

## Your Best Performance Measure Is the One You Don't Need

Charles R. Thomas, Jr. and Tom Pryor

Abstract: Much has been written about the recommended use of SMART performance measures ... specific, measureable, attainable, realistic, and timely. While this approach is fundamentally sound, authors Chuck Thomas and Tom Pryor propose ideas and present examples of how organizations are better served by focusing on the improvement of business processes and corporate culture.

Unlike children, business leaders don't like surprises.

Good surprises ... such as better than expected sales revenue for the month ... rank better than bad surprises ... critical raw materials in back-order ... but leaders don't want either type of surprise. And they especially don't want to receive surprises AFTER they occurred. Month-end reports are the WORST way to be surprised. You're learning about a surprise 30 days *after* it happened.

While good news surprises are preferred to bad, they still leave leaders open to criticism. "If you had better anticipated, thing could be even better..." Stripping things down to their bare essentials, investors value firms based upon their perceptions of managers' abilities to anticipate and adjust (Trueman, 1986). The arrival of really good surprises can trigger questions about a leader's ability to anticipate.

Performance measures can be an effective and efficient method to prevent surprises in an organization. This article describes three principles for using performance measures to predict and prevent financial and operational surprises in an organization.

Peter Drucker, the father of modern management, valued questions more than answers. A tax accountant noticed his client gave a significant amount of money each year to a small number of charities. The accountant asked "How do you decide which charities to support?"

The benefactor replied "I have three criteria for my giving. The charity would be negatively impacted if I don't donate. Second, they must be well-managed with low overhead cost. And most importantly, the charity's mission must include identifying and eliminating the root causes of the need for the charity."

The most effective organizations are NOT those with lots of performance measures. Instead, the best focus on social controls (such as culture) and improving processes such that the output is so predictably good, performance measures are no longer needed.

### Create Accounting Control Systems that Prevent Surprises

Create accounting [control] systems that prevent variances to budget—instead of explaining variances with prose. One of the responsibilities of cost accountants at Johnson & Johnson during the 1970s was to provide senior management with written commentary explaining why actual results varied from budget. Accountants repeatedly wrote "The variance was *primarily due to* \_\_\_\_". There were three significant weaknesses in this focus:

1. Accountants wrote about the primary cause 30-45 days after it happened. Too late for managers to act. Closing the books took 10-15 days after month-end. Twenty-first century software and hardware now enable companies of any size to close the books daily if desired.
2. Accountants wrote about symptoms, not the root causes. The advent of Six Sigma and Total Quality Management in the 1980s properly refocused everyone in the

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organization on identifying and eliminating the root causes of the variances. Learning and asking The Five Whys Method enables people to identify the root cause of a variance to standard.

3. Accountants are influenced by their past-tense name, *account* for things *after* they happen. To be of greater value in the 21<sup>st</sup> Century, accountants must strive to create mistake-proof processes that *pronounce* results. By focusing on eliminating the root causes of errors and variances to plan or standard, accountants can influence desired results before they occur.

[insert “The variance was primarily due to...” graphic about here]

### **The variance was primarily due to....**

**Replace**

**Too late to act...symptom descriptions**

**With**

**Mistake-proof processes**

**By eliminating root causes**

Merchant (1985, p. 29) suggested that some controls inform employees where to focus their efforts and motivate them to produce the desired results, while arguing that others are restrictive and involve “making it impossible, or at least more difficult, for people to do things that should not be done” (Tessier & Otley, 2012, p. 176).

Accountants teaming with other disciplines in an organization to identify and eliminate the root causes of errors eliminates what Tessier & Otley say “should not be done”. When implementing Activity Based Costing (ABC), the non-value added activity (NVA) “Machine Downtime” was identified in several manufacturing cost centers. One of the objectives of ABC is to eliminate NVA. Using The Five Whys Method, the ABC implementation team identified the root cause of waste instead of treating the symptom.

The team asked Why five times:

*Q1: Why does the machine have downtime?*

*A1: Because we run out of raw material?*

*Q2: Why do you run out of raw material?*

*A2: The inventory record said we had more than we actually do.*

*Q3: Why is the computer inventory record wrong?*

*A3: The receipt quantity from our supplier is occasionally wrong.*

*Q4: Why is the receiving data wrong?*

*A4: We have two receiving docks with two data terminals that sometime overwrite the correct data.*

*Q5: Why do we have two receiving docks?*

*A5: We don't have enough space to receive using our current delivery process.*

Machine Downtime will not be eliminated until one receiving dock with one data entry computer terminal is achieved. The accountants implementing the ABC system led to both an

elimination of non-value added cost but also the need for a Machine Downtime performance measure. That's the best measure...the one they do not need.

## **Rely Upon Social Controls—Rather than Technical Controls When Possible**

Technical controls, defined as controls that specify how tasks are to be performed (Perrow 1986) and how individuals and groups are organized (Malmi & Brown, 2008), are based on rules, procedures and standards. These controls govern day-to-day activities (Tessier and Otley 2012, 180). Technical controls are necessary, increasingly necessary as organizations grow in size, become more decentralized, and jobs become more specialized. Just as planning is a 'tax on doing', technical controls are a tax on doing.

Social controls (core values, beliefs, norms, and symbols) provide an alternative to technical controls (Tessier & Otley 2012, 179). Social controls appeal "to the emotional, non-rational, affective elements within employees (Ray, 1986, p. 288). Reliance, as much as possible, upon social controls promotes efficiency. Unnecessary reliance upon technical controls represents a form of waste.

[insert "Rely Upon Social Controls" graphic about here]

### **Rely Upon Social Controls Appealing to employees' emotional and affective aspects**

#### Herb says, "give 'em the rope"

Clear guidance—plus empowerment—provides social control. Southwest Airlines has long followed a path of enlightened empowerment.

Herb Kelleher, co-founder, Chairman Emeritus, and former CEO of Southwest Airlines recounted his visit one evening several years ago to one of the airline's aircraft maintenance facilities. It was a social call--just Herb out visiting to see how things were going. What he found was a hornet's nest of angry dockworkers. Angry about their Leaders, angry about their work, angry about their working conditions, Herb got an earful of "Southwest Airlines really sucks! Southwest is a terrible company!" (Guinto, 2006, p. 109). Herb listened patiently to the several tirades as the mechanics recounted numerous beefs. Then, Herb went about sorting out the issues; well, when Herb got to the bottom of the matter, he discovered that the problems stemmed from one significant issue--a rope. It seems that the mechanics needed a rope to be able to carry out their work. They'd been asking for one for some time and their requests had become demands, but...no rope.

Herb's solution was Southwest-simple (and Solomon-like)--give 'em the rope!

Herb recounts this story to illustrate a couple of key points. One, the job of leaders is to serve. When your team needs a rope to do their job, get them a rope. If that's problematic, then the leader should stay on it, redouble his or her efforts, look hard for ways to overcome the barriers. That's what our fellow employees expect of us. That's what we do each and every day for our customers--find a way to make it happen.

The second reason that Herb likes to recount this story is to emphasize the directness in decision-making that Southwest leadership requires. If a resource is needed to carry out your mission, you get the resource. Budgets are important guides to our spending, but no budget should

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ever stand between a Southwest employee and what he or she needs to get the work done--and safely. As management accounting pioneer Charles T. Horngren (2004, p. 210) has described budgeting: "...it manifests the essence of accounting and management...Budgets have often led to misguided and/or unethical decisions. Sometimes managers have erroneously picked the budget as their villain. But budgets are inanimate tools. They can be used widely or stupidly."

These norms are deeply embedded in the accountability structure of Southwest. For unusual and infrequent spending, Leaders follow a careful process to obtain authorization prior to committing our moneys. But, if something is needed to get the job done--all bets (all bureaucracy/administration) is off. Get what your folks need to operate flights, load bags and cargo, handle customers. When the dust settles and you've delivered that legendary customer service that Southwest is known for, then go back and carefully follow the prescribed procedures. Just note that you've already committed Southwest to the costs--because that's what it took to make it happen for your customers. No budget, no forms in triplicate, no five signatures--just you doing the right thing for Southwest.

If a rope is needed, give 'em the rope.

Here's another example provided by Herb himself:

*"A probationary agent at BWI – I just love this one – she wrote me a little note and said, "Herb, I'm a probationary agent," she hadn't been there six months, and she said, "I hope you mean what you say," and then she proceeded to tell me that because an airplane couldn't get into the airport at Islip because of weather she went out and hired five buses to take the passengers to Islip.*

*So we told her "we not only approve, but you're our Star of the Month." That kind of thing goes on ALL the time at Southwest Airlines, and people feel free, and if it doesn't work out, or if they do something that would bankrupt us if everybody did it, again we address it on an individual basis. We sit down and say, "we applaud your intentions," but if everyone at every one of our stations did this we might go broke. And this is why we'd ask you not to do it again. Although, we'd laud the attitude you showed in doing it (Cohen et al., 2004.)*

All workers at Southwest Airlines are empowered, through 'mission orders', to provide safe, reliable service. And this is continually reinforced through storytelling. If a rope is needed, give 'em the rope!

### Storytelling Reinforces Social Controls

Herb Kelleher's "rope story" illustrates Southwest Airlines' use of storytelling to reinforce a social norm of exercising facts-and-circumstances judgment rather than slavishly following technical controls such as budgets.

### Nurture an Ethos of Frugality

Some successful organizations nurture an ethos of frugality as a social control over spending; that is, some organizations maintain "an enduring corporate trait of consistent, disciplined management of spending to achieve long term strategic objectives and sustainable profit (Anderson & Lillis, 2011). Two such organizations are Southwest Airlines and IKEA.



Figure 1. *Lost Time Is Waste, Too!* By Unknown Artist (U.S. National Archives and Records Administration) [Public domain], via Wikimedia Commons

Southwest Airlines recognizes that its fortunes ebb and flow with economic cycles, interrupted, from time to time, by external calamities and fortuitous opportunities. Tough times tend to bring a clarity of vision as organizations strive to stay on track, return to track, or merely survive. During good times, though, focus can be lost. IKEA and Southwest Airlines share a social control mechanism for retaining focus during prosperous times.

Kelleher explained about Southwest, “It’s our philosophy. We figure there’s going to be at least two crises in every decade, and we’d better be ready for them. My slogan has always been, ‘We manage in good times so that we’ll do well in bad times’” (Johnston, 2006). He has jokingly admitted, “Our pilots have accused me of predicting eleven of the last three recessions” (Freiberg & Freiberg, 1998, p. 62).

[insert “Nurture an ethos of frugality” graphic about here]

### **Nurture an ethos of frugality**

***We manage in good times so  
that we’ll do well in bad times***

**—Herb Kelleher**

IKEA nurtures frugality through humility, simplicity, and a focus on waste. Ingvar Kamrad, founder, has said:

*The true IKEA spirit is founded on our enthusiasm, on our constant will to renew, on our cost-consciousness, on our willingness to assume responsibility and to help, on our humbleness before the task, and on the simplicity in our behavior...waste of resources is a mortal sin at IKEA. Expensive solutions are often signs of mediocrity, and an idea without a price tag is never acceptable (in Bartlett & Nanda, 1990).*

The frugality of companies like IKEA and Southwest Airlines is not a temporary or periodic attention to cost reduction; rather it is an essential feature of corporate life in which employees take pride in eliminating waste and treating corporate resources with a sense of responsibility and stewardship. Reactive cost cutting is the antithesis of true frugality; its use indicates a failure to

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consistently manage costs for a plausible range of economic circumstances (Anderson & Lillis, 2011).

Anderson and Lillis (2011) have studied frugal organizations and report the following for the companies they examined:

- Frugal companies are more likely to employ methods of rigorous evaluation of capital spending.
- Frugal companies are no more likely than others to employ layoffs (voluntary or otherwise), salary freezes or reductions, reduction or restructuring of benefits packages, or outsourcing to suppliers with lower labor cost.
- Frugal companies are far less likely than less frugal companies to reduce service to customers as a means of managing costs.

Consistent with Kelleher's quote, Anderson and Lillis (2011) offer this explanation:

*Because frugal companies have conservative approaches to spending, they are rarely in a position of responding to crisis....Rather, they structure themselves around conservative estimates of business activity and make greater use of methods aimed at "flexing" to higher levels of activity.*

Performance measures do not by themselves create corporate culture but measures can be counter-culture. Leaders should ask and answer a question during the annual planning and budgeting process: Does this measure promote or prevent the corporate culture we desire?

## Focus the Metrics You Do Use

When it comes to performance measures, more is not better.

*"A Non-essentialist thinks almost everything is essential. An Essentialist thinks almost everything is nonessential."*

If we go back to 1972 and invest a dollar in each company in the S&P 500, the company with the greatest return on investment by 2002 is Southwest Airlines. Author Greg McKeown (2014) attributes this result to Herb Kelleher's essentialist approach to business. "Kelleher was totally clear about what the company was—a low-cost airline—and what they were not." To successfully implement a strategy, such as Kelleher's, it is essential to limit performance measures to a small handful that support fulfillment of the strategy.

### A Focus on Everything is a Focus on Nothing

While performance measurement and reporting systems are intended to improve results by increasing overall effort while reducing efforts that are at odds with organizational objectives, they may have just the opposite effect. (Robert Kaplan (2006) invoked the second law of thermodynamics, referring to unfocused efforts as orthogonal and occasionally even subtractive, rather than additive and reinforcing.)

[insert "About Seven to Ten" graphic about here]

**About Seven to Ten**  
**Number of objects a**  
**highly-skilled person can**  
**juggle**

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Art Schneiderman (1999) offered the “juggler’s rule of seven to ten” as a guide. About seven to ten is the number of objects that a highly-skilled person can juggle successfully. Schneiderman’s recommendation was to restrict a scorecard to a single letter-sized page. That recommendation, extended to electronic format, remains sound—and parsimonious.



Photo courtesy of Wellcome Library London; from Newberry (1893)

### Highlight Your Critical Few

In his 2002 book, “How Organizations Work: Taking a Holistic Approach to Enterprise Health”, Alan Brache said it colorfully and succinctly:

*Measuring anything that moves. Anything can be measured. That does not mean that everything should be measured. With an excessive number of dials on the instrument panel (usually more than eight for any one organization, process, team, or individual), (1) too much time that could be spent performing is devoted to measuring performance and (2) the critical few metrics can be lost amidst the noise of other measurement.*

During an introductory visit to a Dana automotive parts manufacturing facility in the 1990’s, the plant manager began the tour at a large wall full of performance measurement charts next to the timeclock. There were over fifty (50) individual charts, all measuring important things such as defects per unit, customer complaints, inventory turns and lost time accidents. But as Brache states, just because the issue measured is important does not mean it should be measured.

The phrase “You get what you measure” is familiar to most leaders. If there are fifty (50) performance measures, what you get in that organization is collateral noise, not corporate harmony of purpose.

### Emulate Automobile Dashboards not Aircraft Cockpits

To focus we need to be able to fixate our eyes on something. Executive dashboards modeled after automobile dashboards with 6 to 8 gauges is an effective method to focus leaders on the most important issues of the organization they lead. Most executive dashboards use numbers and colors.

Numbers measure actual performance compared to a goal. Colors indicate direction of the numbers. Green signifies the measure is tracking in a positive direction towards the goal. Yellow means performance is not improving. Red indicates executive investigation and action is needed.

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Unlike automobile dashboards with six to eight (6-8) gauges, the cockpit of a Cessna 152 has forty-one (41) gauges (measures), including fuel, altitude, attitude, direction and many more. While forty-one gauges is too many for even the most proficient leader to fixate, aircraft dashboards do offer useful performance measurement design principles. Chirag Kataruka suggests that airplane cockpits offer useful clues when designing a corporate leader's dashboard:

- Tell a Story ... Organize the dashboard dials to tell a story. Even though there are over forty dials in an airplane cockpit, there is a story. To tell the story, there is a distinct pattern to the sequence of dials, from left-to-right and from top-to-bottom, incorporated in every model of aircraft. The pattern become part of a pilot's muscle memory. A corporate dashboard should tell a story as the leader scans it horizontally and vertically.
- Placement of the most important metric ... Cockpit gauge placement is based on factors such as flight sequence, frequency of use, and priority. Altitude, fuel and position are placed at eye level. For most businesses, that focal point is revenue, cash and quality.
- Action Orientation ... A cockpit is not an information source – it's a decision-support tool. So is the business leader's dashboard. The dashboard should allow colleagues make better, more informed decisions. The emphasis should not be just on insight but also actionability.
- Automated, but programmed to raise alerts ... The purpose of autopilot is to free pilots to concentrate on a broader set of operations. Autopilot incorporates rules that allow it to raise alerts when manual intervention is needed. This philosophy also applies to corporate dashboards – use green, yellow and red colors to alert the leader to current conditions.

Blog author Chirag Kataruka (2014) cautions that a well-designed dashboard is not guaranteed to produce positive results if the pilot is uninformed and inexperienced. *"One key difference between cockpits and business dashboards is the sophistication of the user. Airplane cockpits are not designed to enable anyone to fly a plane – pilots still must be highly trained. But business dashboards should be simple and easily understood by non-technical business users – designed for the lowest common denominator, with drilldowns available for more sophisticated readers."* Dashboard-based performance measures do not by themselves create high-performing organizations. Performance measures are only effective when read, interpreted and acted upon by high-performing people.

## Conclusion

Peter Drucker said in FORBES magazine in 1997, *"The Salvation Army is by far the most effective organization in the U.S."* No other organization earned as much praise from Drucker for its work in meeting human needs and for developing its volunteers as The Salvation Army.

One of the factors contributing to this praise is the Salvation Army's choice and use of performance measures. Their performance measures incorporate the three principles outlined in this article:

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- The Salvation Army targets the root causes of individual (i.e., alcoholism) and family needs (i.e., unemployment) and defines performance measures for each service area.
- The Salvation Army thrives on a culture of trust and results. Similar to Southwest Airlines, the Salvation Army chooses measures that support, not obstruct organizational culture. Drucker told the leaders of the Salvation Army “*Your fund-raising activity is successful because you are enabling the average American to live up to her beliefs and values and commitments.*” That is a positive culture.
- The Salvation Army uses a focused, narrow list of measures to place their resources where results are being achieved. The Army has about a million and a half volunteers that share the same short list of performance measures as paid staff.

Portland State University Professor of Business Administration H. Thomas Johnson (2007) said, “*Perhaps what you measure is what you get. More likely, what you measure is all you’ll get. What you don’t (or can’t) measure is lost*”. Use the three principles discussed in this article to get the results you want and prevent overlooking something important that might have been lost.

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