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Why Leaders Should Reconsider Their Measurement Systems by Michael Hammer

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THE chaotic state of contemporary measurement was impressed upon me when I attended a senior executive meeting of a major electronics company, at which the company's leaders were carefully reviewing their dozen or so key performance measures.

The executives meticulously examined a list of measures that was notable for its breadth: customer satisfaction, sales closure ratio, market share, order fulfillment time, employee satisfaction, working capital, service cost per customer, customer retention, new product break-even time, revenue per employee, and return on equity. Some of these numbers described overall company objectives (return on equity and market share), some were operational metrics (service cost per customer and order fulfillment time), some were miscellaneous items (employee satisfaction and customer retention).

But what was most enlightening about the meeting and the list of measures was that the executives around the conference table had no idea what could be done to improve any of these numbers. If the numbers were good they would smile. If the numbers were bad they would click their tongues and make a careful note that something would definitely have to be done to improve that measure by the next executive meeting. Then they would move on to the next item.

The measurement system did not connect the numbers to each other in a meaningful way or provide executives with any guidance as to how to improve them.



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[Michael Hammer](#)

Michael Hammer is the originator of reengineering, process-centered enterprises, and superefficiency -- managerial innovations that have become part of standard business practice. He has written four books, including the international best-seller *Reengineering the Corporation*. From his base in Cambridge, Massachusetts, he disseminates his latest ideas and discoveries through public courses and conferences that are attended by thousands of people annually. (3/2002)

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This should not surprise us. After all, most measurement systems were designed not for leaders but

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for accountants so that companies could report their financial results to shareholders and tax authorities. These systems were then inappropriately pressed into service to support management decision making, where for the most part they are useless. When you see that costs are high, sales are low, and profit is falling, you know that action is necessary, but you do not know what kind. Or, to cite an oft-used cliché, "Using financial measures to manage your company is like driving while looking into the rearview mirror."

In simpler times, the dynamics of business were easier to comprehend. When a measurement indicated trouble, leaders intuitively knew what to do. Before the advent of the customer economy, they didn't need sophisticated measurement systems and, for the most part, they could get by with only the most basic financial information. In a world of placid customers and genteel competition, performance was a low priority. Higher costs could be passed along, dissatisfied customers could be safely ignored, and innovation was optional. Businesses were less complex. Customer demands were more narrowly focused, product lines were thinner, and the technologies of manufacturing were less intricate. The size and scale of most operations were a fraction of what they are today. Intuition and relatively simple interventions worked. If sales were down, managers could push their regional sales reps to push their sales reps harder; they could raise or lower prices, or they could fire all the sales managers. Those were the choices. With such limited options for treatment, there was little need for elaborate diagnosis. The analytics associated with sophisticated measurement were overkill.

But now the age of intuition is over. Businesses are so complex and change so rapidly that a gut feel for what is important is extraordinarily difficult to develop and impossible to maintain. There is relentless pressure to improve performance and to do so immediately. It is not obvious what steps are necessary to achieve the required improvements.

The age of intuition is over.

An organization's measurement system should be able to reveal the sources of performance inadequacies. Yet few measurement systems do so. As businesses became more complex and harder to understand, many companies responded by grafting nonfinancial elements onto their existing financial measurement systems. These systems developed as department managers were called upon to improve the performance of their various domains. To this end, managers invented measures to track how their people were doing; they measured cost, accuracy, speed, and productivity, often using dozens of variables. They compiled these statistics with the unarticulated belief that if their employees performed well according to them, then the company as a whole would achieve its overall objectives. This was an idle hope -- no connection was ever made between the items being measured and the company's objectives. Instead, what was created was a measurement monster, a vast outpouring of data that was of little use to anyone and therefore ignored by almost everyone.

Companies need a new approach to measurement, one that begins with the

recognition that measurement is now an essential part of managing. A Talmudic dictum teaches, "Study is not the essence, but action." Similarly, measurement is not the essence, but improvement. The purpose of measurement is not to know how a business is performing but to enable it to perform better. To this end, a contemporary measurement system must have two basic features. First, all data must include a rationale and a purpose; people must know why things are measured and, more important, what they are supposed to do about them. Second, all measurement must be based on a careful analysis of the business, one that links the objectives of the business to the things over which managers and front-line personnel have control. Only then can the recognition of a problematic measure lead to the right actions that will correct it and to improved performance of the business as a whole.

The old saw "Be careful what you wish for, you may get it!" has a business version: "Be careful what you measure, you may get it -- and it may kill you." Unfortunately, it is

What you measure may
kill you.

commonplace for companies to measure their way into disaster when they have not paid sufficient attention to the design of their measurement system. Confronting unprecedented competition in the aftermath of deregulation, one major telephone company was trying desperately to improve customer satisfaction. Its measures of this variable seemed stuck in concrete. Its managers' intuition was good enough to tell them that the caliber of service delivered to customers was a key determinant of satisfaction. But how they measured the performance of the people who helped solve customer complaints was their downfall.

The customer service representatives (CSRs) were measured on personal productivity-how many calls they handled each day. The dispatchers who sent field crews to fix the problems were measured on how much time the crews spent working on site, as opposed to traveling between sites. The field crews were measured on productivity -- how many jobs they finished each day. Everyone did their best to perform well according to these measurements. Unfortunately, all this measurement and diligence produced nothing that was of even the mildest interest to the customer, who was interested in accurate information, the immediate restoration of service, and a neat, durable repair. The CSRs were motivated to end each call quickly, even if that meant failing to give necessary information. The dispatcher was motivated to send field crews to sites that were located close together, even if that increased customer waiting time. The field crews were motivated to finish jobs quickly; the quality of the repair was secondary. In theory, the idea behind these measurements was that the faster everyone worked, the faster customers would have their service back, and the happier customers would be. In practice, the theory and the reality didn't connect.

To make them connect, an organization needs to create a formal, structured, and quantified model of the enterprise -- the kind that scientists and engineers use to describe physical systems. Such a model connects an organization's overarching goals with its controllable activities. Then, the organization needs to create a deliberate process for using measurement data to improve enterprise performance. This process must be structured and focused to use measurement information to identify the causes of inadequate performance and then do something about them.

Building a model of an organization means understanding the dynamics of the business. When it works, it works beautifully. For example, a few years ago, a credit card company wanted to improve customer retention and increase card utilization (that is, to increase both the percentage of customers who renewed expiring cards and the percentage of each customer's spending that went through the company's card), thereby boosting the number of card-carrying customers and the company's revenue from the commissions it received from merchants. The company's leaders had many ideas about how to achieve these goals -- strong ideas. But the leaders couldn't reach a decision because there was so little supporting evidence about which idea was most likely to be successful. To get the facts, the leaders decided to build a model of their business.

The first draft was qualitative and answered the question, Why do our customers buy our product? Answer: they are satisfied with our product and they are not drawn to the competition. The leaders recognized that the second factor was out of their control, but the first was not. They continued building their model, asking themselves what it was about their credit card that satisfied the customer. They made a list: its value (including cost and value-added services), customers' experiences using it, customers' experiences interacting with the company, and the overall corporate image.

The second draft was quantitative. The company used its databases and did research to determine the relative importance of each factor in the qualitative model. Some of what the model revealed surprised them. One service enhancement their intuition told them was important turned out to have little impact on either retention or usage. Corporate image was important to retention but not usage. And so on. As a result, they made adjustments in their priorities and resource allocation. As all the steps were taken, the customers responded just as the model had predicted. Usage and retention -- and in turn profitability and growth -- all went up.

The credit card company had successfully modeled how its products and services affected customer behavior. But this is not a model of an entire enterprise since it does not include the rest of the company's operations. A complete model is one that correlates all a company's specific activities with desired outcomes. Connecting these individual activities to company results is the great challenge in the area of performance measurement and improvement.

Allmerica Financial has created and used such a model with great success. Its managers identified three goals for achieving its financial ambitions. These became the company's overall objectives and were placed at the top of the model. The first was customer retention. The second was employee retention. The third was to add more products and acquire more partners to distribute them.

Then the company analyzed each of these goals, and came to understand what factors would lead to achieving each goal -- and which of these factors Allmerica could control or influence. For example, using an industry-wide measure of customer satisfaction, the Dalbar rankings, Allmerica discovered that it ranked 37th out of 55 companies on the list. Like the credit card company described earlier, Allmerica undertook, through research and surveys, to determine what would

improve customer satisfaction. It made a model -- a fairly complex one -- and in a very disciplined way set out to climb to the top of the Dalbar rankings. Two years later, it was number 4 out of 55 while cutting expenses by tens of millions of dollars. Its people were able to cut costs because their model allowed them to stop doing what was unnecessary and to concentrate on what was important -- serving the customer!

Once a company has a model, it has to use the information it generates. Duke Power has 200 measures, each of which tracks an important aspect of the company's progress toward its goals: boosting revenue and cutting costs. Every month, the 200 go out in a notebook to every manager, providing a freeze-frame image of the company. Each measure is on its own page: current value, trend over the past several months, value in each of the company's locations. Team leaders receive printouts of the measures that their teams can influence and for which the teams are held accountable. (Teams are held accountable for a set of measures, not just the lagging ones, to prevent slippage.)

This -- or any other -- organizational model is not useful until a formal system for using the information is created. First, target levels must be established for each of the important measures. Then actual calculations must be performed regularly so that the value of each measure will be known. Then the obvious comparison must be made between achievement and aspiration. If all measures are on target, then no improvements need to be made. If they are not, managers must intervene by addressing the root causes of the performance problems.

Most managers know how to recognize and handle problems that stem from inadequate individual performance. But what can be done when individual performances are fine yet organizational performance lags? The first step is to recognize that when this occurs, the strong suggestion is that the fault lies with the model and how it connects the company's goals to the work the people in the company are doing.

There are two possibilities to investigate. First, the model may have been flawed from the outset. Perhaps the model makers did not understand their customers well enough so the company's imperatives have been incorrectly defined. Second, the model may have become obsolete as a result of changes in customer needs or competitors' actions. Using models as a basis for measuring is an excellent way to keep up with changes in the marketplace in a disciplined fashion. It is to be expected that models will be revised and retooled over time as conditions change. In either case, when a model isn't working, it needs to be updated, and the whole cycle begun again. As with so many things, the true value lies in the process, not in the end result.



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(formerly the Drucker Foundation)
320 Park Ave 3rd Fl
New York, NY 10022 USA
Tel: +1 212-224-1174
Fax: +1 212-224-2508
Email: info@leadertoleader.org
Web: leadertoleader.org

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