SPIs NOT KPIs MEASURING STRATEGIC PERFORMANCE

As most readers know, the Institute of Directors recently issued an updated Code of Practice for Directors. One key feature is stronger and more explicit board responsibility for strategic management (emphasis added):

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3.04 "Engage in the development, approval and monitoring of company strategy"

3.08 "Align director and employee remuneration and incentives with company strategy and performance"

3.15 "…Performance matters relate to value creation and... include strategic risk management and the long-term attraction and allocation of human, physical and financial resources."

To fulfil that responsibility, boards need the right tools. Does your board have them?

We've all heard what happens when you drive a car by looking only in the rear-view mirror rather than through the windscreen. Of course you don't drive your car or direct your company like that. Or do you?

To drive your car safely and effectively where you want to go, you look around and ahead. Occasionally you will look at the dashboard to see what it tells you, especially if a warning light comes on. And you will check the rear-view mirror regularly too. But the main way to navigate safely to your destination, or take interesting opportunities, is to look ahead. In fact modern cars have systems that don't just monitor and warn but also actively support planning and navigation.

What about directing your company?

That's probably quite different. Typically directors receive data centred on financial measures, together with management reports on immediate problems and opportunities. The base data should have been usefully analysed and informatively presented. Non-financial indicators such as customer and staff information may be routinely included. For items such as sales and cash flow there may be forward projections. You may even receive a useful one-page "dashboard" of key indicators. And management reports should draw your attention to longer-term issues not just immediate ones.

But even a good reporting package will tend to be based on "lagging" not leading indicators. For example:

- Dollar figures for revenue and costs look backwards – they are the final score resulting from past decisions and activities.
- KPIs that compare current operational performance with the past or this year's targets tell us little about the future performance that may be needed.
- Non-financial information is often hindsight that misses the real point. For example the rate of staff turnover is a poor substitute for measuring the collective level of capability and potential that company staff have.

So even a good reporting package of the traditional sort will tell us much more about where the company has been and is today than about where it's going. The emphasis is short-term operational performance, not long-term strategic performance. Even a board trying hard to think strategically will have to rely heavily on short-term, specific and lagging measures, and supplement that informally from personal experience and intuition.

Measurement and management

And as we all know, what gets measured gets managed. Management rewards will probably be based on those non-strategic measures. Public criticism about managers being rewarded for achieving short-term goals at the expense of long-term value creation is painful for boards – but often all too true. Can we do better?

The management literature doesn't help very much. There is no established body of knowledge about how to monitor deployment well. Most of what has been written suggests elaborate measurement systems that few New Zealand companies can realistically implement. And a board that demands "more information" can easily swamp itself, or cross the line between government and management. What can we do?

There is no magic bullet. But it is possible to build a framework of objectives, measures and risks that can be used to monitor strategic achievement. Many features of that "strategic dashboard" - particularly its strategic performance indicators ("SPIs") - will be quite different in nature from traditional operational dashboards and their KPIs.

A strategic approach demands measuring things that are often hard to measure. How many companies glibly say "people are our greatest assets" but then give directors far more information about the performance of physical assets than the performance of those people? How many boards receive no systematic information to help them monitor organisational capability, competitive differentiation, customer relationships and internal innovation? How often does an organisation facing a crisis find out that the causes of the crisis lacked visibility at board level until it was too late?

Monitoring

Strategic monitoring will differ somewhat from company to company to reflect business sector characteristics and differences in strategy. Keeping it simple and succinct will not be easy. Customisation is crucial. We can, however, identify some key features good SPIs are likely to display:

- An outside-in view and a focus on what customers value.
- Links to strategic (not operational) risk and the risk/return relationship.
- Leading not lagging measures - SPIs should focus on future success.
- Trends and ratios not point-in-time readings.
- A focus on economic value, unclouded by accounting complexity.
- Benchmarking against external standards and other organisations.

The Company Directors' Course devotes significant time to such issues. But even experienced directors need better frameworks and tools to fulfil their growing strategic management responsibilities. So this year's Senior Directors' Workshops will include a session on "How to Monitor Longer-Term Company Performance and make Management Responsible".

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Conclusion

The key messages for all directors on measuring strategic performance are:

- Monitoring strategy fulfilment at board level is a requirement, not an option.
- The KPI performance measures of traditional financial and management reporting are likely to have a short-term operational focus.
- Strategic monitoring demands a different set of measures - SPIs.
- SPIs should measure what is really important, not just what is easy to measure.
- One size does not fit all. SPIs need to be customised for each company.
- Staff performance measurement, especially at senior levels, should be linked to strategic performance measurement for the organisation as a whole.

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The plan must also take into account potential media and consumer backlash (a spokesperson should be identified who can be the designated point of contact for all inquiries), and communicate internally a consistent message about what the company is doing in response.

As part of any response plan, companies must also determine how they are going to help the "victims". This help can range from credit monitoring of limited duration to full-scale identity-restoration services.

Most importantly, the response plan needs to be tested before an incident occurs. Waiting for an actual incident may be too late. If there are problems with the plan – something completely overlooked, or an element that just won't work in practice – it's better to realise so before the incident becomes headline news. Just as the terrible events of September 11, 2001 taught companies to test their business continuity plans before a disaster occurs, the continuing string of identity theft incidents should be the warning to corporate executives to develop and test identity theft incident plans.

By Allan Brill and Troy Allen of Marsh Limited's sister company Kroll.

COMPANY DIRECTORS' COURSE, MARCH, AUCKLAND

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Correction to February *Board*room

In an article entitled Why Accreditation? *Board***room** stated Sandy Maier was a director of the Shareholders' Association. The information on which this was based was incorrect. Mr Maier is not a director of the Shareholders' Association.

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