White Paper
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IBM

Scorecarding best practices

Choosing metrics and setting targets for performance management

Information Management

Cognos software

Contents

Abstract

Scorecards are a powerful tool for executives to manage performance against strategy. But to perform this critical task, scorecards have several basic requirements. First, it is vital that executives contribute to setting up the metrics and targets; this is not just IT's job.

It's also important to integrate scorecards into everyday processes and develop a strategy map to show the relationship among metrics. Assigning a strategy officer to own the process helps with these requirements. These scorecarding basics are outlined in the companion to this white paper, Scorecarding basics: How to drive strategy and manage performance.

Overview

The current paper takes you beyond the basics and into the realm of choosing metrics and setting targets. Carefully designed scorecards link employee incentives to outcome, driving the right behavior. Successful scorecards hinge on the care taken when both choosing metrics and setting targets. This effort cannot be taken lightly. Ill-chosen metrics and poorly defined targets inhibit the very goal they strive to create: a focus on performance.

Business problems

Choosing metrics

When choosing metrics or key performance indicators (KPIs), you need to ask yourself the following questions

1. ***Is this KPI strategically important?*** Just because you can include a metric doesn't mean you should. While it is easy to add metrics to a scorecard, every metric added makes the scorecard more of a monitoring tool and less of a management tool. A good management metric is cross-functional, clear, well-aligned with customer value, and actionable.

2. ***How would your customer feel about the metric being red?*** We often focus on how people will view a metric internally. But if your customer would be indifferent to or happy with a "red" metric, your metric is misaligned with your customer. Answering this question will help you focus on the value you provide to your customer.

3. ***What will you do if the metric turns red?*** If you cannot define the action you will take, the metric is probably not worth managing. Thinking through this process is good discipline for making your metrics actionable.

4. ***How will you set up targets?*** Who will define the policy for the metric and how? Target setting says a great deal about an organization. If teams are overly hesitant to define targets, it's clear that goal ownership will come more slowly. In addition, soft targets will engender far less discipline about the results.

5. ***Are there any negative consequences of improving the metric?*** A check processing house that improves check turnaround time may experience a decline in quality. The reduction in time might be worth the quality decline, but thinking about the tradeoff in advance can help you understand the correlation among metrics, quantify the impact of meeting a target, and focus on your goal.

If your metrics stand up to these questions, you have likely identified a metric that is well-aligned with the business. Since we usually measure business processes in time and money, your metrics should be mindful of the value your business processes create.

Setting Metric Targets

Metrics vary in the direction they move and the way their thresholds are set. Some green scores represent the lowest value; others, the highest. Some will appear green when the metric is above target; others, below. You will need to define the correct setting in your scorecarding software to reflect the correct behavior for the metric. Below are three ways to define green metrics.

- **Above target:** The metric is green when the value is above the defined target. Typical examples here are revenues, profits, and customer satisfaction scores.
- **Below target:** The metric is green if the value is below the target. Common examples here are expenses or response time.
- **On target:** The metric is green if the value falls between a high and a low mark. Examples here are manufacturing controls (Six Sigma process controls) or just-in-time inventory levels.

Business drivers

Target and Metric Type

There are a few options to consider when choosing how to measure your business and set corresponding targets. Setting the right kind of targets lets you send the right message and ensure the right behavior that leads to your strategic goals. The type of target you choose will depend on the nature of your business, your goals, and the metric itself. The right type of target will help you move in the right direction from month to month.

- **Discreet/raw value:** This is the most common type of metric target. A discreet value uses a raw score for each period. Use this when you know your values change period over period and the goal is the success of the individual period. You can set targets individually by period, or flat throughout the cycle.
- **Year-to-date (quarter-to-date, month-to-date):** Use this type of target when the only thing that matters is hitting an annual (or quarterly or monthly) goal.

Measure your progress against that goal with increments leading up to the target for the time period. A sales rep annual quota is an obvious example here, a "perform or perish" metric where the goal and the repercussions are clear.

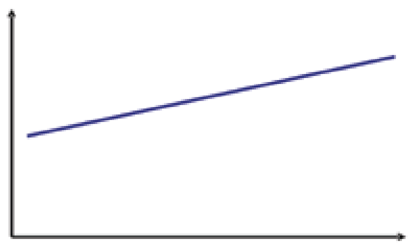
- **Rolling averages:** When your discreet or raw scores vary too much to tell you something meaningful, a rolling average smoothes out the extremes. It is useful when an annual, quarterly, or monthly target is not well defined and the real goal is continual improvement. A common application is the rolling 12-month average, which uses the scores from the last 12 months, adding the most current value while dropping the first. It could also be a rolling four-quarter, 52-week, or three-month average: any amount that smoothes out the values.

Target Variations

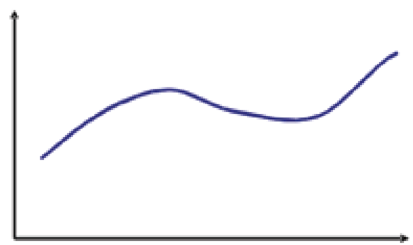
It's important to understand the picture of your data before setting your targets. The target needs to follow the real-life pattern of your data. Using a flat trend line to track data with natural seasonal fluctuations may result in the wrong message: an artificially red metric causing people to respond when there is no need, or, worse yet, a green metric when in fact action is required.

Metrics often follow trends. You will need to do some research to understand the trend, or, better yet, appoint someone who understands the business in a quantitative manner to own the research.

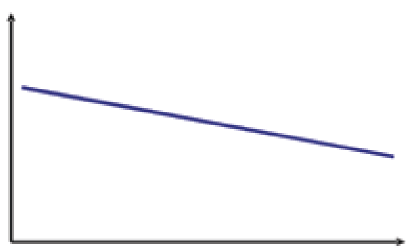
Trend: This is the more common type of target variation, and often takes the least amount of thought. Trends can be linear, curvilinear, or seasonal.



Upward



Curvilinear



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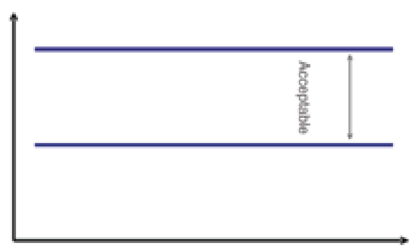

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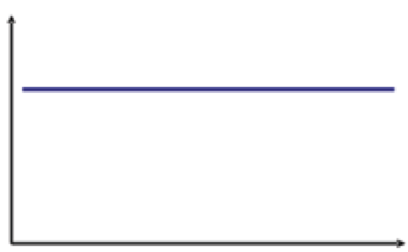

Flat

Continual improvement: Sometimes a precise target is not well defined, and the goal is simply improvement. Here the target is often the last month actual or the same month last year actual. The downside to this type of target is that performance could be less than desirable, yet still appear green.

Indexing: A number of metrics combined create an indexed score. The Dow Jones Industrial Average (DJIA) is a good example. This type of metric works well for measures that need to be combined, perhaps because data is captured at different intervals. An example is when an organization combines customer satisfaction survey results with Days Sales Outstanding (DSO) into an index to measure overall customer service consistently.

Weighted averages: A weighted average is similar to an index, but it combines like metrics. It is an average of the scores based upon the relevance or weight of the individual metrics. For example, to accurately measure the average selling price of a product, you might weight the price in different regions based upon the revenue that region brings in, and the corresponding impact it has on your business.

Rule-based or compliance: Here you want to measure the number of something belonging to a group or corresponding to a certain rule. For example, a cable provider with a goal of up-selling its offering may want to measure the percentage of households simply paying for basic service.

Alternative targets

A secondary or alternative target is another exercise in communicating the goals of the organization and how performance is going to be measured.

- **Stretch targets:** A stretch target is a great tool to drive breakthrough performance. This target is above and beyond the initial target and is usually tied to some type of incentive.

- **Competitive targets:** A competitive target tracks your performance against the competition, typically one or two primary competitors where the goal of the organization is to take over market share.

- **Industry targets:** Similar to a competitive target, this target tracks your performance against the industry average. Use caution with this type of target, however: industry average is typically lower than what you need to aim for. People shouldn't think that above average is good enough. To achieve outstanding performance, look backwards at the average, just as a long distance runner looks back to see how far ahead she is.

The solution

Tolerance

Scorecards can build tolerance, or variance, into a metric's target thresholds. A typical margin of five or 10 percent, for example, provides some latitude for when a metric changes from green, to yellow, or to red. Choosing allowable tolerance is important because the color of a metric drives action and change, and a yellow metric, while cause for alarm, receives far less attention than a red metric. The strategy officer can help to decide whether to include these variances and how much to allow.

Scorecarding is an important strategic tool to communicate goals and create focus throughout an organization. Formally revisiting metrics and targets at regular intervals helps you ensure that metrics continue to provide value to the organization. It also gives you a forum for re-examining and evaluating plans.

Conclusion

Choosing targets carefully will ensure you set the right expectations with employees and communicate the precision to which your organization holds itself. Loosely defined targets can send a message that mediocrity is acceptable. Of course, strategic targets should always be linked to compensation plans to reinforce the right behavior and strengthen the performance message to the organization.

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