Punished By Rewards

Are your incentives and rewards focused on metrics or customer satisfaction?

By Inez Blackburn, Retail Expert/Marketing Consultant

Why should we change our performance metrics when we have so much on our plate already?

- More demanding, socially conscious consumers
- Impact of global economy
- Emergence and convergence of technology
- Impact and opportunity of demographic shifts and affluence of emerging economies
- Renewed focus on distribution economics
- Changing retail landscape convergence and emergence of sales channels

These forces will individually and collectively impact and alter your value chain and will change how and where consumers live shop and work. Are you prepared for what lies ahead? Are your old ways of working giving you the desired result or do you need to find new ways of working together?

Consumers are evolving and are more demanding, resulting in the current revolution in how companies are designed, measured, and rewarded.

Measure what matters has always been the battle cry of armies of tacticians and accountants. Why, then, do we focus our efforts on metrics that fail to positively impact customer satisfaction?

Revolutions begin long before they are officially declared. For many years businesses have been struggling with how to measure performance and have concluded that new strategies and competitive realities demand new measurement systems. At the heart of the debate lies a radical decision: to shift from treating financial measures as the foundation for performance measurement to treating them as one among a broader set of measures. Tracking non-financial measures are one thing giving them equal billing is truly a revolution. Therein lies the need for balanced metrics that reward the right behaviors and are focused on consumer satisfaction.

Ask anyone how you measure a company's success and they will tell you "Obviously by how much money they make." It would be hard to find anyone in management that wasn't focused on the bottom line. Gross margins, net margins, net income, gross revenues, and return on capital are the typical and critical "bottom line" survival metrics. But what happens when management only focuses on bottom line metrics? Financial measures are always lagging indicators that measure past performance and past successes. Unfortunately these lagging indicators fall short in predicting future performance. They are essentially measures that monitor past events that you no longer control. When you run out of gas on a desolate highway, does it really matter that you know the exact location of a gas station that you passed two hours ago?

The biggest drawback of just focusing on financial measures is the fact that they are disconnected from your customers. Too often, decisions are made that positively impact the bottom line but compromise customer relationships. Have you ever been in a store near closing time with long lines at the checkout, and happened to notice that, despite the long lines, cashiers are closing their lanes?

Measures that focus on inward looking goals such as return on investment are primarily concerned with past performance rather than potential performance. As a result, measurement systems in most firms fail to track customer satisfaction, customer loyalty, and customer profitability because they don't know how to. Products and customers are measured in accordance to profitability and market share and as a result provide little insight into whether or not current customers and product offerings support an organization's goals and objectives.

You cannot depend on past performance to predict future behaviors. A more balanced and comprehensive approach demands equal emphasis on measures of outcome (the financial measures or lagging indicators), current performance measures that will tell us how well the company is doing now (current indicators), and measures of how you may perform in the future (leading indicators).

A recent white paper commissioned by VICS in conjunction with the GCI *New Ways of Working Together* project team highlighted the fact that financial measures continue to be financial in nature with a noted absence of metrics focused on employee or customer satisfaction.

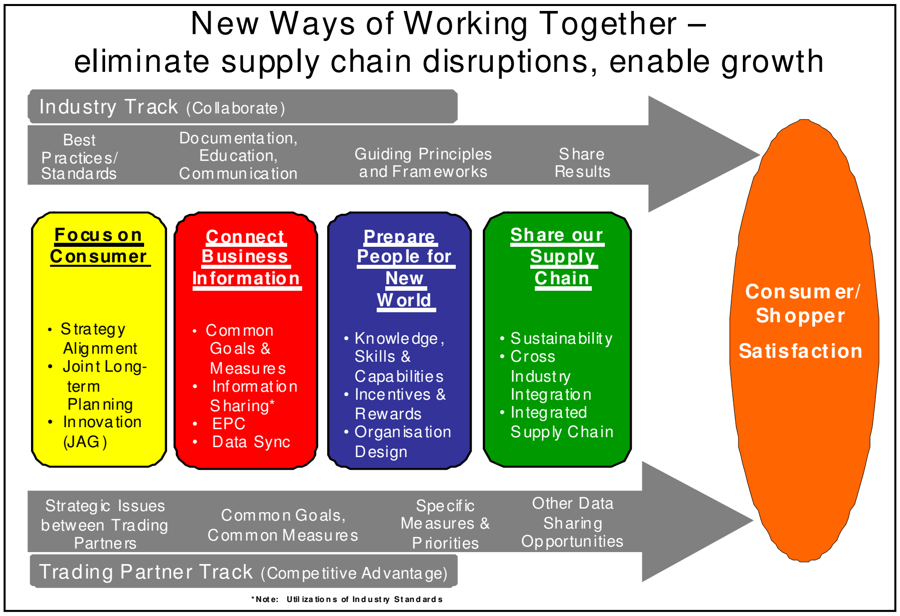
The main focus of the *New Ways of Working Together* research was to identify new ways of collaborating, communicating, and understanding consumer behavior. The *New Ways of Working Together* framework was designed to address the key pillars of performance that would maximize customer satisfaction. A core mandate of the research was to understand key barriers and enablers of performance with respect to structures incentives and rewards and the importance of collaboration across the value chain and to determine when and how companies were collaborating.

What Will Drive Improvement?

If we are to improve, then we must change by impacting at its core the behavioral, cultural and structural drivers of change:

- We need to understand what to change (Structure, Incentives, Rewards)
- The catalyst for change and how to change (Current performance)

The *New Ways of Working Together* framework and core objective was to develop new ways for vertical trading partners to work together – including sustainable changes in culture, collaborative business planning, and new measures and rewards.



New Ways of Working Together is about business transformation to better satisfy the consumer and shopper. It offers a framework for getting alignment and commitment on four key strategic choices in the collaboration of trading partners.

Focus on the Consumer: involves trading partner bilateral collaboration to better meet the needs of our consumers and shoppers. One breakthrough concept here, the Jointly Agreed Growth (JAG) methodology addresses the fact that, in more strategic relationships, annual business planning is simply insufficient. Business plans must stretch the time horizon to allow for *bricks and mortar* or capital investments. With this longer term business planning, protecting intellectual property and creating trust are essential.

Connect Business Information: involves establishing common goals, common measures and a common language. Key components of this *plank* include the establishment of GS1 standards for key performance indicators called: *Trading Partner Performance Measures* and the use of Global Data Synchronization to ensure there is one single view.

Prepare Our People: addresses the organizational structures, capabilities, measures, incentives and rewards that either facilitate or create barriers to collaboration. If people behave as they are measured, are we confident that we are measuring and rewarding the right behaviors?

Share Our Supply Chain: is all about how the industry and trading partners must do things differently to address volatile energy costs and the need for more sustainable business practices. It is also about creating visibility across the supply chain to ensure a more *pro*active versus *re*active culture.

Aligning financial measures around a customer impact metric that recognizes the importance of standards and balanced performance metrics was identified in the research as a challenge as incentives and rewards were limited to financial metrics. Numerous respondents in the research indicated that performance metrics were often designed in accordance to department and division requirements rather than customer satisfaction.

The clear identification of barriers that block structures, people, and processes to work in tandem with incentives and rewards has been the major epiphany from this research. Most participants in this research were more consumed by short-term metrics driven by department objectives rather and perceiving collaboration and commitment to joint business planning as a preferred but unattainable luxury. Most respondents fear the risks involved from change as a greater threat than the opportunities they create.

All respondents overwhelmingly agreed that the removal of barriers that block the parts of an organization from working together as a fully integrated unit would result in significant and sustainable growth focused and fueled by the consumer.

Participant Quote: Manufacturer- “Our departments are like tribes each focused on their needs in the name of survival often at the expense of the consumer – We are much more focused on profit than customer satisfaction”

Participant Quote: Manufacturer - “Focus on profit has impacted training which impacted learning and innovation which impacted customer service”

Developing and deploying metrics designed around customer satisfaction will, when deployed, require a complete evaluation of current structures incentives and rewards. Manufactures and retailers alike will be forced to step outside their comfort zone with a renewed commitment to a longer planning horizon and metrics and incentives that reward the right behaviors.

While many organizations claim they are committed to their employees and customers and hold them in high regard, the driving force behind any and every organization remains the desire for increased profits. Unfortunately, many companies with the best intentions fail to realize their full potential because they fail to understand the importance of how measures of performance influence behaviors.

The myopic focus on economics of production means that suppliers and consumer goods companies continue to manage to market share and revenue goals with a strong focus on financial short-term metrics. More specifically, they aim to maximize these numbers for each of the categories that they control. Synergy internally and externally across trading partners with respect to structures, incentives, and rewards are often overlooked.

Retailers, on the other hand, aim to maximize profits by consumer. They are constrained in terms of their shelf-space in terms of the revenue they can capture from their customers.

The NWWT research further validated this situation as numerous participants voiced their frustrations and concerns with respect to the impact of misaligned measures and rewards.

Research Highlights

1. 50/50 split on whether current metrics support effective collaboration and cooperation

2. Majority of respondents believe corporate and group goals are aligned with strategy, trading partners, customer satisfaction and enable collaboration

3. Only 50% believe metrics are aligned across internal departments

4. Only 50% are willing to change metrics to more effectively drive performance, but over 70% are willing to change trading partners' metrics to drive performance

5. Almost 70% admit to having incentives and rewards in place that negatively drive performance

Business-level challenges:

1. Misalignment of strategic/financial metrics

2. Lack of holistic goals or a vision for strengthening customer relationships

3. Most planning is annual and episodic, not able to adapt to ongoing changes in the marketplace

Practitioner-level challenges:

1. Mismatch and lack of contact between marketers vs. sales reps and buyers
2. Narrowly focused KPIs/Metrics that drive dysfunctional behaviors
3. Lack of information on KPIs/Metrics of other suppliers and trading partners
4. Lack of knowledge/insight into stakeholders both within and outside of each company
5. Lack of visibility into impact of decisions taken in isolation of other stakeholders
6. Lack of investment into training and development of people's skills

One possible solution to these challenges is the creation of Balanced Metrics and Scorecards to ensure that you are proactive in rewarding the right behaviors. The Balanced Scorecard is one approach that allows companies to move from vision to reality by creating metrics focused on customer satisfaction, employee satisfaction, and financial success through the creation of the required infrastructures.

Robert Kaplan and David Norton authors of the Balanced Scorecard understood that it is the people in an organization that represent the scarcest resource and they need to be knowledgeable, experienced, and forward looking with an ability to lead through inspiration. If this resource is wasted on customers and products that are not strategically important, profitable or significant the company will never achieve its full potential.

Balanced Scorecards is one approach that is focused on:

· Effectively measuring organizational, business unit, or department success

· Balancing long-term and short-term actions metrics and Behaviors

· A Balanced approach focused on different measures of success

  · Financial

  · Customer

  · Internal Operations

  · Human Resource Systems & Development (learning and growth)

· An effective way to tie strategy to action

People will continue to behave as they are measured, therefore it is essential that we effectively communicate that performance measures quantify how well the inputs activities and outputs of a process achieve a specified goal. Because value is added to an organization via processes and not functions we must convey the message that shareholder and customer value can only be maximized with a balanced set of process performance measures.

Performance metrics, even if they are balanced, must be effectively aligned with your company's strategy. The alignment with strategy is critical to any measurement framework, balanced or not. Clearly defined mission, strategy, and objectives should be monitored by measures that deliver the intended results from the perspective of all stakeholders.

About The Author

Inez Blackburn is a globally recognized speaker, industry leader, innovator, and pioneer in launching global brands. Inez has initiated and deployed category and marketing plans across numerous products and industries and knows firsthand the importance of developing rather than managing categories. She has worked with many Fortune 500 companies and led numerous executives through her Positioned for Profit seminars and Category Management and Marketing to the Max workshops. She has been on the Dean's list for excellence in teaching for ten years and is a featured trainer at numerous executive events. Inez is the president of Market Techniques & Innovations, Inc. and an adjunct professor at the University of Toronto and S.P. Jain University