CHAPTER 38
Performance Management

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1. INTRODUCTION

This chapter is about performance management. Performance relates to the measurable outcomes or results achieved by an organization. Management relates to the actions or activities an organization deploys to improve its desired outcomes. This chapter focuses on three major themes:

1. Key ideas organizations have found helpful in dealing with powerful and fundamental forces of change at work in the world

2. How goal setting and metrics can improve performance at the individual, team, working-group and organizational-unit levels
3. How the formal and informal aspects of an organization each contribute to managing performance in a world of change

We have grounded this chapter in our own extensive experience as well as the writings of leading commentators. Our objective is to provide readers with a blend of best practices. In particular, we seek to avoid—and advise readers to avoid—selecting any single approach to performance management as ''the best and only.'' Rather, we promote a ''both/and'' view of the world, in which readers carefully craft that blend of approaches that best fits the needs and challenges ahead of them. This contrasts with the far too dominant ''either/or'' mindset that maintains, incorrectly, that performance is best managed by selecting a single comprehensive approach through some debate grounded in the proposition that either approach A or approach B is best. In our experience, it usually turns out that both approach A and approach B are relevant to the challenge of managing performance in a changing world.

This chapter concentrates on providing guidance that can be applied, practiced, and perfected by any individuals and teams in any organization. The concepts and techniques we put forward do not depend on senior-management support. We do not attempt to put forward a comprehensive performance-management system model. Our focus is on performance in an environment of change and on how individuals, teams, and groups can significantly improve their mindsets and approaches to improving performance. You and your colleagues can begin to make a performance difference tomorrow for yourself and your organizations. We will provide some ideas and perspectives on formal aspects to integrating performance management and to formal top-management-driven approaches to change. But by and large, our ideas are for you, and you can use them wherever you sit in an organization and on whatever performance challenge arises.

2. THE CHANGE IMPERATIVE

After summarizing the fundamental forces of change that so often determine the nature of today's performance challenges, this section reviews a series of key concepts and ideas useful in managing performance itself. These include:

- The balanced scorecard: a change in what performance means and how its is measured
- New mental assumptions for managing performance and change
- Disciplines of learning and performing organizations
- Work as process and competition as time based
- Characteristics of high performance organizations
- The trend toward impermanent organizations and alliances

2.1. Forces of Change

If you are young enough, the world of change is all you have. For others, managing performance is very different today than in years past. Regardless of your age and experience, you should have a picture of the fundamental forces at work that shape and determine the challenges ahead of yourselves and your organizations. One of our favorite frameworks comes from John Kotter, a professor at Harvard Business School. Figure 1 shows Professor Kotter's summary of the economic and social forces driving the need for major change.

These forces are fundamental because they will not be going away any time soon and many market responses to them are irreversible. Globalization and internet technologies are but two examples of changes with permanent and lasting impact.

New market and competitive pressures represent both danger and opportunity. Organizations everywhere are attempting to capitalize on the opportunities and to mitigate their risks from the dangers. The economic headline stories we read about and listen to every day are all in some way responses or reactions (or the lack thereof) to the fundamental forces.

Frameworks like Kotter's help and encourage readers to look at the external environment for the drivers of change. They give clues as to what is important, how organizations might adapt and lead and, if probed, possible clues about what's around the corner. Naturally, organizations must continue to look at themselves as well. But far too many organizations under perform as a result of only looking inward for both the causes and solutions to better performance. The ability to understand change and adapt to it more quickly than others is among the most important dimensions of managing performance for organizations to master as we enter the 21st century.

Figure 1 Economic and Social Forces Driving the Need for Major Change in Organizations. (Adapted from Kotter 1996)

2.2. A Changing View of Performance Itself: The Balanced Scorecard

The forces of change have altered what performance itself means. Gone are the days when financial results were all that mattered. In today's world, organizations must deliver a combination of financial and nonfinancial performance outcomes. Readers who do not understand the new scorecard of performance will fall into the three main traps of a financial-only approach to performance management:

1. *Unsustainability:* Achieving sustained organizational performance demands outcomes and results that benefit all of the constituencies that matter. Shareholders provide opportunities and rewards to people of the enterprise to deliver value to customers, who generate returns to shareholders, who in turn provide opportunities to the people of the organization, and so on. If you substitute citizens or beneficiaries for customers of the enterprise, you can apply this concept to profit and not-for-profit organizations. Focusing solely on financial measures will create shortfalls in customer service, employee satisfaction, or product/process quality. The wise executive looks at financial measures as lagging measures and seeks other more direct measures of contributing performance to serve as leading measures.
2. *Demotivation:* Executives at the top are motivated by performance measures because they also receive big paydays from achieving them. But today's competitive environment requires tremendous energy and contribution from people throughout the organization. For most people in the organization, financial measures are a too-distant indicator of success or failure, to which many have contributed. Concentrating solely on the financial dimension of measurement is not motivating. It can go further toward being demotivating if people suspect that leaders are concentrating on financial measures out of self-interest.
3. *Confusion:* People need to see how and why their contributions make a difference. Financial goals alone will not reach or connect with very many individuals or groups. These people can become confused and resort to activity-based goals to fill their void.

This new scorecard was first popularized by Kaplan and Norton (1995). All organizations have multiple constituencies such as shareholders, customers, employees, and strategic partners. Each of these constituencies has performance needs and concerns that must be met if the organization hopes to survive and thrive. Kaplan and Norton's scorecard emphasizes the need to convert an organization's strategy into a series of linked performance metrics and outcomes across a 4D logic that suggests that a firm's financial results directly arise from results that matter to customers, which in turn arise from results of internal processes, which in turn arise from results that matter to the people of the organization in terms of learning and growth.

Smith (1999) fundamentally improved on Kaplan and Norton's thinking by suggesting that the balanced scorecard can be both more balanced and more integrated by replacing the linear logic of people-to-process-to-customer-to-shareholder with a reinforcing, integrated logic wherein results for each constituency both leads and lags results for others. Accordingly, managing performance in a sustainable way looks more like Figure 2, which depicts a philosophy for never-ending success.

When viewed in this way, financial and nonfinancial goals all reinforce and link to one another. Moreover, the goals support a narrative or story of success that will not fall victim to unsustainability, demotivation, and confusion.

2.3. New Mental Assumptions for Mastering Performance and Change

Managing both financial and nonfinancial performance in a world of change demands that readers know how to manage change. Having said that, the first and foremost principle of managing change (see Smith 1996) is to keep *performance* the primary objective of managing change, not *change*. Far too many people and organizations do the opposite. If readers are to avoid this trap, they must work hard to connect real and sustainable performance achievements to the changes underway in their organizations.

With clear and compelling performance objectives in mind, readers must avoid a variety of world-views that do not respond to the challenges at hand in today's fast moving world. Kanter (1983) foresaw many of the new and different ways for people and organizations to picture and respond to change. She called for a ''necessary shift from segmentalist to integrative assumptions.'' Today, we might paraphrase her thoughts as shifting from ''stovepipe'' to ''horizontal'' views of work and organization (see Smith 1996). Here are what Kanter described as ''old'' vs. ''new'' assumptions:

- *Old assumption #1:* Organizations and their subunits can operate as closed systems, controlling whatever is needed for their operation. They can be understood on their own terms, according to their internal dynamics, without much reference to their environment, location in a larger social structure, or links to other organizations or individuals.
- *Old assumption #2:* Social entities, whether collective or individual, have relatively free choice, limited only by their own abilities. But since there is also consensus about the means as well as the ends of these entities, there is clarity and singularity of purpose. Thus, organizations can have a clear goal; for the corporation, this is profit maximization.

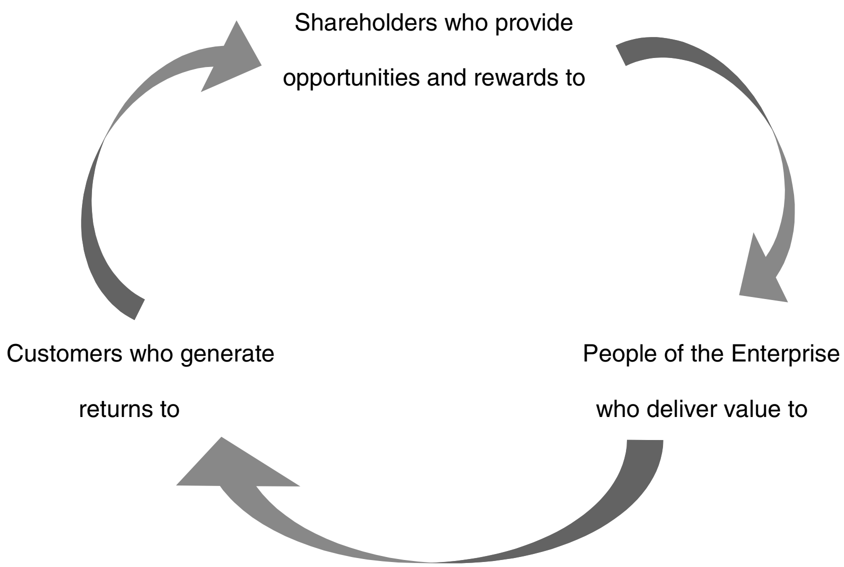

Figure 2 The Performance Cycle. (Adapted from Smith 1999)

- *Old assumption #3:* The individual, taken alone, is the critical unit as well as the ultimate actor. Problems in social life therefore stem from three individual characteristics: *failure of will* (or inadequate motivation), *incompetence* (or differences in talent), and *greed* (or the single-minded pursuit of self interest). There is therefore little need to look beyond these individual characteristics, abilities, or motives to understand why the coordinated social activities we call institutional patterns do not always produce the desired social goods.
- *Old assumption #4:* Differentiation of organizations and their units is not only possible but necessary. Specialization is desirable for both individuals and organizations; neither should be asked to go beyond their primary purposes. The ideal organization is divided into functional specialties clearly bounded from one another, and managers develop by moving up within a functional area.

Here are the new assumptions that Kanter puts forward as alternatives that are more responsive to the external pressures in our changing world:

- *New assumption #1:* Organizations and their parts are in fact open systems, necessarily depending on others to supply much of what is needed for their operations. Their behavior can best be understood in terms of their relationships to their context, their connections—or non-connections—with other organizations or other units.
- *New assumption #2:* The choices of social entities, whether collective or individual, are constrained by the decisions of others. Consensus about both means and ends is unlikely; there will be multiple views reflecting the many others trying to shape organizational purposes. Thus, singular and clear goals are impossible; goals are themselves the result of bargaining processes.
- *New assumption #3:* The individual may still be the ultimate—or really the only—actor, but the actions often stem from the context in which the individual operates. Leadership therefore consists increasingly of the design of settings that provide tools for and stimulate constructive, productive individual actions.
- *New assumption #4:* Differentiation of activities and their assignment to specialists is important, but coordination is perhaps even more critical a problem, and thus it is important to avoid overspecialization and to find ways to connect specialists and help them to communicate.

The contrast between old and new is sharp. In the old-assumption world, the manager was in control of both the external and the internal. In the new assumption-based world, uncertainty dominates and the need to be fluid and lead by influence rather than control has become the norm. An organization cannot become a strong 21st-century performer if it remains dominated by the old assumptions. It will not be able to change to adapt to new market needs, new technologies, or new employee mindsets. The old model is too slow and costly because it produces unnecessary hierarchy and unneeded specialization.

It takes a very different mindset and perspective to thrive in a world dominated by the new assumptions. One cannot be successful at both in the same ways. Success in each requires a different mental model.

2.4. Disciplines of the Performing and Learning Organization

A variety of new mental models and disciplines have arisen in response to the shifting assumptions so well described by Kanter. Peter Senge is perhaps best known for triggering the search for new disciplines. He suggests five disciplines that distinguish the learning organization from old-world organizations that do not learn (or perform) (Senge et al. 1992):

- *Personal mastery:* learning to expand personal capacity to create the results we most desire and creating an organizational environment that encourages all of its members to develop themselves toward the goals and purposes they choose.
- *Mental models:* reflecting upon, continually clarifying, and improving our internal pictures of the world and seeing how they shape our actions and decisions.
- *Shared vision:* building a sense of commitment in a group by developing shared images of the future we seek to create and the principles and guiding practices by which we hope to get there.
- *Team learning:* transforming conversational and collective thinking skills so that groups of people can reliably develop intelligence and ability greater than the sum of individual members' talents.
- *Systems thinking:* a way of thinking about, and a language for describing and understanding, the forces and interrelationships that shape the behavior of systems. This discipline helps us see how to change systems more effectively and to act more in tune with the larger processes of the natural and economic world.

Each of these disciplines requires a commitment to practice to improve our views and skills in each area. Critically, readers who seek to master these disciplines must do so with an eye on performance itself. Readers and their organizations gain nothing when efforts seek to make people and organizations become learning organizations in the absence of a strong link to performance. Organizations must be both learning and performing organizations.

2.5. Work as Process and Competition as Time Based

Innovation, quality, and continuous improvement have emerged as primary challenges for organizations to apply learning and performance disciplines in the face of change. Innovation draws on and responds to the technological drivers so present in today's world. But innovation also applies to nontechnological challenges. Indeed, for at least the past two decades, competitive success has gone to those who add value to products and services through information, technology, process improvement, and customer service. They must continually ask themselves how to do better and how to do it faster. The old-world adage of "if it ain't broke, don't fix it" has been replaced by "if it ain't broke, fix it!"

At the heart of this reality is quality and continuous improvement. Quality measures itself from the eyes of the customer and views all work as process. Performance of processes is measured by defects as defined by customers, whether internal or external. Defects themselves have many dimensions. But, with the publication of *Competing against Time* (Stalk and Hout 1990), organizations throughout the world were put on notice that speed was now a reality of success. Whether internal or external, customers want error- and defect-free products and services and they want them *fast*. Or, we should say, *faster*. Organizations who master innovation, quality, and continuous improvement never settle for today's results. They continually seek to improve and do so by setting and meeting goals for reducing defects and errors and increasing speed of processes.

2.6. High-Performance Organizations

Many commentators have concluded that organizations cannot succeed in this new world without a fundamentally different set of characteristics. Figure 3 shows contrasting lists of characteristics from a survey of writers, thinkers, and executives.

Traditional	*High Performance*
• Internally driven design	• Customer and environmentally focused design
• Highly controlled fractionated units	• Empowered and autonomous units
• Ambiguous requirements	• Clear direction and goals
• Inspection of errors	• Control of variance at the source
• Technical system dominance	• Socio-technical integration
• Limited information flow	• Accessible information flow
• Fractionated, narrow jobs	• Enriched and shared jobs
• Controlling and restrictive human resources practices	• Empowering human resources practices
• Controlling management structure, process, and culture	• Empowering management structure, process, and culture
• Static designs dependent on senior management redesign	• Capacity to reconfigure

Figure 3 Contrasting Traditional and High-Performance Organizations. (*Source:* Nadler et al. 1992)

High-Performing Organizations	*Low-Performing Organizations*
• Informal	• Rank is right
• Experimental	• Little risk taking
• Action-oriented	• Formal relationships
• High cooperation	• Privileges and perks
• Low defensiveness	• Many status symbols
• High levels of trust	• Rules rigidly enforced
• Little second-guessing	• Slow action / great care
• Few trappings of power	• Much protective paperwork
• High respect for learning	• Decision making at the top
• Few rules and high flexibility	• High levels of fear and anxiety
• Low levels of anxiety and fear	• Your problem is yours, not ours
• Empowered team members	• Well-defined chain of command
• Failures seen as problems to solve	• Learning limited to formal training
• Decisions made at the action point	• Many information-giving meetings
• People easily cross organizational lines	• Trouble puts people on defensive
• Much informal problem solving	• Little problem solving below top
• Willingness to take risks	• Crossing organizational lines forbidden

Figure 4 High-Performing vs. Low-Performing Team Characteristics. (*Source:* Synectics, Inc.)

Synectics, an innovation firm, has captured the above list in a slightly different way. Figure 4 contrasts the spirit of innovation in high-performing vs. low performing organizations.

2.7. The Impermanent Organization

Finally, we wish to comment on the trend toward impermanent organizations and alliances. More and more often, organizations respond to performance and change challenges by setting up temporary alliances and networks, both within and beyond the boundaries of the formal organization. It could turn out that this model of the temporary organization and alliance formed to bring a new innovation to market will in fact become the norm. Some have suggested this as one very viable scenario, which Malone and Laubacher (1998) dub the ‘‘e-Lance economy.’’ Malone and Laubacher put forward the idea of many small temporary organizations forming, reforming, and recombining as a way of delivering on customer needs in the future. While they concede that this may be an extreme scenario, it is not an impossible one. Their research is part of an ongoing and significant series of projects at MIT around the 21st-century organization. Another research theme is the continued importance of process management in the future, putting processes alongside products in terms of performance-management importance. One view is certain: 20 years from now, very different business models than the ones we know today will have become the norm.

3. PERFORMANCE SUCCESS: GOAL SETTING AND METRICS

Let’s first look at a few fundamental flaws in how many organizations approach performance. As stressed by Smith (1999), ‘‘Performance begins with focusing on outcomes instead of activities.’’ Yet most people in most organizations do the reverse. With the exception of financial results, most goals are activity based instead of outcome based. Such goals read like "develop plans to reduce errors" or "research what customers want." These are activities, not outcomes. They do not let the people involved know when they have succeeded, or even how their efforts matter to their own success and that of their organizations.

3.1. Performance Fundamentals and Obstacles

A variety of obstacles and bad habits explain this misplaced emphasis on activities instead of outcomes. At their root lie the old assumptions, financial-focus, internal orientation, and silo organization models we reviewed above. These obstacles and bad habits include:

3.1.1. Natural Human Anxieties

Most people get nervous about the specificity with which their personal success or failure will be measured. We like some flexibility to say we did the right things and that any lack of desired outcome is due to extenuating circumstances. A common tactic is to declare any outcome outside our complete control as unachievable. The problem with this is that for most people in an organization this leaves a narrow set of activities. The further you are from the front line to the customer, the more tempting and common this tactic becomes.

3.1.2. Difficulty Expressing Nonfinancial Outcomes

It is not easy to state nonfinancial goals in an outcome-based fashion. Yet so many performance challenges are first and best measured in nonfinancial ways. It is hard work and personally risky to move beyond the goal of completing the activities and expose your performance to a measure of how effective that activity is where it counts, in the eyes of customers, employees, and strategic partners. The basic anxiety and aversion to setting real outcomes as goals will always be around, particularly when new and different challenges confront us. A key to success is to control the anxiety rather than letting it control you.

3.1.3. Flawed Assumptions

In many instances, people falsely assume performance outcome-based goals exist when they don't. People in organizations, especially the ones who have achieved a degree of success, often claim they already know what the critical outcomes are and how to articulate them, when in reality they don't. Or people will elude the responsibility to state outcomes by claiming the outcomes themselves are implied in the activities or plans afoot. Or they will refer to the boss, expecting he or she has it all under control. All of these excuses are mere ruses to avoid the responsibility to specifically and expressly articulate the outcomes by which any effort can be monitored for success.

3.1.4. The Legacy of Financial Management

The financial scorecard has dominated performance business measurement in the modern corporation. As reviewed in the Section 1, the financial-only approach to performance management fails to account for performance outcomes that matter to customers, employees, and strategic partners. It produces organizational cultures that are short-term focused and have difficulty breaking out of the silo approach to work. Why? Because functional organizations are uniquely suited to cost accounting. With the introduction of activity-based accounting by Cooper and Kaplan, organizations were given the chance to move toward a process view of work and still keep their numbers straight. That can help, but it is not enough. Until organizations seriously set and achieve outcome-based goals that are both financial and nonfinancial and link to one another, those organizations will continue to manage performance suboptimally.

3.1.5. The Intrusive Complexity of the Megaproject or Megaprogram

Also standing in the way of outcome-based performance management is the grand illusion of a complete solution to a firm's information systems. The promise of information technology systems that provide organizations with an integrated approach to transaction management and performance reporting has been a major preoccupation of management teams ever since computers, and personal computers in particular, have become both accessible and affordable (most recently in the form of enterprise resource planning [ERP] systems).

SAP, Oracle, and PeopleSoft are a few of the more popular ERP software providers who have experienced phenomenal success in the 1990s. While the drive to implement new systems was accelerated by the now-infamous Y2K problem, the promise of integrated and flexible information flow throughout an organization had great appeal. These systems were also very much a part of the broader "transformation" programs that many organizations were pursuing at the same time. Many comprehensive transformation frameworks and methodologies that have emerged over the past decade were built on the success that business process reengineering had in the early 1990s. These programs redesigned the people, process and technology of an organization to bring about the performance promise of transformation. Reengineering programs require at least two years to complete and are delivered through massive teams following very detailed methodology scripts. Completing the activities alone is often exhausting and risky. But their promised paybacks are huge, ranging from industry leadership to a chance to survive (and hopefully thrive once again).

Because of the long timeframes associated with the effort and with being able to see the reward, the value received from the effort is difficult to measure. There is a time lag between the team's implementation activities and the outcome. This is true of many things strategic. Consulting teams (and executive sponsors) are often onto their next assignments long before outcomes can be realized as they were defined in the business case.

A focus on performance outcomes for strategic initiatives most often gets lost or mired in the operational systems that are used in most companies. These systems are designed to support the tactics of an organization, which are very often bounded by the time cycles inherent in the formal budgeting and planning systems. All of these realities overwhelm the manager trying to create performance change. The bigger and more complex the organization, the more complicated the improvement of formal performance-management systems.

Many of the large consulting firms (certainly the ones showing annual growth rates in the 30–35% range during the past decade) play to the formal side of organization performance, bringing frameworks and methodologies that require large consulting teams that provide comprehensive solutions to performance management. At the same time, many corporate executives and managers are in need of "having it all integrated" for the promise of accelerated decision making and improved information flow.

Each of these goals has merit and the results can provide large payback. The problem is that in far too many situations, the payoff does not come because of the sheer complexity of the solutions. Much of the implementation cost and business case payback for these endeavors deals with taking activities out of the process. With the advent of the Internet, completely new business models are being pursued for connecting products or services with customers. The sheer size and cost of these approaches require a focus on the formal systems.

So to the list of obstacles to making performance measurable we add this significant pressure to focus on large, complex projects. As consulting firms and their clients have gained experience with "transformation" over the past decade, they have added more emphasis on the informal systems and the people aspect of change. However, their business models still require large teams that will continue to have a bias toward changing the formal systems rather than working at the informal.

3.2. Overcoming the Obstacles: Making Performance Measurable

So what can you do to overcome this formidable list of obstacles? Getting focused on performance outcomes rather than activities is the place to begin. But it is not enough on its own. You will need more to sustain your focus. There are three additional aspects to performance management:

1. Picking relevant and specific metrics
2. Using the "four yardsticks"
3. Articulating SMART goals

Let's take a brief look at the most important aspects behind each of these attributes.

3.2.1. Picking Relevant and Specific Metrics

Sometimes metrics are obvious; other times, the best measures seem elusive. Revenues, profits, and market share are universally recognized as effective metrics of competitive superiority and financial performance. But no universally recognized measures have emerged for such challenges as customer satisfaction, quality, partnering with others, being the preferred provider, innovation, and being the best place to work. Management teams must learn to avoid getting stuck because of the absence of an already accepted standard of measure. They must be willing to work together to pick measures that make sense for their particular challenges.

A good set of measures will have a proper blend of qualitative and quantitative metrics. Consider a company's aspirations to build partnering relationships with key suppliers or customers. Certain threshold goals for the amount of business conducted with each potential partner can provide quantitative and objective performance outcomes. However, it is easy to imagine an outcome where these measures are met but a true partnering relationship is not achieved. Partnership implies a variety of subjective and qualitative characteristics such as trust, consulting each other on critical matters, sharing knowledge, and relying on each other for difficult challenges. Using metrics around these important outcomes will require special candor and honesty from both partners to track behaviors, learn from results, and motivate improvement for both parties in the relationship. Using these types of subjective measures is acceptable and may in fact provide superior results. But you must understand the difficulties associated with such use and overcome them.

Here are several additional pieces of guidance about selecting measures that, while obvious, are often sources of frustration.

- Many metrics require extra work and effort. This will be true for almost all measures that do not already exist in an organization. So if the challenge is new, the best measures will most likely also be new.
- If the measure is new, you will not have a baseline. Organizations and managers must be willing to use their gut feeling as to their baseline performance level. Researching ranges of normal or best-in-class measures can give clues. It is not important to be exact, only to have a sufficient measure to allow the group to move.
- Some measurement criteria will demand contributions from people or groups who are not under your control or authority. In fact, most serious challenges in an organization will require all or many departments to contribute. It will take extra work to get all groups or departments aligned with both the goals and the measures.
- Some metrics are leading indicators of success, while others are lagging indicators. Revenues, profits, and market share are common examples of lagging indicators and therefore are routinely overused. Leading indicators must also be developed to get at the drivers behind the financial success.

The key is to work hard enough at it to make good measurement choices and then stick with them long enough to learn from them. Organizations and managers must overcome the anxieties and frustrations that come with outcome-based performance measures and learn how to select and use the best measures. The following section on the four yardsticks can help you become increasingly comfortable in choosing and sticking with the best measures of progress.

3.2.2. Using the Four Yardsticks

All performance challenges are measurable by some combination of the following:

- Speed/time
- Cost
- On-spec/expected quality
- Positive yields

The first two are quantitative and objective and the second two a blend of objective/subjective and quantitative/qualitative. Becoming adept at the use of these yardsticks will take you a long way toward overcoming the anxieties and obstacles inherent in performance outcome-based goals.

3.2.2.1. Speed/Time Process management is the most common application of this metric. We use it anytime we need to measure how long it takes to complete some activity or process. It is one of the measures that usually requires extra work. Most processes in an organization cross multiple department boundaries, but not neatly. The extra work comes in the need to be specific about beginning and ending points. The scope you place on the process end points will depend on your goal and level of ambition behind the process. For example, an order-generation and fulfillment process that is designed to be both the fastest and totally customer-driven will need to go beyond receipt of delivery and include process steps that measure your customers' use and satisfaction levels. If the process you want to measure is complex, you also must define the specific steps to the process so that you will understand where to concentrate efforts and where your efforts are paying off.

There are six choices you need to make when applying a speed/time metric:

1. What is the process or series of work steps you wish to measure?
2. What step starts the clock?
3. What step stops the clock?
4. What unit of time makes the most sense?
5. What number and frequency of items going through the process must meet your speed requirements?
6. What adjustments to roles and resources (e.g., systems) are needed to do the work of measurement and achieve the goals?

Some of the more fundamental processes in organizations in addition to order fulfillment include new product/service development and introduction, customer service, integrated supply chain, and the hiring/development/retention of people.

3.2.2.2. Cost Cost is clearly the most familiar of the four yardsticks. But here too we can point to nuances. Historically, organizations have focused mostly on the unit costs of materials or activities. These units paralleled organization silo structures. This approach to costing still makes sense for certain functionally sensitive performance challenges. On the other hand, many of today's process-based performance challenges demand the use of activity-based costing instead of unit costing.

3.2.2.3. On-Spec/Expected Quality Product and service specifications generally derive from production, operational, and service-level standards, legal and regulatory requirements, and customer and competitive demands. Another way of viewing specifications is through a company's value proposition, which includes the functions, features, and attributes invested in a product or service in order to win customer loyalty. Some dimensions of quality are highly engineered and easily defined and measured. Others can become abstract and very hard to measure unless the specifications are stated and well defined.

This is key when using this family of metrics. When customer expectations are unknown or poorly defined, they cannot be intentionally achieved. You cannot set or achieve goals related to aspects of performance that you cannot even define. The approach to quality and continuous improvement reviewed above therefore, emphasizes the need to let the customer define quality, to consider any deviation from that a defect, and to set specific goals about reducing defects on a continual basis.

3.2.2.4. Positive Yields This final yardstick category is designed to deal with more abstract or unknown dimensions to customer expectations. It is also a catch-all category whose measures reflect positive and constructive output or yield of organizational effort. Yields are often prone to subjective or qualitative measures, and their purpose is to get at the measurement of newer performance challenges such as alliances or strategic partnering, "delighting customers" or core competencies. While it is hard to reduce these aspirations to specific or quantifiable measurement, the subjective or qualitative measures in this area can be very effective as long as they can be assessed and tracked with effective candor and honesty. (Note how this brings us back to Kanter's "new assumptions" and Synectics' high-performance organization attributes.)

Good performance goals nearly always reflect a combination of two or more of the four yardsticks. Moreover, the first two yardsticks (speed/time and cost) measure the effort or investment *put into* organizational action, while the second two (on-spec/expected quality and positive yields) measure benefits you *get out of* that effort or investment. The best goals typically have at least one performance outcome related to effort put in and at least one outcome related to the benefits produced by that effort.

3.2.3. Articulating SMART Performance Goals

People setting outcome-based goals can benefit from using the SMART acronym as a checklist of items that characterize goals that are specific, relevant, aggressive yet achievable, relevant to the challenge at hand, and time bound. Thus, goals are SMART when they are:

- *Specific:* Answers questions such as "at what?" "for whom?" and "by how much?"
- *Measurable:* Learning requires feedback, which requires measurement. Metrics might be objective or subjective, as long as they are assessable.
- *Aggressive* (yet *Achievable*): Each "A" is significant. *Aggressiveness* suggests stretch, which provides inspiration. *Achievable* allows for a more sustained pursuit because most people will not stay the course for long if goals are not credible. Setting goals that are both aggressive and achievable allows people and organizations to gain all the advantages of stretch goals without creating illusions about what is possible.
- *Relevant:* Goals must relate to the performance challenge at hand. This includes a focus on leading indicators, which are harder to define and riskier to achieve than the more commonly relied-on lagging indicators around financial performance (i.e. revenue, profits).
- *Time bound:* The final specific measure relates to time and answering the question "by when?" You cannot define success without knowing when time is up.

4. COMBINING THE FORMAL AND INFORMAL ORGANIZATIONS: THE CHALLENGE OF ALIGNMENT IN A FAST-CHANGING WORLD

Organizations can hardly be called organized if people throughout them are pursuing goals that are random, unaligned, and conflicting. Managing performance, then, must include an effort to align goals, both against performance challenges and across the various parts of the organization (and increasingly, effort beyond the organization itself, e.g., by strategic partners). Until a decade ago, alignment was considered a simple task, one conducted mostly at budgeting and planning time to be certain all the numbers added up. Today, alignment is far more subtle and challenging. To meet that challenge, readers must be certain they are paying attention to only the relevant challenges, the relevant metrics, and the relevant parts of both the formal and the informal organization.

The formal organization equates to formal hierarchy. It reflects the official directions, activities, and behavior that leaders want to see. The informal organization relates to the actual organizational behavior. It reflects the behaviors that individuals and teams exhibit regardless of official leadership. Both are necessary for truly successful performance management and both are real in contributing to outcomes. Readers will fall into a trap if they worry only about alignment among the official, formal organization.

4.1. Identifying the Working Arenas That Matter to the Challenge at Hand

To avoid that trap, readers need to learn about "working arenas," which consist of any part of an organization, whether formal or informal, and whether inside the organization or beyond it (e.g., strategic partner), where work happens that matters to performance. Working arenas are where people make performance happen. They include and go well beyond any single individual's job. Today's organizations exhibit much more variety in how work gets structured, as Figure 5 shows.

A real shift has occurred from hierarchy-based work structures to more horizontal and open work structures. This reinforces our message earlier about the pace of change and how it forces us to consider these newer forms of structuring work to create connection and speed. That is exactly what you and your colleagues need to do with your performance goals—create connections so that you can increase your speed during implementation. The absolute is that you must set outcome-based goals that fit all the relevant working arenas, not just the jobs, of the people who must achieve those goals.

Fit is not a new concept. It has been attached for a long time to the time-honored managerial maxim that formal accountability matches formal responsibility. However, today this maxim is impossible to apply. Performance challenges have too much overlap across formal structures. And they change far too often to live within any set of formal control processes around all we do. Instead, you should apply a new version of fit—where accountability for outcome-based goals must fit the working arenas of those involved in achieving the goals. The right column in Figure 5 implies both formal (departments, businesses, jobs) and informal (teams, initiatives, processes) working arenas. Fit still makes sense; it just needs to cover a broader spectrum of how work actually gets done. Our argument is that more and more high-performing organizations are learning to apply fit to a broader array of

1950s ➔ 1980s	1990s ➔ 21st century working arenas
• Jobs	• Processes
• Departments	• Teams
• Functions	• Joint ventures
• Projects	• Projects
• Business	• Initiatives
• Corporate headquarters	• Task forces
	• Businesses
	• Alliances
	• Programs
	• Communities of practice
	• Centers of excellence
	• Etc.

Figure 5 Working Arenas: Past and Future. (*Source:* Smith 1999)

informal approaches. It's still all about being effective and efficient—but with greater speed and nimbleness.

The concept of working arenas can help you divide up work in ways that include but go beyond the formal job–department–function–business model. It frees you to ask a critical series of six questions that make it easier to apply performance-based outcome goals, including:

1. What is the performance challenge at hand?
2. What outcomes would indicate success at this challenge?
3. What are the working arenas relevant to this challenge?
4. To which of those working arenas do I (or we) contribute?
5. What metrics make the most sense for these working arenas?
6. What SMART outcome-based goals should we set and pursue for each of these working arenas?

If you were to think through any specific performance challenge in your organization, several patterns would emerge. First, most people contribute to only two or three working arenas at any one time. Second, most contributions come first and foremost in the context of the individual or the team. Third, without identifying the working arena that makes the most sense for any given performance challenge, it is hard for people to confidently believe they are organized for success.

4.2. Using Logic to Achieve Alignment across the Relevant Working Arenas

In the silo or pyramid model of organization that dominated for most of the 20th century, alignment was a matter of adding up costs and revenues to be certain that budgets and plans made sense. Given the entirely formal character of organizations and the relatively small number of working arenas (see Figure 5), this made sense. However, in the fast-moving, flexible, "real" world of today, there are far too many different kind of working arenas, far too many different kind of performance challenges, and (as we discussed in Section 3.2), far more kinds of metrics for success. Budgeting- and planning-driven approaches to alignment that focus solely on being sure the numbers add up do not work in this world.

Instead, readers must get comfortable with two approaches to alignment, quantitative and qualitative. Both of these are logical. If a team is working to increase the speed of a critical process such as new product development, they might measure success by speed and quality. Those metrics will not add up or roll up to quantitatively support the entire business's revenue and profit goals. But those metrics do logically reinforce the entire business's strategy to grow through innovation. In the new world of alignment, then, it is most critical to ask whether the outcome-based goals set across a relevant series of working arenas are logically aligned, not just arithmetically aligned.

Table 1 lists many of today's most compelling performance challenges and suggests whether readers will find it easier to discover logical alignment quantitatively, qualitatively, or through some combination of both.

TABLE 1 Aligning Performance Challenges

Today's Performance Challenges	Quantitative Alignment	Qualitative Alignment
Core competencies		X
Customer service	X	X
Diversity	X	X
Electronic commerce	X	
Growth	X	
Innovation	X	X
Mergers/acquisitions	X	X
Profitability	X	
Reengineering	X	X
Relationship-based marketing		X
Speed	X	X
Strategy	X	
Teams		X
Technology	X	
Total quality	X	X
Values/behaviors/best place to work		X

Source: Smith 1999.

4.3. Leadership of Both the Formal and Informal Organization During Periods of Change

Leaders who must manage performance in the face of change will be more likely to succeed if they attend to both the formal and informal aspects of the organization. Those who focus solely on the formal, official organization will fail. Not only will they fall into the trap of believing that formal goal alignment is in place so long as the financial numbers add up, but they will also fail to address the most critical performance-management challenge of all: how to get existing employees and managers to take the risk to do things differently.

When performance itself depends on lots and lots of existing people learning new skills, behaviors and working relationships, leaders are faced with behavior-driven change. By contrast, if a new strategy or direction can be accomplished based on existing skills, then leaders are faced with decision-driven change. Many of the old assumptions reviewed in Section 2 work better for decision-driven change than for behavior-driven change. However, an ever-increasing number of performance challenges now require leaders to master the disciplines for managing behavior-driven change.

Here are four questions that will help you tell the difference between decision-driven and behavioral-driven change:

1. Does all or any significant part of your organization have to get very good at one or more things that it is not good at today?
2. Do lots of already employed people have to change specific skills, behaviors, and/or working relationships?
3. Does your organization have a positive record of success with changes of the type you are considering?
4. Do those people who must implement the new decisions and directions understand what they need to do and urgently believe the time to act is now?

If the answer is no to the first two questions and yes to the second two, you can employ a decision-driven change approach. If the answer is yes to the first two questions and no to the second two, you are facing behavior-driven change.

If you do face decision-driven change, we suggest following the following best practices (Kotter 1996):

1. Establishing a sense of urgency
   - Examining the market and competitive realities
   - Identifying and discussing crises, potential crises, or major opportunities
2. Creating the guiding coalition
   - Putting together a group with enough power to lead the change
   - Getting the group to work together like a team
3. Developing a vision and strategy
   - Creating vision to help direct the change effort
   - Developing strategies for achieving that vision
4. Communicating the change vision
   - Using all available avenues to communicate vision constantly
   - Having the guiding coalition role model the behavior expected of employees
5. Empowering broad-based action
   - Getting rid of obstacles
   - Changing systems or structures that undermine the change vision
   - Encouraging risk taking and nontraditional ideas, activities, and actions
6. Generating short-term wins
   - Planning for visible improvements in performance, or "wins"
   - Creating those wins
   - Visibly recognizing and rewarding people who made the wins possible
7. Consolidating gains and producing more change
   - Using increased credibility to change all systems, structures, and policies that don't fit together and don't fit the transformation vision
   - Hiring, promoting, and developing people who implement the change vision
   - Reinvigorating the process with new projects, themes, and change agents

8. Anchoring new approaches in the culture
   - Creating better performance through customer- and productivity-oriented behavior, more and better leadership, and more effective management
   - Articulating the connections between new behaviors and organizational success
   - Developing means to ensure leadership development and succession.

If, however, you are confronted with behavior-driven change, Kotter's transformational leadership approaches will not necessarily work. Indeed, as extensively discussed in Smith (1996), study after study shows that up to four out of five change efforts either fail or seriously suboptimize. And the root cause of these failures lie in leaders who follow decision-driven approaches like those suggested by Kotter when, in fact, they face behavior-driven change.

Managing performance through a period of behavior-driven change demands a different approach. Here is a series of best practices:

1. Keep performance, not change, as the primary objective of behavior and skill change.
2. Focus on continually increasing the number of people taking responsibility for their own performance and change.
3. Ensure that each person always knows why his or her performance and change matter to the purpose and results of the whole organization.
4. Put people in a position to learn by doing and provide them with the information and support needed just in time to perform.
5. Embrace improvisation; experiment and learn; be willing to fail.
6. Use performance to drive change whenever demanded.
7. Concentrate organization designs on the work people do, not on the decision-making authority they have.
8. Create and focus your two scarcest resources during behavioral-driven change—energy and meaningful language.
9. Harmonize and integrate the change initiatives in your organization, including those that are decision driven as well as behavior driven.
10. Practice leadership based on the courage to live the change you wish to bring about—walk the talk.

Please take these and practice. Get others to try. They will make a huge and lasting difference for you personally and for your organizations.

4.4. Bringing It All Together

We will close with a few suggestions on how your organization can put it all together into an integrated performance outcomes-management system. The concepts, frameworks, and techniques presented in this chapter can be deployed to establish an outcomes-management system in your organization. The objective is performance. You should seek to establish a system and set of practices to help the people of your enterprise routinely set and update the SMART outcome-based goals that matter most to success as well as to choose which management disciplines to use to achieve their goals. The outcomes-management system will enable everyone to see how the goals in your organization fit together and make sense from a variety of critical perspectives, from top management (the whole) to each small group, working arena, and performance challenge and each individual throughout the organization.

Figure 6 presents an overview of the design of what a business outcomes-management system might look like.

Figure 6 summarizes the skeletal design of an outcomes-management system for any single business. It brings visibility to the outcomes that matter most to customers, shareholders, and people of the business. It then links these outcomes to the most critical functions, processes, and initiatives that contribute to overall success. This design can be extended to the multibusiness corporation and can be driven down through the organization to every critical shared service or working arena that is critical to success. See Smith (1999) for more illustrations of how this cascading performance outcomes-management system model can work.

An integrated performance model requires that you create the critical linkages, bring visibility to the interdependencies among working arenas, and drive performance through aggressive planning and execution. But avoid the trap of spending all the organization energy around the activity of creating the integrated plan. Make sure you remember the paramount rule: focus on performance outcomes, not activity.

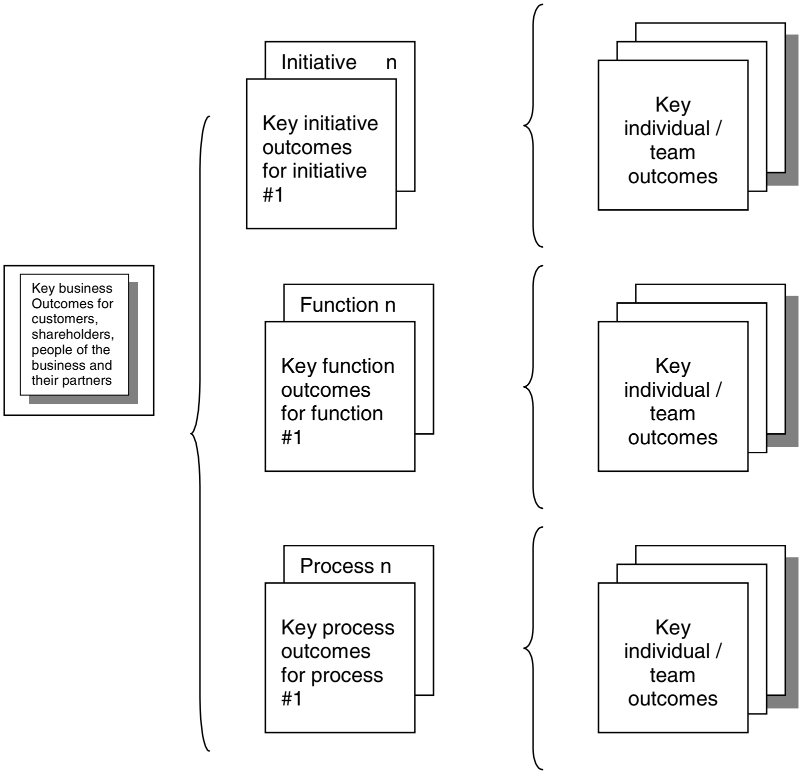

Figure 6 Business Outcomes Management System: Design. (Adapted from Smith 1999)

5. CONCLUDING THOUGHTS

We have presented a view of how organizations should view performance in order to improve it. We recommend that you combine the approaches that effect the formal and informal systems in an organization. Success comes not from a single program, slogan, or initiative, but from working the total picture.

We have covered a lot of ground around our original three themes: change, measurement, and combining informal and formal organizational approaches to achieve performance success. We have tried to share with you our experiences and to give you ideas and techniques that will enhance your perspectives on performance management and will also allow you try new things today. We hope we have succeeded.

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