as shown in the column "Prevention/Mitigation Actions" of Figure 2.
6. Now we can extend the performance management system even further. We can ask about the impact of these corrective actions, as shown in the column "Impact of Actions." In effect, what this suggests is that the risk of lower customer satisfaction ratings can be mitigated by granting client-facing staff the authority to solve the problem immediately but at a cost. And if the problems are severe enough, that cost might mean that the organization fails to achieve its financial targets!

Therefore, the most effective way for performance management systems to support risk management is to incorporate those measures that predict events or trends, as well as enable the tracking of mitigation actions. The latter situation is shown in Figure 3, where we have added the period results of our risk mitigation actions, such as tracking the spend on customer service actions as well as the change in performance ratings resulting from those actions.

Area	Prevention/ Mitigation Actions	Impact of Actions	Period Results	Common Actions
Customer	<ol style="list-style-type: none"> <li>1. Wider authority to customer service to resolve issues</li> </ol>	<ol style="list-style-type: none"> <li>1. Additional customer service costs of \$1 million / year</li> </ol>	<ol style="list-style-type: none"> <li>1. Spend of \$430K by service representatives</li> <li>2. 17% reduction in ratings other than #1 from prior period</li> </ol>	<ol style="list-style-type: none"> <li>1. Reduction in price charged or future discount offered</li> <li>2. Free goods or services to customer</li> <li>3. Apology from senior site manager or executive</li> </ol>

FIGURE 3: RISK TRACKING DATA

The role of Finance in these areas is to provide the analytical tools and capabilities to enable performance metrics to be estimated, calculated, interpreted, and reported to senior management. But through it all, it's important to keep in mind that the ultimate goal is not keeping score, but improving the score!

### **About Robert Torok**

Robert Torok is an Executive Consultant with IBM Global Business Services, leading the development of solutions and methods, and delivering Enterprise Risk Management (ERM) services for IBM clients. Mr. Torok can be reached at [robert.torok@ca.ibm.com](mailto:robert.torok@ca.ibm.com).

### **About IBM Business Analytics**

IBM Business Analytics software delivers complete, consistent and accurate information that decision-makers can trust to improve business performance. A comprehensive portfolio of business intelligence, advanced analytics, financial performance and strategy management and analytic applications gives you clear, immediate and actionable insights into current performance and the ability to predict future outcomes.

Combined with rich industry solutions, proven practices and professional services, organizations of every size can drive the highest IT productivity and deliver better results.

### **For more information**

For further information or to reach a representative: [ibm.com/cognos](http://ibm.com/cognos)

### **Request a call**

To request a call or to ask a question, go to [ibm.com/cognos/contactus](http://ibm.com/cognos/contactus). An IBM Cognos representative will respond to your enquiry within two business days.



---

© Copyright IBM Corporation 2010

IBM Canada Ltd.  
3755 Riverside Drive  
Ottawa, ON, Canada K1G 4K9

Produced in Canada  
May 2010  
All Rights Reserved.

IBM, the IBM logo, [ibm.com](http://ibm.com) and Cognos are trademarks or registered trademarks of International Business Machines Corporation in the United States, other countries, or both. If these and other IBM trademarked terms are marked on their first occurrence in this information with a trademark symbol (® or ™), these symbols indicate U.S. registered or common law trademarks owned by IBM at the time this information was published. Such trademarks may also be registered or common law trademarks in other countries. A current list of IBM trademarks is available on the Web at "Copyright and trademark information" at [www.ibm.com/legal/copytrade.shtml](http://www.ibm.com/legal/copytrade.shtml).

Other company, product and service names may be trademarks or service marks of others.

References in this publication to IBM products or services do not imply that IBM intends to make them available in all countries in which IBM operates.

Any reference in this information to non-IBM Web sites are provided for convenience only and do not in any manner serve as an endorsement of those Web sites. The materials at those Web sites are not part of the materials for this IBM product and use of those Web sites is at your own risk.

P24432



Please Recycle