IN AN EPISODE of Frasier, the television sitcom that follows the fortunes of a Seattle-based psychoanalyst, the eponymous hero’s brother gloomily summarizes a task ahead: “Difficult and boring – my favorite combination.” If this is your reaction to the challenge of improving the measurement of your organization’s performance, you are not alone. In my experience, most senior executives find it an onerous if not threatening task. Thus they leave it to people who may not be natural judges of performance but are fluent in the language of spreadsheets. The inevitable result is a mass of numbers and comparisons that provide little insight into a company’s performance and may even lead to decisions that hurt it. That’s a big problem in the current recession, because the margin for error is virtually nonexistent.

So how should executives take ownership of performance assessment? They need to find measures, qualitative as well as quantitative, that look past this year’s budget and previous results to determine how the company will fare against its competitors in the future.

In the following pages I present what I’ve found to be the five most common traps in measuring performance and illustrate how some organizations have managed to avoid them.

**Trap 1 - Measuring Against Yourself**

The papers for the next regular performance assessment are on your desk. What are those numbers? Most likely, comparisons of current results with a plan or a budget. If that’s the case, you’re at grave risk of falling into the first trap of performance measurement: looking only at your own company.

To measure how well you’re doing, you need information about the benchmarks that matter most—the ones outside the organization. They will help you define competitive priorities and connect executive compensation to relative rather than absolute performance—meaning you’ll reward senior executives for doing better than everyone else.

The trouble is that comparisons with your competitors can’t easily be made in real time. You have to be creative about how you find the relevant data or some proxy for them.

One way is to ask your customers. Each branch of the company telephones a random sample of customers and asks whether they will use services again. When the index goes up, the company is gaining market share; when it falls, customers are taking their business elsewhere.

**Trap 2 - Looking Backward**

Beating last year’s numbers is not the point; a performance measurement system needs to tell you whether the decisions you’re making now are going to help you in the coming months. Look for measures that lead rather than lag the profits in your business.
The quality of managerial decision making is another leading indicator of success. Boards must assess top executives’ wisdom and willingness to listen. Qualitative, subjective judgments based on independent directors’ own experience with an executive are usually more revealing than a formal analysis of the executive’s track record.

Finally, you need to look not only at what you and others are doing but also at what you aren’t doing. **The managers of one European investment bank told me that they measure performance by the outcomes of deals they’ve turned down as well as by the outcomes of deals they’ve won. If the ones they’ve rejected turn out to be lemons, those rejections count as successes.** Good management is about making choices, so a decision not to do something should be analyzed as closely as a decision to do something.

**Trap 3 - Putting Your Faith in Numbers**

The problem is that numbers-driven managers often end up producing reams of low-quality data. Numbers-driven companies also gravitate toward the most popular measures. If they’re looking to compare themselves with other companies, they feel they should use whatever measures others use. The question of what measure is the right one gets lost.

Similar issues arise about the much touted link between employee satisfaction and profitability. The Employee-Customer-Profit Chain pioneered by Sears suggests that more-satisfied employees produce more-satisfied customers, who in turn deliver higher profits.

A particular bugbear of mine is the application of financial metrics to nonfinancial activities. Anxious to justify themselves rather than be outsourced, many service functions try to devise a return on investment number to help their cause.

**Trap 4 - Gaming Your Metrics**

In 2002 a leaked internal memo from associates at Clifford Chance, one of the world’s largest law firms, contended that pressure to deliver billable hours had encouraged its lawyers to pad their numbers and created an incentive to allocate to senior associates work that could be done by less expensive junior associates.

Lawyers aren’t the only one: A number of prominent companies have been caught trying to manipulate their numbers.

You can’t prevent people from gaming numbers, no matter how outstanding your organization. The moment you choose to manage by a metric, you invite your managers to manipulate it. Metrics are only proxies for performance.

You can also vary the boundaries of your measurement, by defining responsibility more narrowly or by broadening it. To reduce delays in gate-closing time, Southwest Airlines, which had traditionally applied a metric only to gate agents, extended it to include the whole ground team – ticketing staff, gate staff, and loaders – so that everyone had an incentive to cooperate.

Finally, you should loosen the link between meeting budgets and performance; far too many bonuses are awarded on that basis. Managers may either pad their budgets to make meeting them easier or pare them down too far to impress their bosses. Both practices can destroy value. Some companies get around the problem by giving managers leeway. The office supplier Staples, for example, lets them exceed their budgets if they can demonstrate that doing so will lead to improved service for customers.
When I was a CFO, I offered scope for budget revisions during the year, usually in months three and six. Another way of providing budget flexibility is to set ranges rather than specific numbers as targets.

**Trap 5 - Sticking to Your Numbers Too Long**

As the saying goes, you manage what you measure. Unfortunately, performance assessment systems seldom evolve as fast as businesses do. Smaller and growing companies are especially likely to fall into this trap. In the earliest stages, performance is all about survival, cash resources, and growth. Comparisons are to last week, last month, and last year. But as the business matures, the focus has to move to profit and the comparisons to competitors.

It's easy to spot the need for change after things have gone wrong, but how can you evaluate your measures before they fail you? The answer is to be very precise about what you want to assess, be explicit about what metrics are assessing it, and make sure that everyone is clear about both.

Why do organizations that excel in so many other ways fall into these traps? Because the people managing performance frameworks are generally not experts in performance measurement. Finance managers are proficient at tracking expenses, monitoring risks, and raising capital, but they seldom have a grasp of how operating realities connect with performance. They are precisely the people who strive to reduce judgments to a single ROI number. The people who understand performance are line managers – who, of course, are crippled by conflicts of interest.

A really good assessment system must bring finance and line managers into some kind of meaningful dialogue that allows the company to benefit from both the relative independence of the former and the expertise of the latter. This sounds straight-forward enough, but as anyone who's ever worked in a real business knows, actually doing it is a rather tall order. Then again, who says the CEO's job is supposed to be easy?

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