

strategy&

***Strategic
performance
measurement***

&

**Creating a common
language to drive
execution**



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Executive summary



The execution of strategy is often difficult and always critical to a company's success. Companies that excel in execution consistently stand above their peers. To help drive strategy execution and performance improvement, executives in a range of industries should consider using strategic performance measurement (SPM). SPM is an approach that makes an organization's strategic goals more transparent to line executives and provides an ongoing mechanism to monitor progress toward these goals through simple and intuitive performance measures. SPM creates a common language among all parts of the organization so they can interact transparently and effectively, thus helping to break down silos. SPM has four elements: (1) aligning and cascading strategic objectives down to day-to-day operational goals; (2) developing balanced scorecards for reporting; (3) making reporting easier and focusing on "metrics that matter"; and (4) testing and validating operational and strategic decisions.

Choosing the right metrics to track is the key to successful SPM implementation. In this report, we share several best practices for determining the correct metrics for a company's specific strategic goals. We also elaborate on some of the common challenges that companies confront when trying to put SPM into action — such as ineffective communication, an excess of data, and the need for executive buy-in — along with possible solutions. Three case studies involving global financial institutions describe in detail how CEOs have employed SPM to align strategic goals with day-to-day operations and on-the-ground, agile decision making.

The key to 21st-century growth

As the U.S. and world economies continue to grow, we are gradually entering a period where many companies in a variety of industries and geographies are finally able to shift from a cost-cutting agenda to a growth-focused, capabilities-building agenda. But for any new growth strategy to succeed, all levels of the organization must clearly understand enterprise and corporate goals, how they cascade down to individual executive goals, and the strategy to achieve those goals. Senior leaders are expected — and need — to make fact-based decisions at all levels of the value chain, and align incentives across the organization and achieve traction against strategic objectives.

Indeed, what sets a firm apart from its peers is how well it executes its strategy. In a recent Strategy& survey of more than 500 senior executives, nearly two-thirds of the CEOs said executing a strategy is more difficult than developing the strategy and 80 percent felt that their overall strategy was not well understood even within their own company. (For more information, please refer to the book *Strategy That Works: How Winning Companies Close the Strategy-to-Execution Gap*.) With this need for execution in mind, executives should consider strategic performance measurement (SPM), an approach that makes an organization's strategic goals more transparent to line executives and provides an ongoing mechanism to monitor the achievement of these goals through simple, intuitive performance measures.

All companies have some performance measurement practices in place, yet many common challenges persist. These include a lack of clear linkage between strategic objectives and operational performance measures, limited accountability for outcomes at the operational level, an unmanageable number of sometimes random metrics, fragmented and redundant systems and efforts, and a greater focus on metric analysis than on management decision making.

Without a consistent framework for measuring performance that is explicitly and clearly linked to the overall strategy and anchored in strategic goals, organizational units often don't understand what is

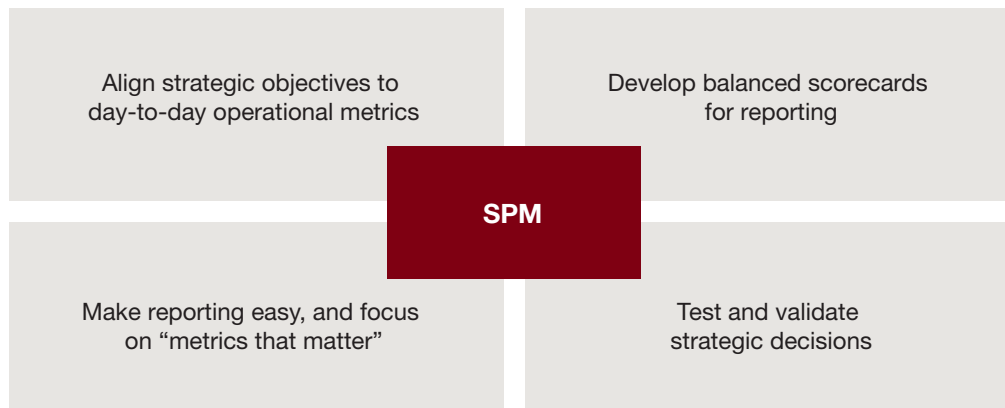
expected of them to achieve strategic alignment. At a more basic level, there is often no uniform approach to describe the performance of a business unit, a functional organization, or a department. Consequently, performance-related conversations are often based on anecdotes rather than a common fact base of outcome measures and a common understanding of causal drivers.

The SPM methodology

SPM creates a common language for the various parts of the organization to interact transparently and effectively, thus helping to break down silos. SPM has four key elements (see Exhibit 1).

First, SPM creates a clear line of sight that links and integrates all levels of the organization, thus aligning strategic objectives to day-to-day operational goals. At the highest level, SPM measures overall progress toward the organization’s vision and strategic goals. It can measure execution in individual parts of the organization all along the value chain, which helps identify those areas that are contributing to strategic goals and those that are not. This line of sight includes assessing how organizational measures influence individual and managerial performance appraisals.

Exhibit 1 Key elements of SPM



Source: PwC Strategy& experience and analysis

Another element of SPM is the balanced scorecard — i.e., measures of both financial and nonfinancial aspects of the business. To ensure that strategic objectives are not too narrowly focused, SPM balanced scorecards should capture measures of performance against four dimensions: financial, customer, internal business or operations, and innovation/growth. This balanced model helps executives make smart trade-offs between competing objectives (e.g., lowering unit costs versus increasing service standards).

The third element of SPM is making performance measurement easy and a part of your daily life. The first step toward this goal is improving the structure, production, and consumption of reports. Instead of having hundreds of reports hitting executives' inboxes with critical information scattered across multiple pages/screens, companies should present senior executives with weekly, monthly, and quarterly streamlined reports focusing on "metrics that matter" that executives can review while sipping their morning coffee. Companies should also make the same simple metrics available at all levels of the organization (across business units and supporting functional areas).

Last but not least, SPM provides a medium for the senior leadership to test and validate organizational changes and strategic business decisions and can also help with change management. Examples include restructuring lines of businesses, developing P&L statements for business units and products, and transitioning from a sales-focused organization to a product-focused organization. Leaders can use SPM to stress-test these decisions before committing to them.

Choosing and using metrics for SPM

Besides providing a common taxonomy, SPM offers the advantage of agility. A company can shed old metrics and adopt new ones as goals change, such as targeting a new market or making an acquisition. Metrics too often become hardwired into an organization and continue to be tracked even when they no longer capture useful or actionable information. For this reason, SPM is a powerful tool for creating everything from a five-year strategic plan to an accelerated 90-day program that a new CEO or division head might use to jump-start the change.

There is no set list of metrics appropriate for all companies at all times. And we've learned that determining the right metrics for a particular company's strategy is part art and part science. In our work with clients, we have identified several best practices for picking the right metrics for all dimensions of the balanced scorecard (financial, customer, internal business, and innovation/growth).

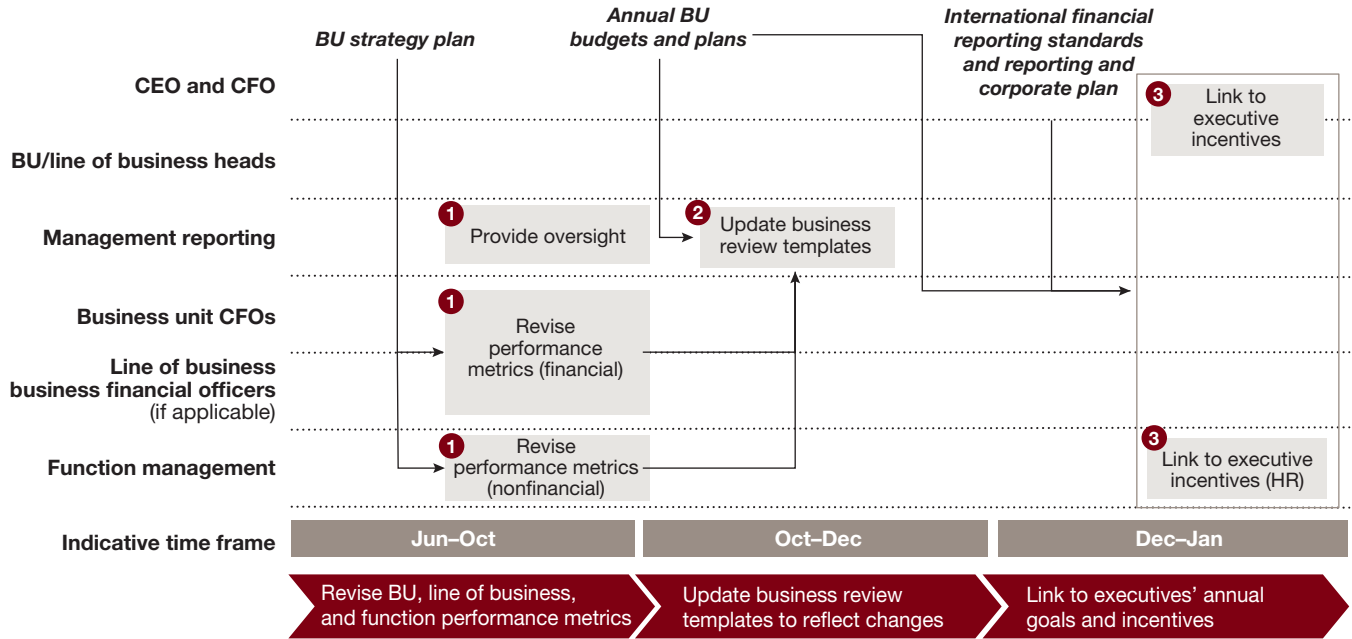
First, metrics must be tied to strategic objectives and must be translatable into business unit (BU) goals and individual actions. Metrics need to balance visibility into both current and future performance. They should also be "benchmarkable" so senior leaders can compare performance across client segments, products, and divisions, and even against peers. And, ideally, the company should start with focusing on metrics that can be collected with existing or easy-to-implement processes and systems. SPM should not require a wholesale technology overhaul; indeed, ease of implementation is one of its major benefits.

Furthermore, companies need to be able to aggregate the metrics to some degree so they can be rolled up across the enterprise and so people can slice and dice the data for different views. Finally, companies should begin acting on metrics as soon as sufficient data is available, and not become stalled by trying to get to the perfect set of metrics. Good metrics are good enough.

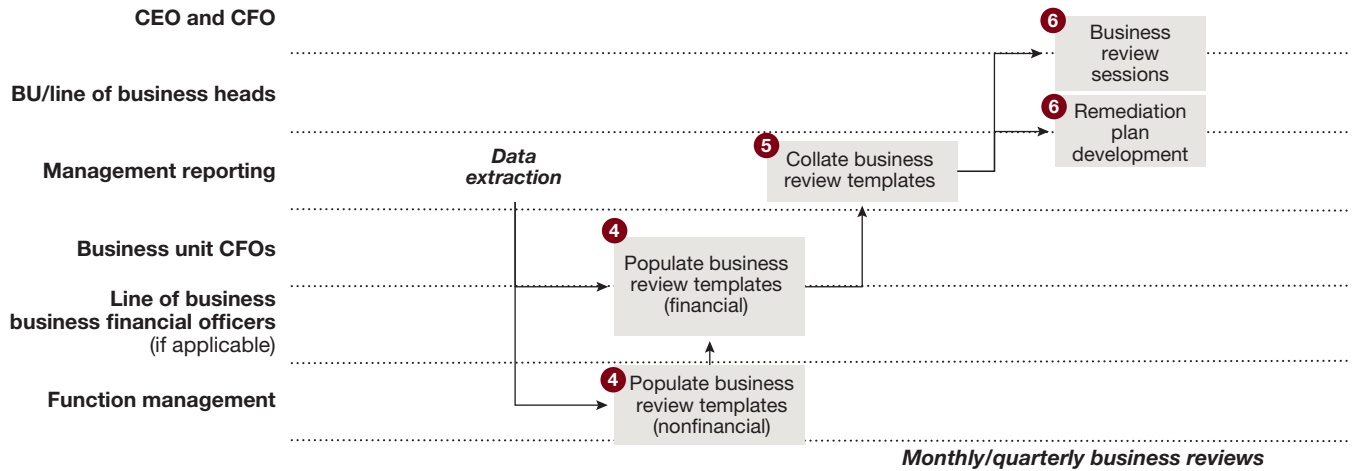
Once chosen, these metrics can power dashboards that drive *business management and decision making* (e.g., for better dialogue between business and functional leaders, to understand gaps in client services and/or performance, and to set more achievable stretch targets); *performance improvements* (e.g., to understand linkages between metrics, to benchmark performance, and to prioritize resources); and *a positive feedback loop across management processes* (e.g., to align metrics with strategic planning and annual budgeting processes, and to link executive incentives to operating performance). Exhibit 2, next page, shows how elements of the SPM framework and time lines can be linked to the annual planning, budgeting, and incentive management processes typical at large corporations, and with the stakeholders that would typically need to be involved across BUs and key staff functions.

Choosing metrics can be easier than getting everyone in the organization to adopt them. Senior leaders often have their own ideas about the “right” metrics and goals. There is also a preference for metrics that paint a good story (especially when compensation and other rewards are at stake), and people generally dislike being measured on metrics they did not help develop. For these reasons, the selection of metrics should be as transparent and inclusive as possible, with care and time devoted to syndication and achieving executive buy-in.

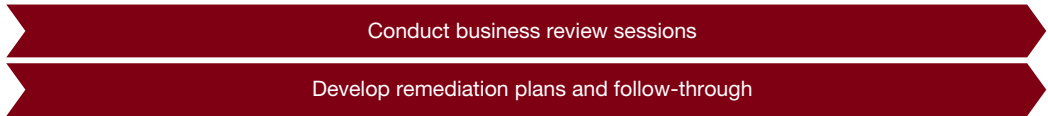
Exhibit 2
Linking SPM to BAU management processes



Annually



Monthly/quarterly business reviews



Monthly

Source: Strategy&

SPM in action

We have worked closely with several large, global financial institutions to put the SPM methodology into practice at relatively low cost. Although all three case studies in this report involve financial institutions (*see Exhibit 3, next page*), SPM has broad applicability across industries. SPM can be used in a variety of situations, from implementing a growth-driven agenda to addressing challenges with existing reporting methods. Implementing SPM, including metrics and alignment with business-as-usual (BAU) processes, is a two- to three-year journey depending on the organization's readiness — although some SPM benefits can be visible in 12 to 18 months.

In these cases, and in our general experience working with clients, virtually all of the executives' initial goals were met. We translated strategic objectives into desired outcomes and developed key performance indicators (KPIs) to improve executives' ability to proactively manage their business and achieve those strategic objectives. The SPM methodology also reduced reporting overlap, as well as variations in formats and frequency. New monthly reports were designed with both financial and nonfinancial dimensions to build a balanced scorecard, and executive reporting was streamlined by report production through a shared-services center of excellence.

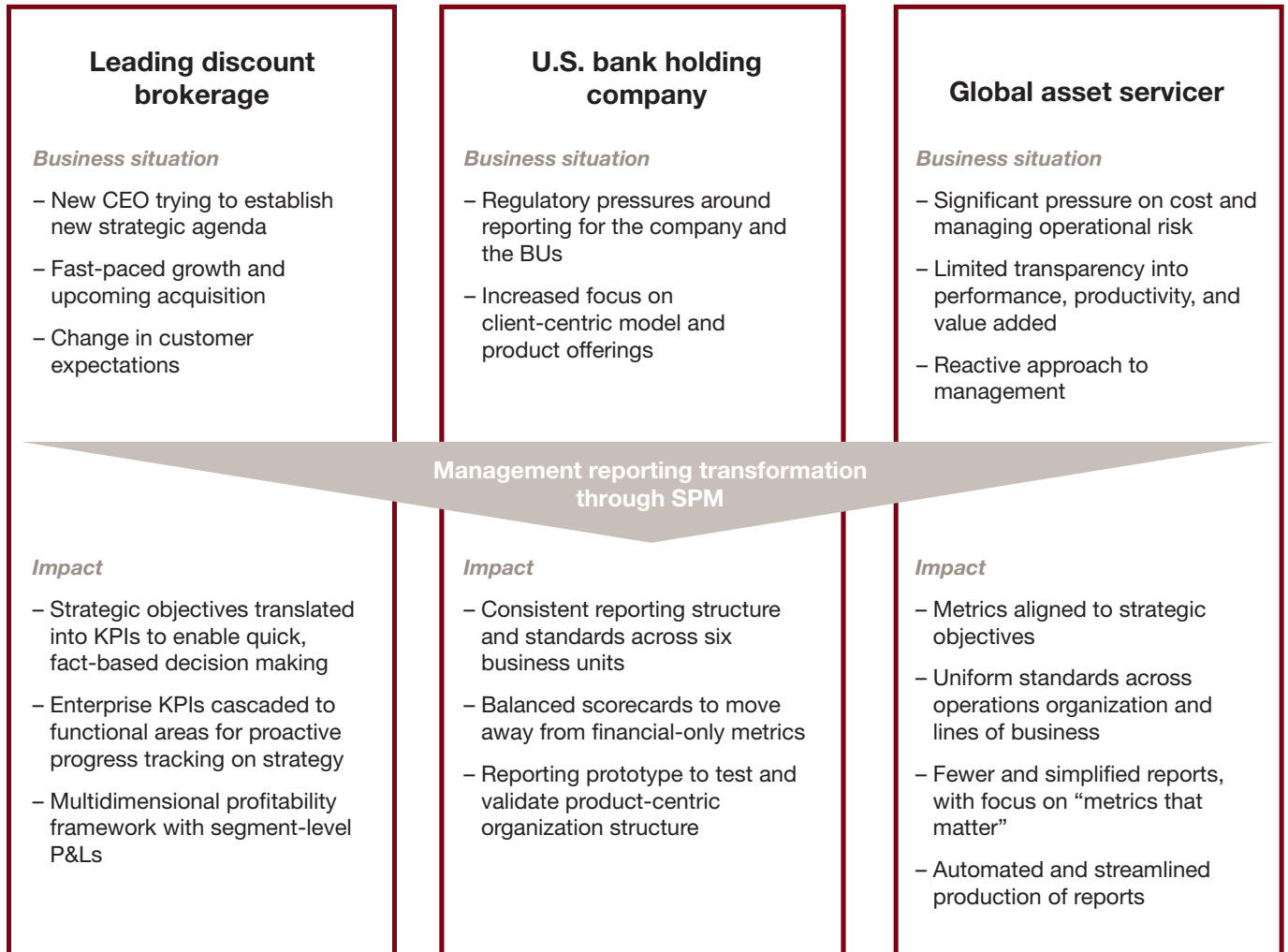
Some of the KPIs we developed helped executives understand the true profitability of customer segments, products, and channels, which allowed a client to refine its cost allocation methodology and develop multidimensional P&Ls (e.g., direct activity costs, indirect activity costs, and enterprise-sustaining costs by customer segments and products).

At most of these institutions, the following activities were required to drive adoption of the SPM framework:

- Cascading strategic enterprise- and corporate-level objectives down to BU and functional objectives
- Defining a KPI library aligned to the BU and functional objectives

Exhibit 3

Three firms that adopted SPM



Source: Strategy&

- Developing a consistent and detailed calculation methodology, benchmarking requirements, and functional data requirements for all KPIs
- Developing a KPI dashboard for each business unit and functional area
- Creating mock-up monthly operating reports using the KPI library as a proof of concept
- Refining the revenue and cost allocation methodology to develop multidimensional P&Ls (client view, product view, and channel view)
- Identifying technology and infrastructure requirements, and developing an execution and change management road map encompassing approximately 12 to 18 months

Challenges with implementing SPM

Although SPM offers enormous institutional benefits, any changes that touch on accountability, incentives, and compensation inevitably present challenges. First and foremost is the need to build executive buy-in. SPM focuses on performance indicators rather than traditional performance drivers, and executives need to agree on tracking, reporting, and following these metrics.

To ensure this buy-in, the CEO or CFO must own the initiative and make sure that executives accept the new or modified metrics. That said, there must be a reasonable transition period — usually three to six months depending on the readiness and maturity of the organization — during which executives report on both the old and new metrics while they get comfortable with the new reporting.

Another common hurdle to SPM adoption is ineffective top-down communication on the importance, purpose, and objectives of SPM. The root of this problem is often that senior leaders haven't clearly defined the strategy for themselves and therefore cannot articulate it convincingly to others. Not surprisingly, this leads to confusion about leaders' goals and the rationale behind SPM adoption, and middle management may interpret SPM as just one more report and not a strategic initiative. Senior leaders need to develop something akin to the classic elevator pitch.

Senior leaders must also guard against drowning in data by making sure they focus on the “metrics that matter.” A company cannot be the best at everything — at least not right away. So leaders need to prioritize five to eight strategic objectives, choose a manageable handful of metrics for each, and assign them to different leaders so no one person becomes overwhelmed. It's also important not to confuse SPM metrics with operational reporting. SPM must inform operations — the two sets of metric can't be siloed, but they shouldn't be conflated either.

Conclusion

To seize growth opportunities today, companies across industries must become much nimbler. In large organizations, success has always depended on all levels of the organization understanding corporate strategy and how it translates into their day-to-day actions. The difference now is that the business environment is in constant flux and changes so rapidly. Agility is essential to keep up, and that means being able to quickly change performance benchmarks and cascade those changes down through the organization so the entire company can work in concert to deliver on strategic goals. SPM is a powerful methodology that can close the gap between strategy and execution.

Case study 1: A leading discount brokerage

A large discount brokerage had integrated several acquisitions successfully over the previous 10 years, fueling fast growth, and its newest acquisition was poised to increase the company's revenues by 50 percent. The new CEO and CFO wanted to connect their strategy to day-to-day operations more effectively — particularly when it came to meeting the changing expectations of customers for more digital and self-service offerings. They also wanted to better understand profitability by each client segment, product, and geography.

The company rolled out strategic performance measurement to accomplish three key goals. First, it translated strategic objectives into outcomes so it could measure using a limited number of key performance indicators.

Second, these KPIs were cascaded down to all functional areas — such as marketing, technology, operations, and other supporting functions — by creating drill-down views of the metrics, thus linking strategic goals to operational-level actions and performance. Dashboards were aligned by using a common language: for example, using the same definitions and parameters to calculate the metrics across different business units and functional areas.

Finally, KPIs were designed to better evaluate client segments. In the past, the company understood revenue, but costs were more difficult to calculate and allocate as there were many common costs spread across the organization. The new set of KPIs allowed leaders to allocate costs more precisely to determine the true profitability of business units and client segments.

Case study 2: A U.S. bank holding company

New U.S. regulations required an international bank with large U.S. operations to create a U.S. bank holding company for all its business units, which included a commercial bank, retail bank, wealth management unit, auto lending unit, and investment banking arm. In the past, these business units reported results independently with little uniformity. But the new holding company structure required that these BUs report results as a bank holding company so results could be rolled up.

The new CEO settled on three strategic objectives: creating a common language among the BUs; driving consistency of reporting across business units; and using uniform monthly reporting to understand performance across the

businesses on a regular basis. One of the big changes for this institution was to delve much deeper into nonfinancial metrics, such as client segments, products, and operations. In the past, it had focused only on financial income statements.

The executive also wanted to evaluate switching the business strategy from branch-based sales to product-based sales. That required organizational changes and the implementation of new metrics to measure profitability by branch, client, and product. SPM offered a way to stress-test the idea and various scenarios before full implementation. A prototype of the reporting templates for the executives was tested and refined before being moved into production.

Case study 3: A global asset servicer

The CEO of this global asset servicer felt that the company’s strategy was not well connected to the operational goals. Moreover, there was little consistency in reporting among business units, and executives were being sent too many reports on a daily basis — anywhere from five to 10 — that did not aid decision making.

Here, the SPM framework was used to streamline the reporting process, help the company focus on “metrics that matter,” and execute the strategy better by drawing a clear line from strategic goals to the outcomes. KPIs were defined to measure the progress against the outcomes and the specific on-the-ground operational initiatives that drove the KPIs. For example, one of the company’s strategic goals was to improve the

client experience. The metrics selected to measure progress against that goal were a client satisfaction index and a net advocacy score (which measures current customers’ willingness to promote the institution to others).

One specific operational goal the company settled on to improve those two metrics was to drive average hold time in the inbound customer service call center to less than one minute. This led to internal debates on whether the company should hire more customer service reps or invest in making the process more efficient, questions that were resolved through some rigorous financial modeling and cost-benefit analysis — a good example of connecting strategic goals to day-to-day operational decisions.

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