Measuring Success: Making the Most of Performance Metrics


The best metrics are those that communicate to senior management whether the company is progressing toward stated goals or is stuck in a holding pattern. Good metrics involve buy-in at all levels of the organization—not just from management but also from those whose activities are being measured. “Performance metrics are a way to keep your strategic planning activities honest,” says Justin LaChance, Senior Vice President, Financial Planning & Analysis.

Key Takeaways
The best performance metrics are developed to meet a company’s particular long-term goals. Start by identifying what your most important shareholders think is important. The credibility of the chosen metrics is crucial to ensure buy-in at all levels of the organization. Just as a company’s goals and objectives evolve over time, the set of performance metrics management uses to track progress toward those goals should also change over time. If metrics are well designed and continually examined for relevance, they can be the precise tools management needs to turn strategic planning into action, and guide company-wide decision making so that stated goals are achievable and continually in focus throughout the organization.

Measuring Success
GE believes that the best metrics companies can develop and use to measure performance are the ones that each company develops to meet its own particular long-term goals. While certain general performance metrics such as operating profit percentage are important and useful to most companies, no combination of ideal, “one-size-fits-all” measurements exists to deliver the right information for every company in every industry or operating environment. For example, inventory and sales volume metrics—tracked with detail and frequency—may be the most important metrics for large retailers. Inventory turnover ratios might be crucial information for a distributor, but of limited value to a service provider.

“The right combination of metrics, studied as a group, can show not only where the company is succeeding but also highlight specific areas of weakness.” The first step in devising metrics that fit your company’s needs is to look carefully at your own company, and your competition. “Always begin by identifying what your most important stakeholders think is important,” says LaChance. The second step is to make sure you clearly define long-term and short-term operational goals, so that you can create metrics that align with those goals.

Strategic planning and metrics
Performance metrics are most useful when analyzed as a group. Therefore, an important next step is to develop a matrix of measurements that, taken together, will provide management with insight into how a particular area of the business is performing in relation to strategic goals. The right combination of metrics, studied as a group, can show not only where the company is succeeding but also highlight specific areas of weakness. As data accumulates, the matrix can display trends and identify places where management can take steps to improve performance.
For example, management might decide on a one-year goal of raising yearly sales growth from 3% to 5%. From that goal, the strategic planning team would develop more specific execution targets. In order to boost overall sales growth, a goal for one division might be to increase sales by 6% in the coming year. Meanwhile, at another division, a tough economic forecast might cause planners to conclude that new sales volume will not materialize in the coming year. Therefore, management may decide that the primary one-year goal for that division is to generate stronger earnings growth from core operations. From these division-specific goals, a matrix of performance measurements could be created to track progress toward those goals and identify areas that need improvement.

The next step for planners is to test and then demonstrate that their method for calculating metrics is consistent and repeatable—and to develop a well-defined and controlled process for generating and reporting those metrics over time. “More than anything else the credibility of the metrics is crucial,” says LaChance.

**Operating profit percentage: A key performance metric**

While the strategic planning process identifies business-specific goals and develops new metrics for tracking progress toward those goals, some performance metrics are particularly valuable at all times and common to all types of business. At GE, the primary metric used for measuring overall performance and productivity is operating profit as a percentage of revenue. Operating profit metrics strip out the impact of one-time revenues and expenses to reveal how the business is performing.

**GE’S calculation of operating profit**

Subtract variable costs from sales to arrive at the contribution margin.

Subtract base costs from the contribution margin to arrive at the operating margin.

Add in external “other income,” net interest income or expense, and subtract minority interest to arrive at operating profit.

Calculate total revenue by adding external income to sales.

At GE, all eyes focus on operating profit. But having that metric is only the beginning of performance metrics development, not the end. In examining operating profit components, GE’s analysts dig deeper, searching for the drivers of change and then identifying specific activities that can be quantified, tracked and improved.

**Maximizing the benefit from your metrics**

To get the most benefit from performance metrics, consider the following:

At their most fundamental level, performance metrics measure the performance of your team. The most direct way to achieve results is to tie compensation to the most relevant metrics. However, in GE’s experience, pride, more often than not, drives performance. When team members examine measurements of improvement and must justify to their peers whether goals...
have been met, satisfaction in achieving those goals on a personal and group level is a strong incentive that drives superior performance.

If the metrics developed are not relevant to performance, or if they are measuring something that is too insignificant to affect performance, then management jeopardizes effectiveness by focusing on those measurements instead of others. “If I am publishing metrics that are not relevant or impactful, I am wasting my time and the time of others,” says LaChance. The credibility of the metrics that are developed, how they tie into broad company goals and whether they are communicated to and adopted by all stakeholders involved in the activity measured are critical factors to the success of performance measurement.

Calculate metrics accurately. Unless a company calculates metrics carefully, the operations personnel whose activities are being measured will not cooperate—or will ignore the metrics altogether. It is important to have buy-in not just from management but also from everyone whose activities are being measured.

**Resources**

- Measuring Success: Creating the metrics that deliver the information you need
- Forbes: Counting What Counts – How Outcome Metrics Have Changed the Game
- Inc. Magazine: Performance Metrics: Get the Numbers Right
- How to Secure Corporate Financing: 10 Tips for Smart Borrowers
- How Mid-Market Businesses Are Built on Better Capital
- Ten Tactics for Improving Middle Market Businesses
- Optimizing Working Capital: How to Deploy Liquidity and Create Value
- Capital Perspectives Articles