PYRAMIDS AND SCORECARDS:

PERFORMANCE MANAGEMENT SYSTEMS

TEACHING NOTE

DRAFT 2020

8 Pyramids and Scorecards: Performance Management Systems

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8.1 Organizational Control – The Great Balancing Act

Management is under huge pressure to exercise control over the objective-driven performance of a company, even if it is situated in dynamic markets and faces multiple challenges. With the ascendance of the Balanced Scorecard and other Management Control Systems like EFQM or the performance pyramid in the 1990s, the classical management control dyad of operational budgets and capital budgeting has been greatly enhanced -especially on the communication side trying to achieve a cultural reach within companies beyond financial numbers and incentives.

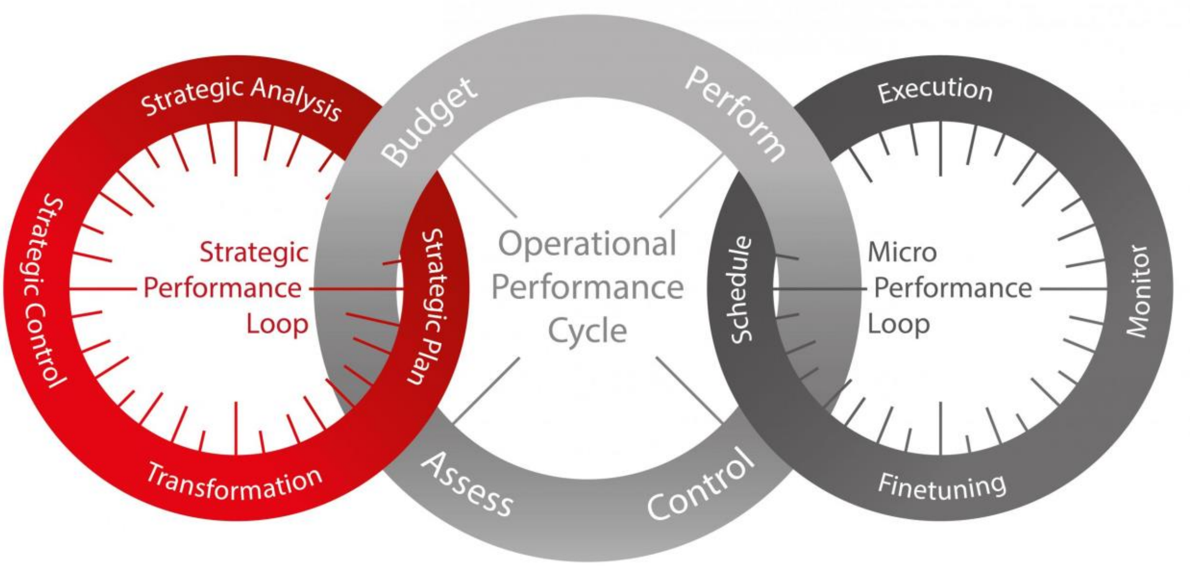
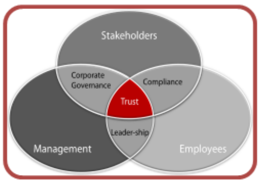


Figure 1: The Performance Management Chain

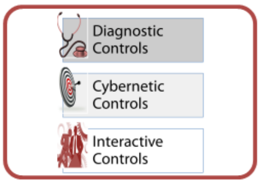
Top management has to orchestrate the full performance management cascade, run the business and generate money, while continuously improving the business processes and transforming the business model itself. It might be compared to a great balancing act with ongoing manicure and pedicure and open-heart surgery while dancing on a rope. To stay in the image management also has to sing at the same time to woo the stakeholders and convince them that management is in full control of the situation.

Thus, the rise of the demand for management control systems in dynamic circumstances comes as no surprise. The threefold objective of this chapter is on the one hand to explain the deeper motivation for management performance systems, which is the generation of trust among stakeholders. On the other hand, it offers an overview of control tools used in the company along the performance management cascade. Psychological insights help to understand the dimensions of the management tasks. Especially the Hawthorne studies showed that there is something magical about performance management.



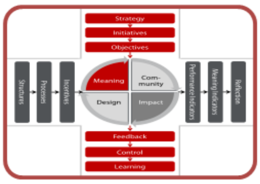
Management Performance Systems

- Trust as the Currency of Management
- From Control to Performance Management



50 Shades of Controls

- Types of Control
- Examples of Control Tools



Blueprint for Performance Management Systems

- Designing a Performance Management System
- The Performance Triangle

The third objective is to explain a blueprint for designing performance management systems. One important aspect is that it works best as a co-creation of management and employees throughout the company.

8.2 Performance Management Systems – Tales of Trust, Control & Rationality

8.2.1 Trust as the Currency of Leadership

The currency of successful leadership and management is trust. The **stakeholders** and especially the share- and bondholders want and need to trust managers with the stewardship of their interests. They have invested money, energy and time. They are

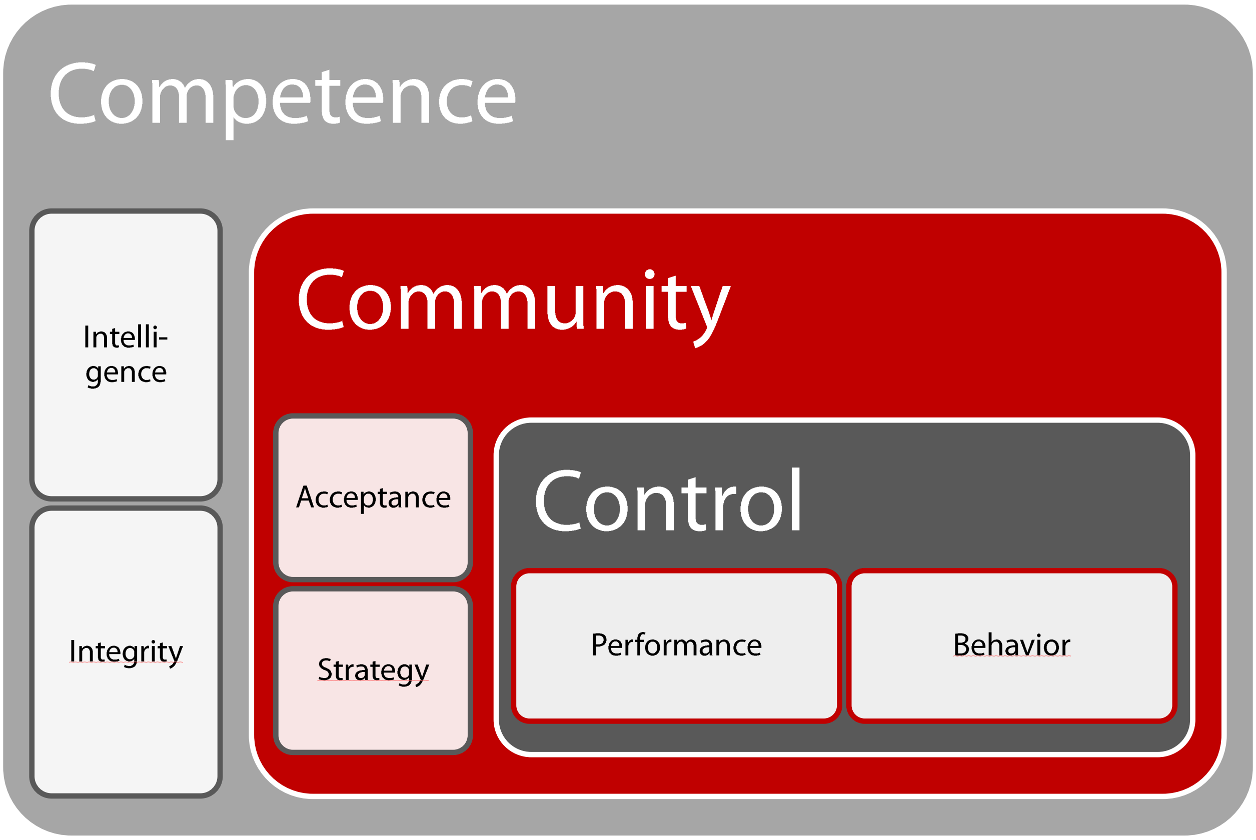
affected directly or indirectly by the performance of the organization. The management of management takes place under the umbrella of **corporate governance** in which management reports to the shareholders and is held accountable for the performance of the company. Moreover, the stakeholders are interested in the performance and behavior of company employees beyond management. They want and need the employees to act in compliance with legal rules and regulations and the values of the company. Compliance management has achieved some prominence over the last decade, partly because of accounting and fraud scandals (WorldCom, Ahold, Enron) but also due to substantial harm that happened to the negligence and omission of companies like British Petroleum (Deep Water Horizon) or Tepco (Fukushima Power Plant). Society is not only interested in financial results of companies but also regulated their behavior as well.

The **Employees** of a company also want and need to trust management. They want to work for a company, which provides a long-term perspective, financial support and a meaningful identity to its members. They trust that management will offer all of this to them and more and more expect a certain degree of active participation in the process. They trust like the stakeholders that management will take the right decisions and act as a fair leader and employ the resources of the company to the best of the long-term success of the enterprise.

Management is therefore in the position to deliver on the trust put in them in decision making, communicating and managing the performance of the company. A lot of pressure is on them to maintain the façade of rational management and control. The key ingrediences for earning and maintaining the trust of the key stakeholders lies within the 3Cs of Trust: Competence, Community and Control.

8.2.2 The Three Cs of Trust

Compentence: The first aspect lies within the person of the manager himself. In order to trust a person with the stewardship of a company, the stakeholders need to trust the personality of the manager, mostly his **intelligence** and his **integrity**. He (or she, of course) has to display his intelligence and show his integrity to the stakeholders not only in the supervisory board meetings. How can he do that? As far as the intelligence is concerned, the manager has to take over the role as explainer of the relevant world, elucidate the current market forces and the resulting challenges and opportunities for the company. If the manager can create a sound vision for the company against a backdrop of credible market assumptions, he might be accepted as a potential leader. The intelligence of the leader will be tested by analysts and stakeholders in various meetings, in and outside the boardroom. He or she does not necessarily have to be the smartest person in the room, but needs the ability to display his intellectual sovereignty concerning the course of the company. The integrity of a leader is a more complicated issue. While stakeholders start with the assumption of good faith, it is clearly helpful to show a proven record of accomplishments. These can be operational success stories within the same companies or similar companies. Credentials from investment banks or strategy consultants can also do the trick. It is difficult to pass through the threshold ("You cannot be a leader, because you have never proven that you can be a leader.") of getting the right experience.



Unfortunately, the integrity can be undermined by bruising details from the past or even unproven allegations about misbehavior. The reputational risks are therefore very high for any manager, similar to those of a politician. Nobody would install a manager whose reputation and integrity is not beyond any doubt.

Community: The alignment of the company community and the **acceptance** as their representative and leader is a necessary condition for maintaining the trust of the stakeholder into the current management. The two categories which are of importance are acceptance and strategy. An organization has issues accepting somebody with no competence as defined earlier, but the community goes beyond the competence side in accepting a leader. In some companies the leader is best accepted if he comes from within the company and has a network to build on. In other companies, especially, if they are in a crisis mode, outside expertise is sought after. The most defining aspect lies with the choice and communication of a convincing **strategy** which inspires trust in the long-term performance of the company. Again, in crisis mode, the strategy accepted is inherently more radical.

Control: Whereas the leader is hired based on her personality, her past credentials and the story about the future she presents, the real litmus test for earning and maintaining the trust is by showing the ability to control the company's **performance** according to the vision the leader proposed. Performance means in this case typically financial performance which can be measured in sales, EBIT and cash flows. The budgets are seen as key promise the new leader has to keep. There might be a beginning period where surprises are allowed but CEOs are quickly fired and replaced after one or two profit warnings. This is also why with a new CEO the first annual report is often very bad, since he writes down all optimistic and critical assets like goodwill and books provisions about future risks. This gives some space for accounting maneuvering in the first two years. Another aspect is **behavior**. Especially in case of an organization's history of fraud, compliance issues or bad communication style, the new CEO will be measured against the behavior of the company with regards to a desired change in behavior and his reactions to bad behavior. The scrutiny is very tough after scandals like the Volkswagen cheating devise scandal ("Dieselgate") or a history of illegal behavior and heavy fines paid by the Deutsche Bank in 2015/2016. If you think that managing the three Cs of trust is a tough job, you are probably right. The average tenure of CEOs of the Fortune 500 companies was less than 10 years in 2013. It is a hot seat.

8.2.3 The Hawthorne Studies – Placebo Management?

The question addressed in this section is how can management influence the performance of employees. One might say that the answer is easy: Optimize the workflow, give clear directions, control immediately and pay attention to performance. However, there is a slight complication about this truism as we learned in the almost 100 years ago, in the late 1920 and early 1930s, at the Hawthorne Works close to Chicago in the experiments under the supervision of Elton Mayo. It was a textile plant haunted by low morale, low performance and high absenteeism.

Before Mayo, a psychologist and sociologist at Harvard, Frederick Taylor had focused on the individual performance of employees, but Mayo looked especially at the group effects.

The objective of the experiments was to examine the effects of physical conditions on productivity and employee morale. Two groups of workers were selected. The lighting in the work area for one team was improved dramatically while the other team's lighting stayed the same. The scientists were astonished to find that the productivity of the more illuminated workers increased substantially compared to the control group. The working conditions were altered in other ways too (working hours, rest breaks, etc.), and in all cases the productivity of the observed employees enhanced when a change was introduced. The productivity and performance improved even in the event that the lights were dimmed to moonlight level. After the experiments ended and everything went back to normal, performance at the factory was at peak level, absenteeism had fallen dramatically and the employees were more satisfied.

The so-called illumination or observer studies were quite revolutionary. The researchers suggested that it was not the alterations in physical conditions that were driving the workers' performance, but the fact that someone was actually concerned about their work, listened to them and gave them the opportunity to discuss possible changes before they were implemented. Also the relationship with the team seemed to be crucial.

What can be learned from the Hawthorne studies in the 21st century? People want to be taken seriously as individuals within groups and to be treated with respect at work. This includes meaningful interaction with management and the team and a say in changes to the working conditions. If this is true then almost any discussed and agreed change will provide the lasting effect of performance and satisfaction enhancement of the employees. Management is thus best described as a contact sport and a people’s game. And although there might be magic and placebo involved, management has influence over the performance of employees.

8.2.4 Cultural Dimensions of Management Control

Before we go into details of control mechanisms, I would like to point out an important aspect in a globalized world. National culture has an important impact on the control aspects of a company. Based on Hofstede’s cultural dimensions Power Distance (to which extent people expect and tolerate differences in status and authority) and Uncertainty Avoidance (the tendency of a society to avoid surprises and the extent to which members of a society try to cope with anxiety by minimizing uncertainty), four cultural models were identified to cope with the topic of management control: The market model, the machine model, the pyramid model and the family model (Hofstede/Hofstede, 2005). People from countries with a low uncertainty avoidance index and low power distance, allow things to happen and to deal with the situation at hand. Hierarchy or administrative burdens do not intervene. Everything is negotiable and the dominant climate resembles a fish market where everything seems possible. Representatives of this model are the USA, UK, the Netherlands or Jamaica. Countries with higher uncertainty avoidance but low power distance are clustered within the machine model. Clear rules and procedures with quasi-automated conflict solutions that do not depend on individuals or hierarchy are perceived as ideal. Representative countries for this control model are Germany, Austria or Israel. High uncertainty avoidance paired with high power distance are reflected in the pyramid model. In this cultural model conflicts are escalated to higher hierarchical places where they are solved. At the top of the pyramid sits a president. This control model can be found in most Spanish speaking countries, France, Russia and most Arabic countries. The remaining combination blending high power distance with low uncertainty avoidance is called according to Hofstede the family model.

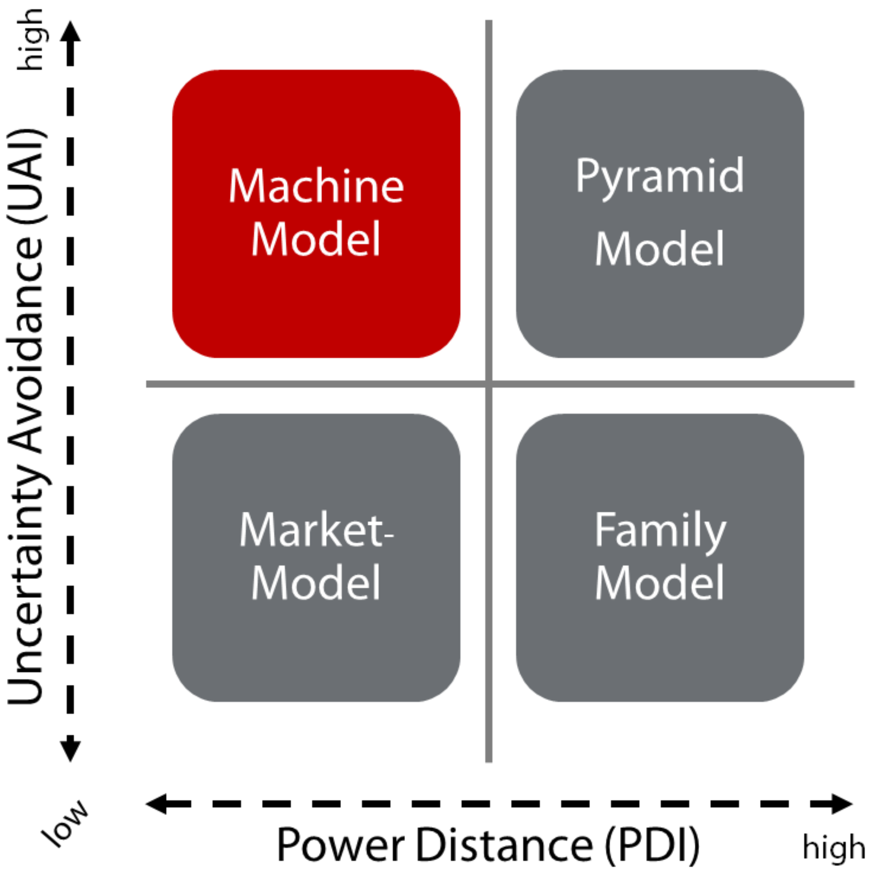


Figure 2: Cultural Management Control Model (adapted from Hofstede/Hofstede, 2005)

All power is concentrated in the hand of the owner and *pater familias* of the company who treats the company as his or her extended family. No internal structures are established to deal with decision or conflict. All power is exercised by the boss and owner of the company.

Most of the literature on management control is dominated by a US American influence. It is noteworthy that this implies a strong cultural bias which might lead to conflicts exporting control concepts into countries that do not share the same cultural traits. The instruments of control work in all different countries. The difference is the intent and effectiveness. Please keep this in mind for the rest of the chapter.

8.2.5 Beyond the Rationality Façade

Modernity imposes several complicated assumptions and conflicting objectives on management. It is asked to exercise control not only on the financial and non-financial performance of the company, but it should also nurture and sustain a positive brand image of the organization, or even create a "love brand". At the same time management is responsible for ensuring the compliance of the organization and its members with rules and legislations worldwide, which pushes them into a police function.

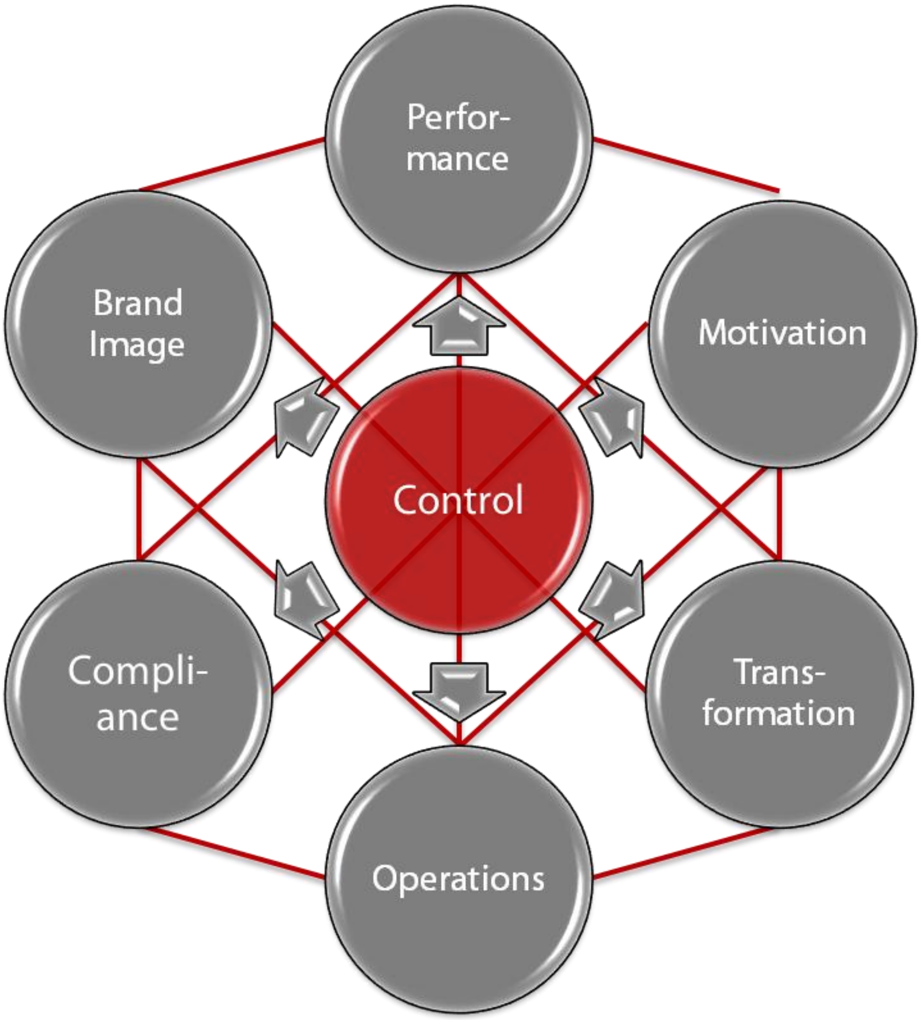


Figure 3: Corporate Control as a Balancing Act

Operations management does not seem to be the first priority of a business, but maintaining a humming money making machine is a challenge of its own. As we have seen in previous chapters, the transformation of the business, its strategy, M&A activities, investments and even cultural change are part of the natural duties of top management and last but not least they have to maintain and increase the motivation of the employees without whom no control whatsoever can be exercised.

8.3 Performance Management Systems and 50 Shades of Control

8.3.1 Defining Performance Management Systems

Managers are confronted with hard pressure to achieve tangible results for shareholders and other stakeholders but are equally dependent on their employees to achieve the promised results. Many managers often experience a partial or full loss of control regarding the behavior of their employees and are (desperately) looking for ways to elicit and control the desired behavior of employees. The social dilemma is that they have to build a credible “rationality façade” which pretends they were in control over the different forces in order to achieve a momentum in performance. Management control systems help managers with this balancing act. It might, however, from an academic point of view be more adequate to call them performance management systems.

I define them as follows:

Performance Management Systems are a comprehensive set of interrelated processes and tools, which:

- Envision and enable the performance of complex organizations in dynamic business environments
- Engage employees through leadership and participation and elicit behavior in accordance with the organization’s objectives
- Link the loops of the operational performance cycle with the micro and strategic performance loops and address performance management holistically
- Provide data based performance feedback with meaningful performance indicators beyond financial numbers

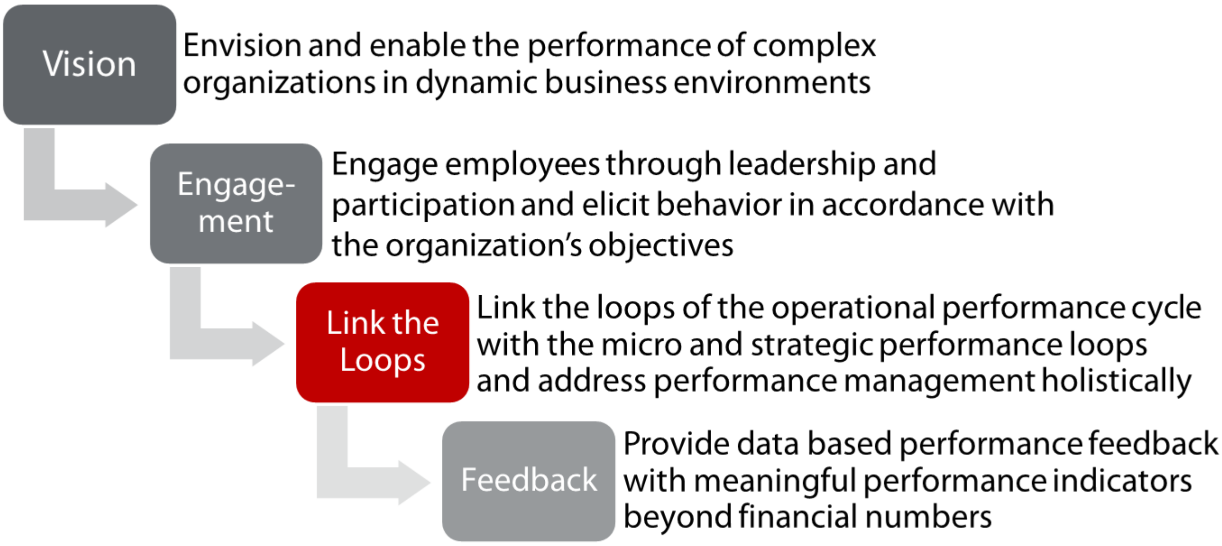


Figure 4: Performance Management Systems

8.3.2 Asking questions about Performance Management Systems

A good Performance Management System should give qualified answers to at least the following seven questions:

1. Does the company have a ***Vision and a Mission*** and how are they incorporated throughout the Performance Management System and communicated to managers, employees and stakeholders?
2. Does the PMS reflect the ***Company Structure?*** *Is there a cascading and consolidating procedure for the planning and reporting established*?
3. Does the PMS reflect the company's ***Plans and Strategies,*** and does it so by pinpointing to the **Key Success Factors** and **Action Levers**?
4. **Does the PMS** highlight ***logical*** links between the performance dimensions and how they are used?
5. **How does the PMS measure Key Performance**? How objective are the **Key Performance Indicators**?
6. **How is the target for each KPI set**? Is there open interaction between different levels of the hierarchy? Are the targets realistic, are they conflicting? Are they under control of the relevant individuals and which ones are relevant for individual or organizational performance evaluations?

7. How are employees **motivated** to achieve the set performance targets? How is the PMS a catalyst for interaction and meaningful communication and can thus increase the motivation of the employees?

8.3.3 Fifty Shades of Corporate Control

Performance Management Systems make use of a plethora of different control instruments, some are obvious and involve direct comparison of targets and real performance, some are subtle like the architecture, the stories told within a company or the recruiting procedures. In the following, the controls are first divided into strategic, operational and micro controls in line with the performance managemen cascade and second analyzed through the lense of their function as diagnostic, cybernetic and interactive controls. In a third step, cultural and international dimensions of corporate control are elaborated.

8.3.3.1 Strategic Control:

Performance Management Systems come as a package. In order to show the dimensions of control in line with the performance management cascade, we choose the three categories strategic controls, operational controls and micro controls to mirror the three performance loops of the performance management cascade.

Strategic controls are controls which aim at the strategic performance and the possibility for the transformation of an organization. In the follwing some aspect are elucidated:

Hierarchy, which means “holy order” in Greek, is the definition of roles and responsibilities within the organisation, especially the management team. Hierarchy reduces complexity, because not everybody is involved in decision making and the job of strategic thinking remains classicly with the top management team. The CEO of a company has the formal power to make many decisions. The holy order ensures that these decisions are binding and that the top management can also take unpopular decisions like restructurings or a reduction in the workforce.

Vision/Mission: Leading by vision and mission has become very popular and almost every company has a vison and or mission statement. Companies tend to check their stategy whether it is in line with their vison and mission. One might call this strategic control normative or ideological. The vision stands for the how the company sees the world. It is mostly a generic statement about how the world is seen as an opportunity for profitable growth. It should be inspiring for the stakeholder and positive.

The preamble to the mission/ vision of Cocacola 2020 in 2016 for example reads like this: [1]

> “The world is changing all around us. To continue to thrive as a business over the next ten years and beyond, we must look ahead, understand the trends and forces that will shape our business in the future and move swiftly to prepare for what's to come. We must get ready for tomorrow today. That's what our 2020 Vision is all about. It creates a long-term destination for our business and provides us with a "Roadmap" for winning together with our bottling partners.”

Our Mission

“Our Roadmap starts with our mission, which is enduring. It declares our purpose as a company and serves as the standard against which we weigh our actions and decisions.

- To refresh the world...
- To inspire moments of optimism and happiness...
- To create value and make a difference.”

Our Vision

“Our vision serves as the framework for our Roadmap and guides every aspect of our business by describing what we need to accomplish in order to continue achieving sustainable, quality growth.

- **People:** Be a great place to work where people are inspired to be the best they can be.
- **Portfolio:** Bring to the world a portfolio of quality beverage brands that anticipate and satisfy people's desires and needs.
- **Partners:** Nurture a winning network of customers and suppliers, together we create mutual, enduring value.
- **Planet:** Be a responsible citizen that makes a difference by helping build and support sustainable communities.
- **Profit:** Maximize long-term return to shareowners while being mindful of our overall responsibilities.
- **Productivity:** Be a highly effective, lean and fast-moving organization.”

Live Our Values

“Our values serve as a compass for our actions and describe how we behave in the world.

- **Leadership:** The courage to shape a better future
- **Collaboration:** Leverage collective genius
- **Integrity:** Be real
- **Accountability:** If it is to be, it's up to me
- **Passion:** Committed in heart and mind
- **Diversity:** As inclusive as our brands

[1] http://www.coca-colacompany.com/our-company/mission-vision-values/

- **Quality:** What we do, we do well”

Mission and vision ideally make clear what a company stands for and which future direction it strives to take. Coca Cola even states its core values. The role of the strategy is to define a way how to better approach the desired future state. It serves as a control because it narrows the room for strategic choices and emanates trust in a sustainable future for the company.

Capital Budgeting: The capital budgeting process has been dealt with intensively in a different chapter. It controls the ressources for the transformation and maintenance of the company’s business model. The decisions about M&As, major investments or R&D are formalized and depend on the consent of the top management. It also makes sure that operational efficiency can be management seperately from strategic issues.

Recruiting: The recruiting process deals with the purchase of the most important and strategic of all assets: the employees. Hiring the right, the bright and the creative employees is crucial for the success of companies. The recruiting process is thus very formalized and includes various stages like an online test, a telephone interview with a recruiter and various interviews with managers in the company apart from providing a battery of documents or even a criminal background check. Personnel policies are at least as important as investment policies.

Architecture: Architecuture can act as a strong control device. This is not only true for Benthams Panopticon, a supertransperent prison, but also for “open space” office buildings, where transparency is a key for peer control and supervision. Imposing architecture also sends a message to the market and to the employees that the company is a force to be reckoned with.

Supervisory Boards/Board of Directors: All publicly listed companies have a supervisory board or a board of directors which controls and advises the executive team of the company. They are an important building block of the corporate governance structure.

Risk Management: Risk Management offers the opportunity for all relevant members of the management team and the supervisory board to review the risk profile of the company and take action if required. Risk management is dealt with in a different chapter.

Figure 5: 50 Shades of Control

8.3.3.2 Operational Control

Operational controls are concerned with the control of the operational business cycle of a company.

Supervision: The supervision means that somebody is indeed physically checking the work of other people by monitoring and giving direct feedback. Electronic devices, trackers and video cameras have revolutionized the ability to monitor employees on a micro level, but the direct supervisor is the backbone of operational control.

Budgets, Forecast: The operational budgeting process, which is dealt with in a previous chapter, is the tool for the operational planning and control. Together with a forecasting system, the budgeting process is bringing order and control into the next months ahead.

Cost Accounting: Although one might say that cost accounting is a prerequisite for budgeting, cost accounting goes indeed beyond the budgeting processs. Ccost accounting, especially in an elaborated form like activity based costing, depicts the value streams within the operational business model and offers a basis for a detailed variance analysis.

Variance Analysis: Comparing plans to facts is the definition of control par excellence. Therefore, the variance analysis is the tool for identifying problems and deviations.

Incentives, Bonus Payments: Incentivizing employees by linking bonus payments to performance goals may not be very effective, but it is widespread and rewards and compensation programs are regarded as an essential part of the alignment of employee and company interest. We know that extrinsic motivation crowds out intrinsic motivation and that incentivation reduces the ability to think outside of the box, but most operational control systems offer a reward system.

Management by Objectives: Giving employees objectives and getting out of their way on how to achieve them is a classical operational control system. It goes together with the budgeting process. It is opposed to micro-management which is concerned not only with the objectives but as well or even more with the actual behavior of the employees.

Risk Management: Operational risk management and the internal control system have gained importance over the last decades.

8.3.3.3 Micro Control

Micro control consists of detailed regulations and control of desired behavior, the optimization of business processes and the detailed management of parts of the value chain.

Rules & Regulation: The handbook on how to do anything, what not to do and whom to ask if you do not know what to do next, is part of the company internal legislation. This might involve leaving the hand on the handle while taking the stairs or not to accept gifts or invitation from a supplier. The compliance with these rules is regularly tested by the supervisors and internal auditing.

Job Description: The individual job description is the list of tasks, responsibilities and limitations of a job. In the following you will find sample job description of a controller (one of the incarnations of control) on the online job plattform Monster:[2]

[2] http://hiring.monster.com/hr/hr-best-practices/recruiting-hiring-advice/job-descriptions/controller-job-description-sample.aspx (retrieved on 2016-03-16)

"*Controller Job Responsibilities*:

Maximizes return on financial assets by establishing financial policies, procedures, controls, and reporting systems.

Controller Job Duties:

- Guides financial decisions by establishing, monitoring, and enforcing policies and procedures.
- Protects assets by establishing, monitoring, and enforcing internal controls.
- Monitors and confirms financial condition by conducting audits; providing information to external auditors.
- Maximizes return, and limits risk, on cash by minimizing bank balances; making investments.
- Prepares budgets by establishing schedules; collecting, analyzing, and consolidating financial data; recommending plans.
- Achieves budget objectives by scheduling expenditures; analyzing variances; initiating corrective actions.
- Provides status of financial condition by collecting, interpreting, and reporting financial data.
- Prepares special reports by collecting, analyzing, and summarizing information and trends.
- Complies with federal, state, and local legal requirements by studying existing and new legislation; anticipating future legislation; enforcing adherence to requirements; filing financial reports; advising management on needed actions.
- Ensures operation of equipment by establishing preventive maintenance requirements and service contracts; maintaining equipment inventories; evaluating new equipment and techniques.
- Completes operational requirements by scheduling and assigning employees; following up on work results.
- Maintains financial staff by recruiting, selecting, orienting, and training employees.
- Maintains financial staff job results by coaching, counseling, and disciplining employees; planning, monitoring, and appraising job results.
- Maintains professional and technical knowledge by attending educational workshops; reviewing professional publications; establishing personal networks; participating in professional societies.
- Protects operations by keeping financial information and plans confidential.
- Contributes to team effort by accomplishing related results as needed.

Controller Skills and Qualifications:

Managing Processes, Financial Software, Developing Standards, Audit, Accounting, Corporate Finance, Tracking Budget Expenses, Financial Skills, Analyzing Information, Developing Budgets, Performance Management"

Quality Management: Quality management tries to assure that a company, a specific product or service is reliable and consistent. It has classicly four main modules: quality planning, quality assurance, quality control and quality enhancement. Quality management is concentrated not only on product and service quality, but also on the tools to achieve it. Quality management uses quality assurance and control of processes as well as products to achieve a more consistent quality. Manangement fashions like Total Quality Management concentrate on consistency and quality throughout the company.

IT-Systems: IT systems like ERP systems play a crucial role in enforcing internal controls as has been explained in the chapter on Risk Management. IT system implementations often trigger a revamp of existing business processes as well.

Business Process Management: BPM aims at improving corporate performance by managing and optimizing the business processes of a company. It can be defined as a process optimization process. This includes the visualization of processes and functions, the measurement of success, the analysis of improvement potential, the improvement or change itself and the control of the performance results. A radical approach to BPM is business process reengineering, which was a management fashion on the 1990s led by Hammer and Champy and started with redefining business processes from scratch.

Peer Control: Peer control happens when employees at the same organizational level or in the same field exert lateral control over their peers. This can be by simply by being in the same room or by watching the work of peers regularly, by taking over the tasks of somebody else and creating thus an indirect control.

Gamification: Gamification is a relatively new management fashion. The underlying assumption is that behavior control can be elicited though a gamelike set-up of work situations. This includes but is not limited to meaningful objectives, a team and community experience, direct feedback, and visualisations (like dash boards). Gamification can be applied to individual business processes (internal innovation contests) or to the company as whole and turn the corporate culture into a behavior changing game.

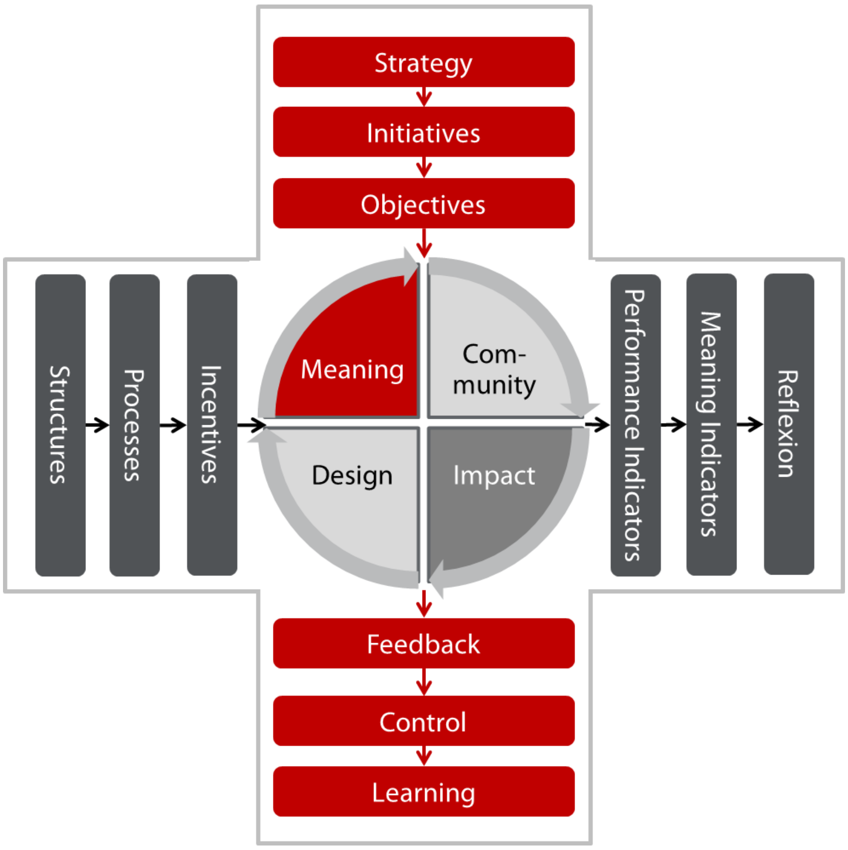


Figure 6: Performance Management Cross

Elements of controls a multi-facetted and their clear allocation as strategic, operational and micro depends on the intent of the control and on the actual effect. Each company combines the different elements of control to its individual package. Controls can serve as levers for performance if appled with care.

8.3.4 Mechanisms and Levers of Control

The nature of controls and controlling others has three different maturity levels: diagnostic controls, cybernetic controls and interactive controls. But all controls work with numbers and data.

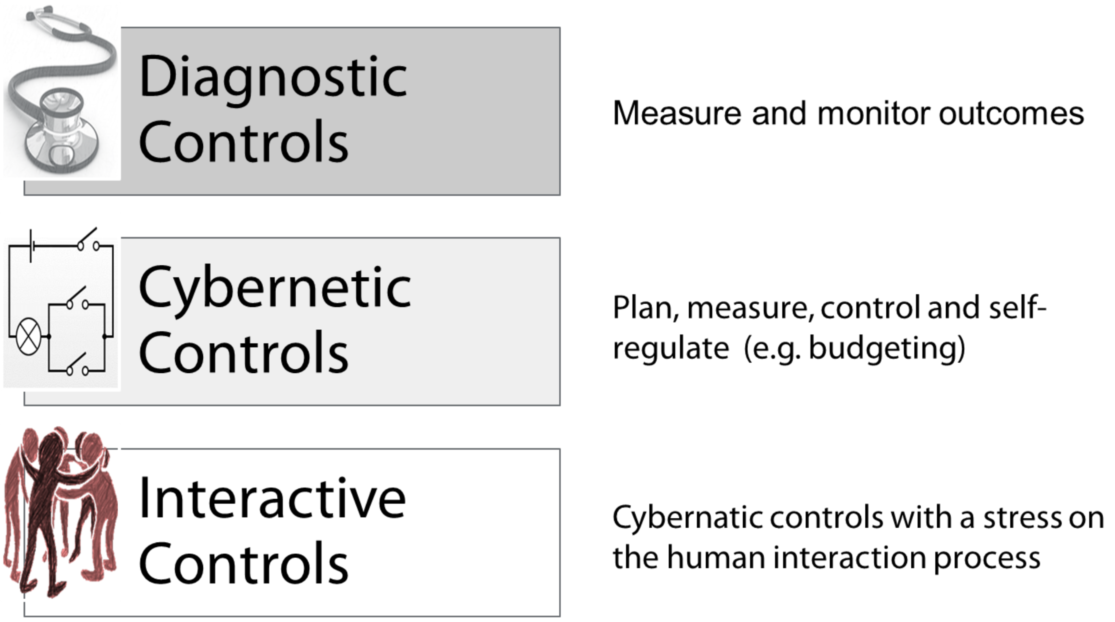


Figure 7: Maturity levels of controls

Diagnostic Controls

Diagnostic controls simply measure and control outcomes. This can be the temperature of a patient or the annual sales numbers or the profit or the average sick days per employee. They have a diagnosing power and can be the starting point for further analysis. The analysis of the financial statements of a company offers the potential for diagnostic control. Key Success Indicators are used to measure and monitor outcomes. These measurements can be financial and non-financial or hybrid. The maturity level is simple in so far as it is not a forward-looking control mode, but an after the fact and outsider view on the object to be controlled.

Cybernetic Controls

Cybernetic controls are a quantum leap further advanced than diagnostic controls, because they create a plan and measure performance against a plan and even leave room for self-regulation of the system. The classical example is the top-down budgeting process. Targets (SMART- Specific-Measurable-Attractive-Realistic-Timebound) impose creative tensions on organizations and companies. Theses could be sales or EBIT targets or Co2 emission targets or the amount of training hours spent. The target creates an image of the future and works as a means for reality construction. The assumption is that organisms, human beings and organizations strive for the fulfillment of goals. Therefore, cybernetic controls have a clear motivational and behavioral effect which goes beyond the effect of purely observing and judging others.

Interactive Controls

Interactive controls take the motivational and behavioral momentum to the next level, by stressing the human interaction process. It goes beyond the cybernetic controls insofar as the goal setting process becomes participative and interactive. Management works together with the employees to establish the targets and develops tactics how to attain them. Numbers thus transcend from performance to meaning indicators. The joint development of the cybernetic controls serves as a team-building effort as well and teaches and empowers the employees through the leadership and interaction with management.

8.3.5 Key Performance Indicators

Key Performance Indicators are key to performance measurement and management. Therefore, I have gathered a list of crucial indicators for various performance dimensions. The list is not complete and rather generic. It may serve for inspirations for further KPIs that are relevant to a particular company and situation:

Financial KPIs relevant for discussions with investors, banks and bonus payments

Table 1: Financial KPI

Financial KPIs	
Sales	Return on Sales
Sales CAGR	Return on Capital Employed
Gross Profit Margin	Economic Value Added
EBIT	Total Shareholder Return
EBITDA	Return on Equity
Return on Assets	Price/Earnings Ratio
Cash Conversion Cycle	Operating Expense Ratio

KPIs relevant for understanding customers

Table 2: Customer KPI

Customer KPIs	
Net Promoter Score	Customer Complaints
Customer Satisfaction Index	Market Growth Rate
Customer Profitability	Cost per Lead
Customer Retention Rate	Page Views
Market Share	Conversion Rate
Average Age	Bounce Rate
Average Bill	App Downloads

KPIs relevant for understanding operations management

Table 3: Operations KPI

Operations KPIs	
Order Fulfilment Cycle Time	Average Sickness Days per Employee
Defect Rate	Sales per Employee
Rework Level	Average Employee Tenure
Inventory Turnover	Salary Competitiveness Ratio
Time to Market	Process Downtime Level
Capacity Utilization Rate	CMMI Level
Employee Satisfaction Index	Innovation Rate

KPIs can serve as diagnostic or cybernetic controls and the joint development can be an opportunity for collaborative interaction controls. Now, that all ingredients for the design of a performance management system are laid out, let’s have a look at how to assemble them to one holistic performance management system.

8.4 Performance Management Systems Implementation Toolkit

8.4.1 PMS Implementation as Interactive Control

Strategy Implementation is more an art than a science. We never know which strategy to pursue since we do not know the future.

Figure 8: Strategy Implementation Process

When the strategy is defined, which usually is an interactive and iterative process, it has to be broken down to get traction and implemented. Since the implementation process involves employees, it is best to use the opportunity to involve the different levels of the hierarchy to get involved in a shared strategy implementation process and develop on the way the next performance management system. In have heard many times managers praising the implementation process be it a balanced scorecard of the EFQM system. The bottom line was, the process was actually more important than the result. This goes in line with the lessons we can draw from the Hawthorne studies.

The strategy implementation process can be divided in at least 6 different stages: The (Re-) Definition of the Strategy, the development of initiatives, the definition of KPIs, the Setting of Targets, Measuring and Reporting and Corrective Action.

8.4.2 (Re-) Define Strategy – Linking the Loops

Strategy definition is an art. Coming back to the performance management cascade, we should keep in mind that a strategy is probably a bundle of different objectives and perspectives also knit together to impress all stakeholders including shareholders who want to see a profitable growth plan. For a strategy to be credible, it should be based on realistic assumptions and explain the general plan by elucidating the different performance perspectives and the cause and effect chains between them and show the funding available for strategic action.

By defining the relevant performance perspectives, management reveals their vision of the market and the industry. At the same time the focus of the performance plan sends a strong message towards stakeholders. This is why the financial perspective is of particular importance. A strategy or five-year plan has to aim for profitable growth. Sales and EBIT numbers will appear there. However, the real question is: How will the company get there? An individual mix of topics of the micro performance loop, the operational performance look and the strategic performance loop will be picked to support the story. Customer perspectives go along with process and quality improvements, waste reductions, R&D, M&A, Investments and restructuring. For over a decade sustainability topics were used as combining unifiers for strategies.

Figure 9: Performance Perspectives

Just picking aspects of performance does not ensure a successful strategy. We need to define performance objectives for the respective performance perspective. Furthermore, it is important to link the loops and show the cause and effect chains between the different areas. A strategy landscape may visualize the intended effects.

An example might look like this: An employee engagement program might increase the morale of the workforce and foster their creativity. This may in turn lead to a more cheerful workforce which will attract and impress more customers and develop more ideas how to improve business processes. One might argue that by improving the business processes, customers can be served even better and the costs go down at the same time. This professional performance culture might further attract new talent to the company. Overall, the revenues will go up and costs will go down.

A strategy itself comes at a certain price. Management should clearly state the amount needed to execute the strategy at hand. In case of a redesign of a strategy, the process has to be reviewed critically.

8.4.3 Develop Initiatives – holistically

Part of the strategic planning process (see the respective chapter) is to develop initiatives which should be pursued over the next planning period. In order to present a holistic approach towards the leadership of a company, they should be chosen to fit the communicated strategy and objectives of the focused performance perspectives. Again, this is partly storytelling and aimed at creating trust in the strategy. The real test lies in defining quantitative targets which are promises to be kept.

8.4.4 Define KPIs of Future Success

The initiatives should aim at improving performance. The (joint or collaborative) development of KPIs to measure success has on the one hand the effect that new rays of transparency are emitted which in itself has a behavioural effect. On the other hand, the definition of KPIs is the embodiment of links between near future initiatives and mid future results.

The choice of KPIs is meaningful and should be limited. It is very difficult to convincingly focus on 27 KPI at the same time. Ideally it should be boiled to around 7 KPI which cover various performance perspectives. The KPIs should be able to be broken down to all hierarchy levels and to be consolidated easily.

8.4.5 Set Targets for all Levels

Now that the KPIs are defined, the targets have to be set for all levels. If this process is taken as an opportunity for participative goal setting, it might create a noticeable motivational effect. “All levels” means in this case that every individual, every team, every company and every country or division should have committed goals and targets that consolidate into the overall targets.

The target setting process helps clarifying the objectives and goals of a company and builds transparency about activity levels and performance measures. This can help generate meaning for the employees, since they know where to go. It can be an opportunity for gaining an in depth understanding of business processes and enhances accountability of all individuals and management.

The reduction on a few KPIs necessarily leads to a simplification of the performance of the company which comes at certain risks. The defined measures might be surrogate or shadow measures of performance in the absence of meaningful measures. The drawbacks of clear targets can also be that people start driving the required numbers at the detriment of other performance parameters which are not closely watched. The EBIT can be increased for example in the short term by reducing maintenance and R&D expenditures. Both will have a negative effect on the long-term performance of the company by a higher machine breakdown probability and a lower propensity to develop new products. If a certain activity level in a special area is agreed (for example in direct sales), it might have the effect that the after-sales service is reduced to cope with the newly agreed activity level. Budget games start to happen, when targets are established. Some parameters might be deliberately underachieved to overachieve in the next year. Targets might be put at a comfortably low level, which will allow for organisational slack and an easy over-achievement.

Since KPIs as clear performance measures are indispensable for accountability and governance, the challenge is to deal with the drawbacks while utilizing the full positive potential of the numbers and the target setting process by integrating interactive elements.

8.4.6 Measure and Report Progress

A performance management system needs to measure performance. A prerequisite is a measurable KPI, but also a predefined way of collecting and processing data. Once the data is generated, it has to be presented. Dashboards give a visualized overview of the progress. A traffic light signal gives direct feedback or whether the team or company is on track for achieving the promised targets.

Figure 10: Dashboard

The weekly, monthly, quarterly or annual reporting routines with the dashboard can help to identify problems and to stir the discussion for possible solutions enabling even better performance.

8.4.7 Corrective Action for better Execution

The reporting rounds are variance analysis sessions but also joint discussions about how to achieve the original targets in changed circumstances. The achievement of the final annual goals might be months away, but along the way the targets exercise their attention focussing reality shaping powers.

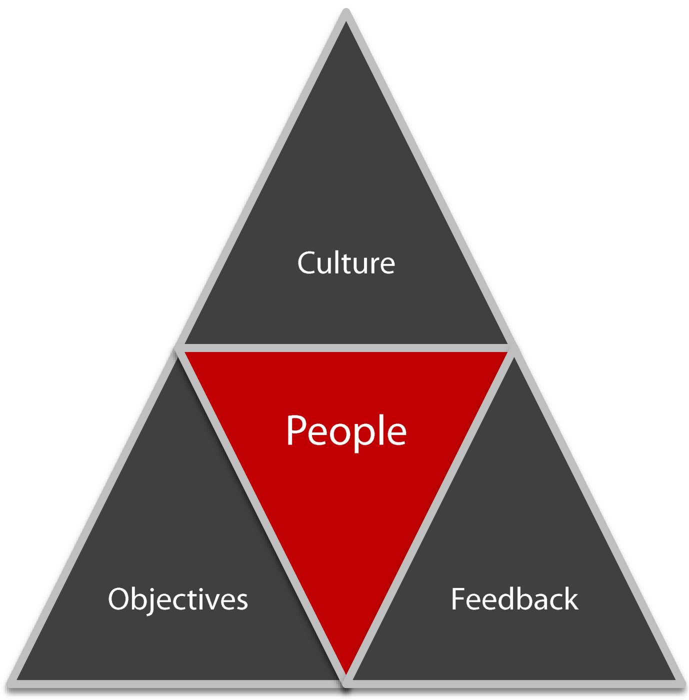


Figure 11: Performance Triangle

The Performance Triangle shows the engine of the inner performance of an organization with people as the beating heart of this engine. It is in my view the interplay of objectives, a performance driven culture and the feedback on achieved results, which will lead to the inner performance of an organization and will turn it into a humming machine. In this culture, a “can-do” attitude and the spirit of changing the plan if the environment is changing, will lead to corrective actions.

Corrective actions might include spending more, investing more money or energy than expected time on certain topics. Since the overall resources are limited, these efforts have to be saved from other activities. Thus the whole operations model is constantly questioned and improved. However, at the end of the day, one might also draw the conclusion that the original objective is unrealistic and needs revision.

8.5 Performance Management Systems as Political Instrument

Performance Management Systems try to tackle the old issue of management control, which is a rather complex challenge with no rational solution. The cybernetic control philosophy applied by many performance management instruments like the balanced scorecard or others hides the complexity of the task at hand. Performance management is arguably more a political than a technical planning and control process. In a business environment which is dynamic or even disruptive, the cybernetic attempt appears futile if not dangerous.

From a political paradigm, management cannot but implement a performance management system to provide accountability to stakeholders. The performance management system and especially the implementation process can serve as fairy dust for the employees, create a feeling of belonging and do the trick of placebo management well known from the Hawthorne studies. The power of self-fulfilling prophecies is a force to be reckoned with in shaping the future. Even rational management cannot forgo this opportunity to create value. A plethora of concepts and management fashions has been created to fulfil this deep management need and this industry will probably also prosper in the future. The eternal task at hand is to develop a company specific creative package of management control with the ingredients presented in this chapter to start the engine of the performance triangle. Good luck with your own performance management system design.

Exercises

Integrated Management Control Systems for Students

Envision your future

Take 5 minutes for yourself and imagine yourself ten years from now. Due to a fantastic career path which led you into the executive board of in internationally respected company, you were selected by a famous TV show with international coverage as one of the five candidates for the *Most Outstanding Career Award*. You are publicly interviewed about various aspects of your life. Imagine your answers to the following two questions.

1. Which competences helped you most to achieve outstanding results and gain influence?
2. How did you use your student time at your university to prepare you for an outstanding career?

The Excellent Student Scorecard

Your affluent Aunt Elisabeth wants you to increase your awareness for performance management as a student, because she assumes from listening to your stories about student life in Berlin that you are not concentrating enough on "what counts". As an advanced business administration student you have accepted the challenge.

She has therefore offered you to generously pay 200 € per month plus a bonus of up to 1,000 € per semester if you set up and monitor your own personal student performance. Unfortunately, she wants a maximum of 500 € back, if you do not perform as planned. The bonus/malus would be paid due to measurable excellent (non-) performance. You told her that the student performance cannot be measured alone on the basis of the results of the exams per semester. She smiles and allows you to define your performance in at least four different performance dimensions. Her initial proposal was to look into personal finance, health & learning processes, social and environmental responsibility and professional market value (where she thinks about your final grades as well as other aspects of your marketability within the business world).

However, she is willing to go with your superior recommendations on the dimensions. She wants you to set objectives for each performance dimension and come up with four Key Performance Indicators per performance dimension that are measurable and auditable. She is also interested in your initiatives that will support your plans and your risk assessment of potential disturbances that might prevent you from reaching your goals. Maintaining a proper risk management system and a set of internal controls will earn you additional 50 € per months.

Required:

1) SWOT Analysis of yourself as a student ("blending" of group profile or choice of one student)
2) Definition of the strategy map of the Student (Which are the core processes? Which are the individual value drivers?)
3) Building a Student Value Proposition – Strategy Definition
4) Definition of a Vision and Mission of an excellent Student
5) Define at least 4 performance dimensions in which your excellence as a student can be shown.
6) Define 4 KPIs per dimension on how to measure your performance.
7) Define a target level for each KPI after the semester. Make sure that every result can be audited and verified by your aunt. Think about different actions how to achieve the

wanted performance level.

8) Make a risk map identifying the main risks that can prevent you from reaching your goals. Which are the 5 Key Risk Indicators which you want to carefully monitor?
9) Define 10 internal controls that will help you to keep on track.
10) Suggest a clear system/algorithm for the bonus/malus payment – Make sure that you will at least not receive any bonus if you fail one course relevant for your degree.

Complication:

Work in Groups where one group is building a top down approach from Aunt Elisabeth and another group defines a management control system for the student from the student's perspective. Both teams have to come up with a system they can both agree on. If no agreement is found, no additional money will be available for the student.

1. Why is financial reporting only one part of management control?
2. Is it possible to design a standardised management control system?
3. Explain the importance of the Three Cs of Trust.
4. You have read about the Hawthorne Studies. Have you ever made the experience, that recognition from superiors or even peers has increased your performance? Explain.
5. What are the three categories of control and how do they relate to the three performance loops of the performance management cascade?