A Stakeholder Approach to Strategic Performance Measurement

Anthony A. Atkinson, John H. Waterhouse & Robert B. Wells

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A model for measuring a company’s performance helps all members — customers, suppliers, employees, and community — understand and evaluate their contributions and expectations. By focusing on the secondary processes for achieving primary objectives, such as profit, the system provides a tool for monitoring implicit and explicit contractual relationships with stakeholders.

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Management practices have undergone many innovations. Companies have been downsized, delayered, and hollowed out. Newly trained and empowered employees have implemented many innovative practices including continuous improvement, reengineering, just-in-time manufacturing, and total quality management. Outsourcing and exclusive supply relationships now allow organizations to focus on core activities.

Many of these innovations have fundamentally changed the relationships between the organization and its employees, customers, suppliers, and other stakeholders. In many instances, arm’s-length transactions between independent parties have been replaced by long-term partnerships in which intangibles such as service, innovation, and flexibility are essential to success. Intangible, difficult-to-measure resources are driving the creation of wealth in many companies. Consequently, traditional accounting-based performance measures that rely on transaction prices are not as useful.

Most companies use formal performance measurement systems that are extensions of their financial reporting systems. They justify this practice because the financial reporting system provides measures that:

- Are generally regarded as reliable and consistent, thereby giving a solid foundation for developing reward and accountability structures.
- Mesh with the primary objective of creating profits for owners, thereby giving a performance measurement focus consistent with organizational objectives.

However, criticisms of conventional performance measurement systems have been increasing. Critics charge that financial performance measures lack the requisite variety to give decision makers the range of information they need to manage processes. For example, one study concluded: “There’s a growing concern . . . that financial measures are inadequate tools for strategic decision making.” Another study found that inadequately designed and operated performance measurement systems have contributed to corporate decline in the United States.

The conclusion is that performance measurement systems based primarily on financial performance measures lack the focus and robustness needed for internal management and control. Financial performance measures are derived from accounting systems that generate and communicate financial information to support the contractual relationships and the capital markets that result from separating owners and managers in the modern corporation. These accounting systems were

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designed with the priority of consistency and hardness — attributes needed to instantly compare firms and evaluate a firm’s behavior over time. These systems were not designed to communicate decision-relevant information to people inside the organization. Some complaints with conventional financial information are that it ignores important issues like customer satisfaction, cannot predict because it is based on historical cost, and provides little or no basis to judge the effectiveness of processes like personnel relations systems.

Interestingly, governments were the first to identify and respond to the limitations of financial information in managing operations. Governments around the world, particularly in England, New Zealand, and the United States, have invested hundreds of millions of dollars to develop performance measurement systems to make their decision making more effective and operations more efficient. So far, the results of these huge investments seem mediocre at best. A common conclusion is that the performance measurement systems have measured too many things and the wrong things. Performance measurement practice needs an increased, improved focus, which an organization’s strategic planning should provide.

The State of the Art

While several articles have discussed the importance of linking performance measurement to strategic planning so that performance measurement can serve the process of organizational control, there is little documented formal thinking about the nature and scope of an integrated model of strategic performance measurement. A notable exception is Kaplan and Norton’s view of performance measurement, which they call the “balanced scorecard.” The essence of their approach is that the drivers of financial performance are the relationships a company develops with its customers and that the internal business processes that it designs and manages to achieve customer satisfaction define and shape customer relationships. Kaplan and Norton develop a model of how process results create customer satisfaction that, in turn, creates owner results.

While we have no basic quarrel with this process approach to performance measurement, we feel that it is incomplete because it fails to:
• Adequately highlight the contributions that employees and suppliers make to help the company achieve its objectives.
• Identify the role of the community in defining the environment within which the company works.
• Identify performance measurement as a two-way process, which enables management to assess stakeholders’ contributions to the company’s primary and secondary goals and enables stakeholders to assess whether the organization is capable of fulfilling its obligations to them now and in the future.

A stakeholder approach to developing a model of performance measurement captures strategic planning issues. In turn, the choices the company makes in strategic planning must direct and inform the design of the performance measurement system. Designing a performance measurement system in a vacuum — that is, uninformed by the strategic planning process — to evaluate the performance attributes of an operating system creates the possibility of disconnecting performance measurement from strategic planning, which is a common reason that performance measurement systems fail to meet expectations.

Therefore, our approach to performance measurement focuses on one output of strategic planning: senior management’s choice of the nature and scope of the contracts that it negotiates, both explicitly and implicitly, with its stakeholders. The performance measurement system is the tool the company uses to monitor those contractual relationships.

A Model of Strategic Performance Measurement

In this paper, we discuss a comprehensive measurement system, which we call strategic performance measurement. We base our proposal on direct and indirect observations of organizations that have developed, both within their respective industries and with management consultants, reputations for skill in managing specific organizational facets. First, we describe our view of the nature of an organization’s objectives. We then consider the traditional roles of performance measurement and relate them to the three classical roles of organizational members. This process provides an integrated, comprehensive view of performance measurement that meshes with the identified information needs of members. We conclude with a
A discussion of a strategic performance system implemented at the Bank of Montreal, one of Canada’s largest chartered banks, to illustrate the scope of strategic performance measurement and the management and practical issues in implementing these systems.

The Nature of an Organization’s Objectives

The modern organization is a complex web of contracts, both explicit and implicit, that specifies relationships between the company and its stakeholders. A stakeholder is an individual or group, inside or outside the company, that has a stake in or can influence the organization's performance. While all companies potentially can have different sets of stakeholders, each usually has five prominent stakeholder groups: customers, employees, suppliers (of goods, services, and debt), owners, and the community.

There are two groups of stakeholders. The environmental stakeholders are customers, owners, and the community. This group defines the company’s external environment that, in turn, defines the critical elements of its competitive strategy. The process stakeholders are the employees and suppliers. This group works within the environment defined by the external stakeholders to plan, design, implement, and operate the processes that make and deliver the company’s products to its customers.

As a creation of its owners, the company exists to serve their objectives, which become the company’s primary objectives. Here we consider only profit-seeking organizations that choose increasing shareholder wealth as their primary objective. This in no way limits the general applicability of the strategic performance measurement model, which applies to profit-seeking organizations that pursue social and profit-related objectives and to governments. The only requirement of the strategic performance measurement model is that the owners state their primary objectives clearly and, when they conflict, find a way to weight each one.

The nature and focus of the relationships that a company undertakes with its other stakeholders are defined by and reflect how they individually and jointly contribute to helping the company achieve its primary objective. In this sense, the purpose of planning is to identify and undertake relationships with each stakeholder. Inevitably, the planning process begins by identifying customer requirements. Then, by simultaneously considering the requirements and contribution potential of employees and suppliers and reflecting the environment defined by the owners and the community, the company chooses strategies and processes that reflect the relationships that it negotiates with each stakeholder group.

An Organization as Nexus of Contracts

The result of planning is the explicit and implicit contracts that the company negotiates with its stakeholders. The contracts specify or imply both what the company expects from each stakeholder group to help it achieve its primary objectives and what each stakeholder expects from the company in return for its cooperation. The nature and scope of the contracts not only define the company’s approach to competition but also provide the focus for the company’s performance measurement and control systems.

For example, consider a company that makes garage doors. After studying the market and evaluating its internal resources, including employee skills and capital, the company decides that, unlike most of its competitors that produce standard-size doors in batches supplied from inventory, it will compete by providing custom-made doors. Planners think that this strategy will be attractive to customers if the cost is kept low, response time is rapid, and the doors meet customer specifications. Moreover, the planners think that if the company can produce to order, it will significantly lower its overhead costs for storing and handling inventories. The key to this strategy is the ability to de-
sign and operate a production system that makes doors to specification quickly and at a low cost on a one-time basis. The implicit contract between the company and its customers specifies high-quality, low-cost doors made to specification and on demand. In return, the company expects to command a small premium over the market price for commodity doors but, more importantly, to develop strong customer loyalty.

To implement this plan, the company recognizes that it will have to invest in equipment that it can set up quickly for customized production. Moreover, the company will have to train employees in quality techniques so that they can manage a responsive, reliable, and short-cycle manufacturing system. Employees will have to develop skills and accept decision-making responsibilities; that is, they must be motivated, so that they can respond quickly and appropriately to unforeseen production line events. Therefore, the contract with employees reflects increased training and increased decision-making responsibility in exchange for higher wages and a share in profits. The company must renegotiate the entire process until it comes up with a plan that simultaneously meets all stakeholders’ objectives.14

The Nature and Role of Stakeholder Objectives

The purpose of strategic planning is to define the relationships or contracts between the company and its stakeholders that are internally consistent and that help it achieve its primary objectives, which are defined by the organization’s owners. These relationships include specifying what each stakeholder group must contribute to the company to help it achieve its primary objectives and what each stakeholder group expects to receive in return.

What the company expects from and gives to each stakeholder group to achieve its primary objectives are its secondary objectives. Secondary objectives are important not in their own right, but because they are instrumental in helping the company achieve its primary objectives. In this sense, the secondary objectives drive or cause performance on the primary objectives. For example, customer satisfaction, a secondary objective, is deemed important because it leads to increased owner wealth, a primary objective.15

A company’s success is created by monitoring and managing its performance on the secondary objectives, since success in achieving performance on the primary objectives follows from the secondary objectives. Therefore, performance measures of the secondary objectives are the way to improve performance on its primary objectives and should be the focus of the company’s measurement. The performance targets set for secondary objectives become the first focus of attention because they contribute to achieving the primary objectives.16

To manage for results or primary objectives, the company must focus on the secondary objectives that create those results and not on the results themselves.

The Role of an Organization’s Processes

Reflecting the company’s plans, employees design, implement, and manage processes (such as manufacturing systems, logistical systems, personnel systems, and customer service systems) to achieve its secondary objectives, with the expectation that the desired primary objectives will result. Therefore, the focus of the company’s performance measurement system is the performance of the processes related to achieving the sec-
ondary objectives, which members must manage to achieve the primary objectives. For example, the appropriate question for a customer service process is how it contributes to satisfying customers and, ultimately, to improving performance on the primary objectives. This illustrates how members focus on and manage secondary objectives to create results on primary objectives.

To implement a performance measurement system, the company must develop measures for its secondary objectives. For example, a company may have determined that customer satisfaction is vital to its long-term success. The problem is how to measure customer satisfaction. Alternatives include direct measures, such as polling customers, or indirect measures, such as quality, warranty claims, and customer complaints.

Therefore, the company evaluates all processes based on their measured contribution to achieving the secondary objectives. For example, the company might evaluate an incentive compensation system for its ability to increase employee satisfaction with the expectation that increased employee satisfaction will lead to improved performance on the primary objectives (see the model of employee behavior in Figure 1). Performance measurement allows management to test and manage its relationships with employees more effectively.

In turn, if the model proves useful, it provides the insights that management needs to make appropriate design choices in the systems that affect employees.

**Implicit and Explicit Contracts**

As organizations rely increasingly on individual employee and supplier skills, motivation, and knowledge to design the processes and deliver products to their customers, they replace traditional methods of arm's-length contracting for goods and services with new methods. Formerly, they relied on short-term, market-based contracts that use audits to verify compliance with specified, measurable contract parameters, such as quantity, quality, and delivery time. Now they establish longer term, implicit contracts that rely on trust, motivation, and a learning relationship to deliver intangibles such as service, flexibility, and innovation. For example, many companies identify and support suppliers whose roles extend beyond just making products to defined specs to include active participation in new product design. Not only do implicit contracts offer the potential for developing high-quality, lower cost products, but when the conditions are right for implicit contracting (that is, there is a basis for trust), implicit contracts can eliminate or at least reduce the significant transactions costs related to finding partners, writing contracts, and monitoring compliance.

The consequence of this stakeholder view is that companies must meet their stakeholders' requirements to ensure their continued participation. Customers will not buy products that fail to meet their price, quality, and service requirements. Shareholders will not continue to invest in companies that don't meet their return requirements. Communities will not tolerate companies that fail to meet their legal obligations and social expectations. Employees will not develop the skills and knowledge or make the effort to design and manage processes unless the company meets their required employment conditions. Suppliers will not continue to provide their skills, knowledge, and resources to companies that fail to give them an opportunity to earn a reasonable return on the investment of their time and capital. For this reason, organizations must monitor and manage measures of stakeholders' performance to ensure their continued participation and cooperation.

From this perspective, customers, employees, suppliers, and the community are important not in their own right, but because they help the company achieve its primary objectives by giving it what it needs to pursue the strategy designed to achieve its primary objectives. If increasing shareholder wealth is the organization's primary objective, meeting the requirements of the other stakeholders (customers, employees, suppliers, and the community) are secondary objectives. Fail-
ure to achieve secondary objectives will cause the stakeholder group to withdraw its contribution from the organization, thereby impairing its ability to achieve its primary objectives.

The Role of Performance Measurement

With performance measurement, an organization can monitor the implementation of its plans and determine when plans are unsuccessful and how to improve them. In short, the performance measurement system is the heart of the control system that provides for organizational learning.

Based on our visits with twelve high-performing companies, we believe that a performance measurement system must do four things:

1. Help the company evaluate whether it is receiving the expected contributions from employees and suppliers, the elements of its internal stakeholder group, and the expected returns from customer groups. If the contribution is not what it expected, the company must find out why and make corrections. This element relates to value received from suppliers and employees.

2. Help the company evaluate whether it is giving each stakeholder group what it needs to continue to contribute so the company can meet its primary objectives. By monitoring this element, the company can identify problems quickly and correct them before they significantly affect the primary objectives. This relates to value provided to the stakeholders.

3. Guide the design and implementation of processes that contribute to the company’s secondary objectives. For example, monitoring the on-time delivery performance of a logistical system determines when the system is unable to meet its targets and suggests how those failures affect customer satisfaction. By monitoring and comparing performance to plan, the performance measurement system identifies the logistical system’s failure to operate as planned or its inability to meet expectations. It thereby implies the need for a major redesign or new system, a process of organizational learning. This relates to process efficiency.

4. Help the company evaluate its planning and the contracts, both implicit and explicit, that it has negotiated with its stakeholders by helping it evaluate the effect of secondary objectives on its primary objectives. For example, planners may think that a high level of employee satisfaction is vital to success and that guaranteed internal promotion to open positions is critical for employee satisfaction. There are two causal links in this chain—first, that internal promotion is important to achieving employee satisfaction, and second, that increased employee satisfaction leads to increased performance on the company’s primary objectives. The performance measurement system, by providing contemporaneous measures of performance on primary and secondary objectives, helps managers test their beliefs about these two causal links. They can also evaluate the efficacy of the cost-benefit estimates underlying the give-and-take relationship that they negotiated with each stakeholder group. This, again, supports a process of organizational learning and relates to the company’s strategic properties.

Therefore, the company’s strategy and structure define the breadth of the performance measurement system and the roles that it defines for each stakeholder group. The contributions and requirements that the company negotiates with each group and the contribution that each process makes to achieving the secondary objectives defines the focus of the performance measurement system (for a summary, see Figure 2).

We now consider the specific design and nature of strategic performance measurement systems and how they support a company’s control process by reflecting and meshing the key elements of planning and by supporting organizational learning.

Managing with Performance Measures

Organizations today face intense competitive pressure to do things better, faster, and cheaper. In response, successful companies have developed three broad strategies:

First, companies have hired, trained, and empowered employees to use information and skills so that the organization will be more knowledgeable and responsive to pressures for change. In performance measurement’s coordinating role, it directs and focuses decision makers’ attention on the company’s primary and secondary objectives.

Second, many companies have chosen to collaborate more fully with key stakeholders, particularly customers, suppliers, and employees, to design more ef-
Coordinating Role
Current management recognizes the nature and potential of the knowledge worker. In a comparison of employees to the members of a symphony orchestra, each orchestra member is an expert and has a unique skill and knowledge. However, if the orchestra leaves each member to his or her own devices to play whatever and whenever, chaos results. Therefore, the orchestra members need a conductor and a score to tie their individual activities together. Drucker has described the importance of clearly stating organizational objectives: “Because the modern organization is comprised of specialists, each with his or her own narrow area of expertise, its mission must be crystal clear. The organization must be single-minded or its members will become confused. They will follow their own specialty rather than apply it to the common task. They will each define ‘results’ in terms of their own specialty and impose its values on the organization. Only a focused and common mission will hold the organization together and enable it to produce.”

Performance measurement focuses and coordinates the decision-making activities of the knowledge workers to whom a company has delegated decision-making responsibility by designing, monitoring, and evaluating coherent, comprehensive performance measures. This requires horizontal coordination, which a company achieves by focusing on its primary and secondary objectives, to ensure that decision makers consider all facets of the decision. It also requires vertical coordination, which ensures that each member understands how he or she contributes to achieving the secondary objectives and, ultimately, the primary objectives.

The performance measurement system also gives a way to evaluate the contribution of the company’s suppliers. By identifying a chosen approach to competing as part of its secondary objectives, the company provides a basis for evaluating suppliers’ potential and actual contributions in helping it achieve its objectives. For example, if a critical element of the company’s competitive strategy is prompt response, supplier attributes, such as product quality and ability to meet delivery commitments, become critical performance elements. The company can assess the realized performance of existing suppliers on secondary objectives and the potential of new suppliers to provide these contributions.

• **Horizontal Coordination.** Performance measurement relating to primary objectives is primarily scorekeeping. Reporting performance levels on a company’s primary objectives signals whether its strategies

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(that is, the contracts that it has negotiated with its stakeholders) and the processes that it has chosen to implement those strategies have been successful in terms of realized performance on primary objectives.

Performance measurement relating to the secondary objectives provides the insight for organizational change and improvement. For example, suppose the performance measurement system reports declining profits. Owners will be concerned that this signal provides little basis for identifying and correcting the cause of the decline. Other stakeholders will be concerned that falling profits signal the company’s inability to meet its commitments to them. However, if the performance measurement system gives information that customer satisfaction is dropping because of poor service, in particular, long lead times and improperly filled orders, that information is a basis for action and improvement. People, both inside and outside the organization, can assess whether the company has the skills and resources to correct the problems that have led to declining profits.

Therefore, the scope of the performance measurement system should reflect the scope and nature of the company’s secondary objectives and should include all elements of performance relating to customers, employees, suppliers, and the community that the decision maker or the responsible unit affects. This breadth ensures that the decision maker understands the elements that he or she must consider when making decisions and that the decisions reflect those elements.

**Vertical Coordination.** Vertical coordination focuses on ensuring that decision making reflects a company’s chosen strategy. In this context, there are three employee roles: planning, tactical, and operating. Planning activities relate to the broad strategies that the company uses to achieve its objectives. For example, a senior executive or committee might decide that the company will pursue its primary objectives by being a high-quality, low-cost producer. Planning activities define the nature and scope of the performance measurement system by defining what is important, what to measure, how to measure it, and what levels of results to expect and consider acceptable. At this level, the system evaluates the efficacy of the planning choices in terms of the realized results for the company’s primary objectives.

Tactical activities relate to implementing the chosen plans. Tactical activities must reflect the organization’s broad strategy. For example, in response to the planning decision to be a low-cost, high-quality producer, the company would design and implement various processes to implement this strategy. It might organize a just-in-time production system. The company would train, empower, and choose incentive compensation systems to motivate employees to make the system improvements required by just-in-time manufacturing. It might train suppliers to provide reliable, low-cost components as needed.

Performance measurement has three roles in tactical activities. First, it guides the development of the process by identifying the process’s expected contribution (for example, faster cycle times, higher quality, or improved decision making). Second, it assesses whether the realized process performance levels, which reflect secondary goals, are contributing to the primary objectives. For example, is the customer-order-tracking system creating higher levels of customer satisfaction and, in turn, higher profits? Third, it identifies opportunities for reengineering activities. For example, consistently poor process performance might signal the need to replace the existing process with a new one.

Operating activities relate to managing the existing systems and processes. The performance measurement system monitors process results — to assess whether the process is operating as planned and to identify opportunities for fine-tuning to enhance performance (continuous process improvement).

An effective performance measurement system supports vertical coordination in two ways. First, by reflecting the company’s primary and secondary objectives, the system identifies the breadth or scope that decisions should reflect. Second, by reflecting the company’s planning choices, the system guides tactical and operating
activities so that they mesh with the chosen plans. We can think of the performance measurement system as a matrix. While different people in an organization make different contributions to its success, all members should focus on the primary and secondary objectives, at least to the extent that an individual can contribute to a particular performance element.\textsuperscript{26} The columns of the matrix are the performance elements related to the organization’s primary and secondary objectives. The rows reflect the different levels of accountability and responsibility for different people. While each level of accountability (matrix row) might contribute to each performance facet (matrix column), the nature of the contributions will be different.

**Monitoring**

An organization’s primary and secondary objectives define the scope of activities that the performance measurement system monitors. Monitoring information identifies: (1) realized performance levels on primary and secondary objectives; (2) opportunities to improve process performance and to suggest what improvements are required; (3) whether existing processes are meeting expectations in terms of how they are contributing to the primary objectives (for example, is an employee incentive plan really improving employee satisfaction, which, in turn, is improving shareholder wealth); and (4) whether existing processes are achieving their performance potential (for example, what level of quality is a new quality system achieving).

Each role is potentially critical to the organization’s success, because these roles jointly define and support a learning process that involves continual evaluation and improvement of existing processes.

**Diagnostic Role**

A critical role of performance measurement is to help organization members identify the cause-and-effect relationships between process results, evaluated in terms of the company’s secondary objectives and primary objectives. This enables them to evaluate the link between planning and tactical activities. A particularly important element of the diagnostic role is to mesh secondary objectives, which are usually nonfinancial (such as increased customer satisfaction), with organization goals, which are usually financial. That is, diagnostic information monitors and compares results on primary and secondary objectives in order to evaluate the nature of their relationship.

For example, what are the effects of increased employee motivation, increased supplier commitment, improved customer service, and lower product costs on a company’s primary objectives? Simply improving process performance is not an end in itself and is not effective management practice.\textsuperscript{27} What is important is to understand how improved process performance increases performance on the organization’s primary objectives. Secondary performance measures, which are process performance measures that mesh with primary results, link process performance to overall organization performance.\textsuperscript{28}

Performance measurement systems should supply the information that employees need to evaluate and quantify these causal links, which, in turn, provide the basis for evaluating and reengineering processes.

**Strategic Performance Measurement at the Bank of Montreal**

In examining the implementation of performance measurement at the Bank of Montreal, we discuss the objectives, role, and nature of the performance measurement system. The bank’s primary objective of performance measurement is to maximize long-term return on investment for shareowners, which it achieves with a performance measurement system. Bank management thinks that to achieve its objective relating to shareholders, it must recognize and achieve its other stakeholder goals. The bank identifies shareholders, customers, employees, and communities as stakeholders.

Bank management identified four primary roles for its performance measures:

1. Reflecting the belief that “what is measured is what gets done,” the measures focus decision makers’ attention on what creates or drives success. For each measured element of performance, management identifies two items: a standard or minimum performance level, which is generally the average in the industry, and the goal or target performance level, which is generally top-tier or top-quartile performance in the industry.

2. The measures require that management understand and communicate to people both inside and outside the bank what contributes to its primary financial objective of providing a superior return on investment to
shareholders. Internally, this communicates to all bank employees a clear message about the elements of success, ensuring that all bank employees work toward the same end. Externally, this conveys to analysts and other interested parties the bank's plan for long-term success.

3. The measures signal and diagnose what drives current profitability performance and how the bank functions, so decision makers can identify gaps and change strategies and tactics to improve financial performance. By monitoring the drivers of performance, the system can give an early warning of potential lower profits so that the bank can correct problems early on. It also supports the bank's learning by identifying and testing models of relationships between drivers and results.

4. The measures form a basis for performance management by setting objectives, planning, and assessing performance. In addition, the measures are linked to the bank's incentive compensation system and enable management to clearly communicate expected levels of performance.

Overall, the critical attributes of the bank's performance measurement system are its integration into the broader management control system, its focus on both financial and nonfinancial measures for both drivers and results, and its consideration of all the bank's stakeholder groups.

Given the overall corporate objective of providing a superior level of return on investment, the bank management establishes objectives for each stakeholder group based on its belief of how performance affects bank profitability. These objectives are examples of the secondary objectives that we described earlier. For each stakeholder group, the bank establishes primary measures that focus on performance results relating to that stakeholder group and secondary measures that focus on the causes or drivers of the primary results. Therefore, secondary measures report the performance drivers of primary results for a stakeholder group. The primary results reflect a key performance indicator for a particular stakeholder group that affects corporate profitability. For example, management might decide that customer satisfaction is a primary measure for the customer stakeholder group because it has a direct effect on corporate profitability. Secondary measures for customer satisfaction might include service times, error rates, and banking hours.

The primary measures for each stakeholder group tend to be consistent across different areas to give the bank a common focus and purpose. However, secondary measures vary considerably across the bank, reflecting different functional responsibilities and accountabilities. (For a summary of the primary and selected secondary measures for each stakeholder group, see Table 1.)

Beyond the roles and characteristics of performance measures mentioned above, the bank identified seven criteria for performance measures:

1. The performance element is independently measurable.
2. The measures are meaningful to the people who use them by capturing a dimension of their performance in a way that they can understand.
3. The measures are defined by and consistent with the bank's strategic goals.
4. The measures are defined by and consistent with the bank's competitive strategies.
5. The measurement methods are consistent and reliable.
6. The performance measures are reevaluated and changed when necessary or appropriate.
7. The measures are reviewed and accepted by all the people evaluated to ensure their buy-in.

The bank's performance measurement system links the five components of its management system: objective setting, planning, performance assessment, rewards, and supporting management information. The system summarizes performance by defining a score for each measured element of performance. Performance scores, which range from one to ten for unacceptable to outstanding performance, are assigned to each realized level of performance based on the relationship between the realized level and the target. The scores for each stakeholder group are then added and the totals weighted (for example, 40 percent, shareholders; 30 percent, customers; 20 percent, employees; and 10 percent, communities) to determine an overall score or index of performance. Management compares the overall scores over time to assess the rate and trend of improvement and across units to benchmark performance with peers.

Bank management thinks that the main benefits of the performance measurement system are:

1. The system has helped integrate the components of the performance management system, which, during rapid, significant change, are difficult to coordinate.
Common performance measures help make the overall system more efficient and useful.

2. The system is based on the concept of openness or transparency, i.e., everyone has all necessary information. Management thinks the result is better decision making as more people have more required information on an ongoing basis.

3. The system encourages organizational focus on results, thereby reducing energy or resources allocated to noncritical goals and objectives. This is due to increased accountability and improved ability to assess results.

The bank recognizes three challenges in the ongoing development and maintenance of performance measures:

1. While the system keeps the complexities of the key components of the management system integrated and synchronized, it requires constant attention. The economic and business environment, objectives, strategies, and causes of results continually change. In addition, the design of the individual components of the management system is continually changing. The performance measures must also change, adapt, respond, evolve, and be flexible, which, in turn, requires a lot of management attention.

2. The emphasis on performance measurement and, specifically, the concept of openness or transparency drives an enormous demand for management information, particularly nonfinancial information. This also requires constant management attention and money.

3. The requirements to support continually changing performance measures and the need for more management information lead to an organizational issue. Maintenance and development of the overall system requires people who are focused on and competent in the disciplines of performance measurement and management information. Because this is not a traditional competence of typical finance functions, it requires that financial managers be creative in devising new information and performance measures.

Overall, management believes its focus on performance measurement has improved the performance of all bank stakeholders.

Conclusion

We propose a model that views performance on a company’s primary objectives (for example, profit in a profit-seeking company) as a result of the processes (for example, manufacturing, logistical, administrative, human relations) used to generate results. For companies to improve performance on their primary objectives, they must develop a comprehensive system of measures that monitor and evaluate the ability of its processes to achieve its secondary objectives. Improving organizational performance by monitoring financial performance is as useless as trying to improve a sports team’s performance by only reporting the scores of its games. Moreover, by focusing on results, rather than their causes, the company resigns itself to being reactive rather than proactive in meeting the need for organizational change. Therefore, the performance measurement system that we envision is a vital management system that includes both financial and nonfinancial measures of performance.

A company’s strategic planning process should define the focus and nature of its performance measure-

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Table 1  Primary and Selected Secondary Measures for Stakeholder Groups at the Bank of Montreal

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<th>Secondary Measures</th>
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<td>Community</td>
<td>Public image</td>
<td>• Different external surveys</td>
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ment system. To be effective, the system must mesh
with strategic plans. The primary purpose of the stra-
gic planning process is to clearly state the organiza-
tion’s objectives and its path to achieving them. The chosen
strategy provides the focus and scope of the per-
formance measurement system and defines the roles and
focus of performance measures for members. At the
most senior level, the performance measurement system
evaluates how well the strategy has met stated objec-
tives. At the middle management level, where decision
makers design and implement the processes to carry out
strategy, the performance measurement system helps
evaluate how well the existing systems achieve
their objectives and support the evaluation of alternative
systems. At this level, the performance measurement
system identifies process results, such as quality, cycle
time, customer service, and employee relations, that cor-
relate with profits. At the lower levels, the system evalu-
ates and reports process results to help members assess
whether the chosen processes are operating as intended.

By meshing with the company’s chosen strategy,
the strategic performance measurement system helps
members understand and evaluate the factors for suc-
cess, whether related to customer, supplier, employee,
or community. Therefore, a defining characteristic of
the system is its breadth in measuring all facets of or-
ganizational performance that contribute to its profit-
seeking objectives.

The notion of primary and secondary performance
measures is central. Primary performance measures are
the shareholders’ objectives, which, in profit-seeking
firms, are almost always related to increasing owners’
wealth. The secondary objectives are those perform-
ance elements that explain or drive performance on
the primary objectives.

This approach to performance measurement sup-
ports the development of organizational knowledge
and leads to more systematic, effective decision mak-
ing. While the process is not easy, it is necessary for
managing and improving a company’s performance. ♦

References
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provided by the Society of Management Accountants of Ontario.

1. C.K. Brancato, New Corporate Performance Measures (New York:
Conference Board, 1995).
2. C.Y. Baldwin and K.B. Clark, “Capabilities and Capital Invest-
ments, New Perspectives on Capital Budgeting,” Journal of Applied
Corporate Finance, volume 5, Summer 1992, pp. 67-82.
3. Based on our observations in the organizations we visited during this
study and based on other observations of practice, we believe that most
people find it unnatural to think of their jobs in financial terms. For ex-
ample, production supervisors seem to think in terms of quality,
throughput, waste, and meeting schedules, not in terms of an accoun-
tant’s financial rendering of the production process. This does not
mean that operations people are oblivious to financial considerations.
Rather, operations personnel tend to focus on the causes of financial re-
sults rather than the financial results themselves. Therefore, operations
personnel often find it unnatural to manage in terms of financial results
rather than the physical process measures, which they feel are the causes
of the financial results.
4. See, for example:
C. Pollitt, “Management Techniques for the Public Sector” (Ottawa,
Ontario: Canadian Centre for Management Development, Research
Paper No. 17, July 1995); and
P. Warrian, “The End of the Public Sector ‘Industrial’ Relations in
Canada?” (Toronto, Ontario: KPMG Centre for Government Foun-
dation, October 1995).
5. The tableau de bord is a performance measurement concept that has
been the focus of attention in Europe, particularly France, for at least
forty years. The primary message of the tableau de bord is that man-
agers need a set of relevant indicators to monitor the process or system
for which they are responsible. See:
M. Lebas, “Tableau de Bord and Performance Measurement” (London:
London School of Economics, Management Accounting Research
Group Conference, paper, 22 April 1993).
6. R.S. Kaplan and D.P. Norton, The Balanced Scorecard (Boston:
7. The issues relating to employees, suppliers, and the community are
implied in Kaplan and Norton’s (1996) balanced scorecard — for ex-
ample, these matters would be included in the activities that they refer to as
learning and growth. However, we feel that the Kaplan and Norton
view fails to recognize that stakeholder issues, including what stakehold-
ers want from and offer to the organization, are issues that must be con-
sidered simultaneously, as they are in conventional SWOT analysis,
rather than sequentially as the Kaplan and Norton model implies.
8. There has been relatively little formal research published about the
role of performance measures, other than financial measures, in practice.
One conclusion that Ittner et al. reach is that “the relative weight placed
on nonfinancial measures is greater in firms following an innovation-
oriented ‘prospector’ strategy than in firms following a cost leader or ‘de-
fender’ strategy.” This implies that, at least to some extent in practice,
the choice of performance measures does reflect the organization’s com-
petitive strategy. The authors conclude that an organization’s choice of
performance measures reflects important choices made about its gover-
nance structure that, in turn, reflects how the organization mediates the
relationships among its stakeholders — a strategic choice that we discuss
as critical in the choice of organization performance measures. See:
C.D. Ittner, D.F. Larcker, and M.V. Rajan, “The Choice of Perfor-
measurements in Annual Bonus Contracts” (Philadelphia, Penn-
sylvania: University of Pennsylvania, Wharton School, unpublished
working paper, May 1995).
9. To provide a preliminary test and to refine our initial notions about
the nature and role of strategic performance measurement, we visited
twelve organizations that had outstanding reputations for their abilities
to deal with one of the five stakeholder groups: customers, employees,
suppliers, shareholders, and the community. Our purpose was to deter-
mine whether and how each organization used performance measurement to support its performance level. We visited the Four Seasons Hotel and Resorts, Xerox Canada, Nisson Canada, FedEx, Loblaws, General Motors, Imperial Oil Limited, American Barrick Resources Corporation, Ben & Jerry’s Homemade, Body Shop Canada, NCR, and TransCanada PipeLines Limited.


12. Our perspective here is on what the community’s role is, rather than what it should be. Most of the organizations in our study clearly understood the role and nature of the community in affecting its ability to contract with its other stakeholders. The causal relationship between social responsibility and financial returns remains unclear. However, the point here is that organizations in the studies quoted here seem to balance the needs and requirements of the community when pursing financial objectives. See: M.L. Pava and J. Krausz, “The Association between Corporate Social Responsibility and Financial Performance: The Paradox of Social Cost,” Journal of Business Ethics, volume 15, March 1996, pp. 321-357.

13. We define increasing shareholder wealth as providing a return to shareholders that exceeds the return that they require for the risks they face by investing in that organization. The strategic performance measurement model we develop here can be applied to profit-seeking organizations that have multiple primary objectives — for example, objectives that are owner-related and those that are community- or employee-related. Moreover, this model can be applied to both profit-seeking and not-for-profit organizations by redefining the definition of the organization’s primary objectives.

14. Realistically, this process may be sequential and evolve over time. The key is that each stakeholder group must believe that, when the process is complete, there will be an acceptable balance between what they give to and receive from the organization.

15. The annual Fortune survey and list of America’s most admired companies provides a good example of an interest in corporate reputation (a community measure) being a secondary objective related to a primary objective of shareholder wealth. See: A.B. Fisher, “Corporate Reputations,” Fortune, 6 March 1996, pp. 90-98.

16. Managing by focusing on the actual shareholder wealth created, for example, profits, is comparable to a coach who is trying to improve the performance of his team and limits himself to studying the final score of the team’s games or to a race car driver who confines her attention solely to road speed during a race.


18. This is the basis and purpose for customer, product, and product line profitability evaluations.


21. For example, how does quality improvement translate into increased sales and profits? Or, how does an employee incentive pay system translate into improved employee motivation and performance that, in turn, result in increased organization profitability?

22. These three roles of performance measurement have been understood, if not implemented in practice, for a long time. For example, based on a controllership study undertaken by Herbert Simon and his coauthors, Charles T. Horngren proposed three roles for performance measurement — scorecard-keeping, attention directing, and problem solving — that are loosely related to the three roles that we propose here. See: H.A. Simon, H. Guetzkow, G. Koiznetsky, and G. Tyndall, Centralization vs. Decentralization in Organizing the Controller’s Department (New York: New York Controllership Foundation, 1954); and C.T. Horngren, G. Foster, and S.M. Datar, Cost Accounting: A Managerial Emphasis (Upper Saddle River, New Jersey: Prentice Hall, 1997).


25. Virtually every organization that commented on a Kaplan and Norton balanced scorecard article had installed a strategic performance measurement system. Each organization indicated that a major benefit of strategic performance measurement is to align or coordinate the activities of different organization groups and decision makers and to focus attention on the organization goals reflected in or communicating by the strategic performance measurement system. See: Kaplan and Norton (1996).

26. For example, a salesperson cannot be held accountable for the quality of the manufactured product, only the quality of the service offered to the customer.


28. An example of an organization that has developed relationships between process measures and financial results, Weirton Steel, a U.S. steel products manufacturer, estimates that each percentage point increase in its raw material yield (the ratio of the weight of finished product to the weight of the raw steel entered into the finishing process) is equivalent to a $4.7 million decrease in operating costs. This provides an important means of relating process improvement results, which are secondary measures of performance, to profitability results, which are primary measures of performance.


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