Strategy Execution

Linking Value, Metrics, and Rewards

A report prepared by CFO Research Services in collaboration with Deloitte Consulting GmbH (Germany), a Deloitte Touche Tohmatsu (DTT) Member Firm

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In early 2007, CFO Research Services launched a research program in collaboration with Deloitte Consulting GmbH (Germany) to examine how successful companies use performance management to generate value. We collaborated closely with several DTT Member Firms to define the scope, methodology, and target companies for this study. We'd like to thank the DTT Member Firm team—including Uwe Kagelmann, Senior Manager, Deloitte Consulting GmbH; Nick Groves, Director, Deloitte MCS Limited; Matthew Schwenderman, Principal, Deloitte Consulting LLP; and Arnick Boons, Director, Deloitte Consulting BV—for their contributions to this study.

After developing the research agenda, we conducted interviews with senior finance executives at more than 25 companies in North America and Europe. To ensure we gathered information from top performers, we sought to interview executives at companies whose total return to shareholders over the last five years is in the top quartile among their peers in the S&P 1200. In addition, we eliminated companies from the study when our research indicated that M&A activity made up a great portion of a company's growth in the last five years.

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Introduction: Strategy as the true north of a business

Top performing companies generate value for shareholders by outperforming their peers, delivering sustained, predictable growth in revenue and profitability, and by deploying capital efficiently. To do so, management teams design business strategies that differentiate their offerings, manage cost, and serve customers in unique and valuable ways.

At SABMiller, for example, management seeks to "tweak the margins in our mature businesses," to turn around companies acquired around the world with "tried and trusted" operating and marketing techniques, and to deploy these techniques as the company expands into emerging economies, says Steve McAdam, finance director at the $15 billion brewer. Autodesk, the U.S.-based $1.8 billion maker of design automation software, focuses first and foremost on technical innovation and product differentiation in developing technology for "designing, experimenting, and making a digital prototype within our software that delivers 'no surprises' later," according to Al Castino, Autodesk's CFO. "Our focus on customer intimacy is the 'true north' of the firm, from the board to our management team to all our associates," says a senior VP at Cognizant, a $1.6 billion U.S.-based technology services company. And at U.K.-based British American Tobacco, head of strategy execution Michael Barnett describes a strategy tied to product differentiation, social responsibility, and brand intimacy: "Productivity is very important, but our strategy is not to be the lowest cost producer in the industry—as doing so would mean that we will not be able to deliver on our growth, [product] responsibility, and winning organization strategies."

By executing on their business strategies, companies can achieve their performance objectives and deliver the value their stakeholders seek. While every company, product offering, market, management team, and strategic situation is unique, this research study among senior finance executives reveals many common practices in managing performance and executing business strategy that, when applied, deliver top performance.

Stated simply, top performers achieve strong results through their own combination of the following practices:

- Defining their value aspirations in the competition for investors' capital and customers' attention.
- Setting performance targets for achieving this value that descend to all levels of the organization.
- Managing business performance to meet these targets using metrics of both financial and operating goals.
- Linking employees' rewards, incentives, career development and performance evaluations to their success or failure in delivering these results.

This progression—from strategy, to value drivers, to targets, to measurements, to rewards—forms the backbone of performance management at leading companies we examined for this report.

Linking strategy execution to the delivery of value through performance management is a unique managerial discipline, and perhaps the most important one. Strategy and performance management are often discussed in vague abstractions, using clichés such as "doing the right things right—the first time" and other well-worn phrases. In other cases, discussions of performance management are tied too closely to technology solutions that are surely important but hardly the source of excellent performance.

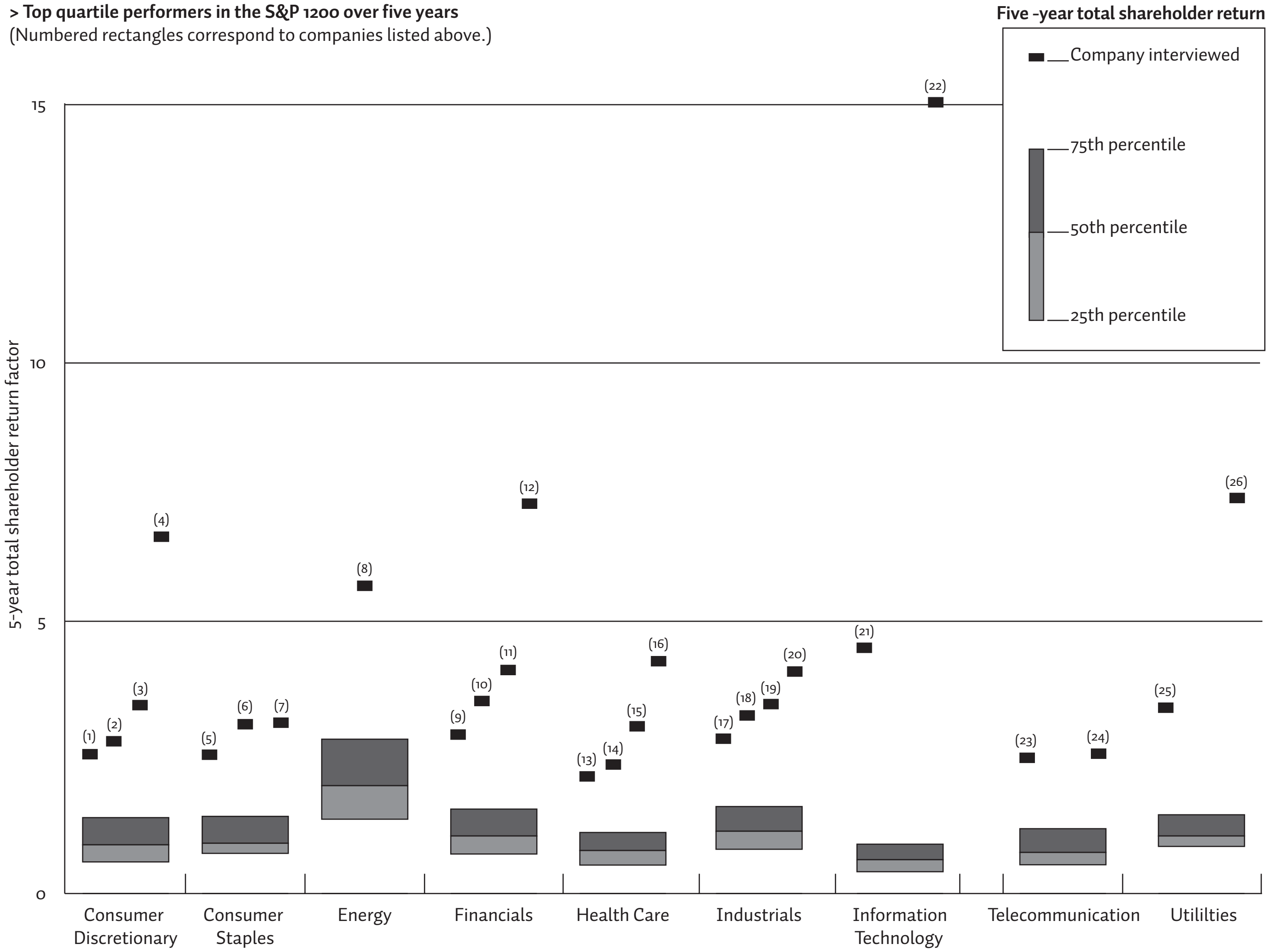
Linking Value, Metrics, and Rewards

> About this report

This study is based on a series of interviews CFO Research conducted with senior finance executives at companies whose total return to shareholders is in the top 25 percent among their peers in the S&P 1200. The companies compete in a broad range of industries and are evenly distributed between North America and Europe.

- The Sherwin-Williams Company (1)
- Renault SA (2)
- Hilton Hotels Corporation (3)
- Continental AG (4)
- SABMiller plc (5)
- British American Tobacco plc (6)
- Reynolds American, Inc. (7)
- Nexen Inc. (8)
- KBC Group (9)
- The Royal Bank of Canada (10)
- Moody's Corporation (11)
- Anglo Irish Bank Corporation (12)
- Thermo Fisher Scientific Inc. (13)
- Becton, Dickinson and Company (14)
- WellPoint, Inc. (15)
- Humana Inc. (16)
- Textron Inc. (17)
- Aktiebolaget SKF (18)
- Atlas Copco AB (19)
- Volvo AB (20)
- Autodesk Inc. (21)
- Cognizant Technology Solutions Corporation (22)
- Koninklijke KPN NV (23)
- Telekom Austria AG (24)
- Constellation Energy Group (25)
- Fortum Corporation (26)

> **Top quartile performers in the S&P 1200 over five years**
(Numbered rectangles correspond to companies listed above.)



With this in mind, we spoke candidly with leaders of the finance function at companies that have demonstrated excellent performance in recent years to hear their views, practices, and priorities in performance management. And as you'll read in the pages ahead, finance executives—as stewards of the finance function, collaborators with business unit managers, and strategic navigators—told us in their own language about the broad array of methods they use to ensure their companies deliver the performance their stakeholders demand. (This report is a study of top performing companies in Europe and North America. In the interest of clarity, we indicate company size throughout the report by citing recent annual revenue figures in U.S. dollars.)

I. Value drives strategy

Finance executives say that a shared view of how a company generates value sets the stage for effective strategy development. No single concept of value dominates the top performers in this study. But the concept of how the company generates value emerges as an important organizing principle for crafting strategy and managing performance. Leading finance teams carry this value mindset to the rest of the organization as supporters, partners, and leaders of business planning.

Across the broad group of top performing companies, finance executives cite many definitions and drivers of shareholder value—economic profit, return on invested capital, and company-specific accounting measures of performance—but no single value definition emerges as the "correct" organizing principle for managing performance. In nearly every instance, finance executives readily cite a clear and acknowledged business performance framework that employees—from the office of the CEO on down through the business units to field offices—embrace as a guiding principle for building and managing the business. Top performing companies use these frameworks for setting performance goals for all levels of their organizations. Such goals, say sources, are seldom tied simply to year-on-year improvement or to a linear extrapolation from prior experience. Rather, executives explained that their definitions of value are rooted in the external world of capital markets amid competition for investors.

"Ultimately, the market doesn't pay for earnings per share; it pays for value," says Stuart Grief, vice president of strategy at $11 billion Textron, a multi-industry company focused on aviation and industrial products and financing based in Providence, Rhode Island. "Obviously, it pays for EPS on some level, but with a great many other constraints applied as well—such as, how effectively are you deploying the capital that generates that EPS and what does the runway look like ahead of you?" Mr. Grief explains that Textron has made a migration from a focus purely on EPS toward a more expansive and externally oriented sense of value that embraces return on invested capital and economic profit. By doing so, he says, the company is more able to meet its goal of delivering a 15 percent or more return to shareholders.

"Five or six years ago," he explains, "you'd have seen a much greater focus on earnings per share." But in recent years, the company defines value more fully by explicitly considering capital efficiency. "It was very important for us to get a focus on capital efficiency given that a number of our businesses were operating close to or below our cost of capital," says Mr. Grief. Today management looks at its current portfolio of businesses and at potential acquisitions "beyond the capital deployed in these businesses… and asks, 'What can we do with our capabilities across the enterprise to create more value in these businesses than an alternative owner could?'"

The equity market "pays for EPS on some level, but with a great many other constraints applied as well—such as, how effectively are you deploying the capital that generates that EPS and what does the runway look like ahead of you?" says Stuart Grief, vice president of strategy at Textron.

At $6.3 billion Swedish ball-bearing manufacturer Aktiebolaget SKF, CFO Tore Bertilsson says the company uses a "simplified version of EVA called TVA that compares operating profit to the amount and cost of that capital." Why this definition of value? For a decentralized company with more than 300 operating units, says Mr. Bertilsson, "we believe [value definition] should be simple and well understood by everyone at the management level. And today, out of our 40,000 employees, we have several thousand making business decisions very well by considering the effects on the TVA measure."

Humana, a $21 billion health-insurance provider, offers a unique point of view on how it delivers value to its shareholders. The company, which provides health insurance to more than 11 million people, is in a self-consciously low-margin industry, says Jim Bloem, Humana's CFO. Its primary customers are employers who purchase coverage on behalf of their employees. In sales evaluations, customers (and their CFOs) often are concerned about prospective rate increases and say to themselves, "We've got to be careful about these guys, because they're trying to pass on the high rate of medical inflation and maximize their profit at our expense," says Mr. Bloem. "In response, I try to say, 'Look, we don't make a high profit margin; we make a 4 or 5 percent profit margin,'" which places the company in the lowest quartile among the S&P 500. The company, he says, makes its money through the combination of scale and operational efficiency—both of which it drives by providing an extraordinary level of information about its business performance to its core constituents, which include its customers, their employees, health-care providers, regulators, creditors, investors, and employees.

Finance as collaborator to build value

These and other central ideas of value are well established among the top performing companies that we examined in this study. These abstract ideas and aspirations become truly useful tools for driving business performance, however, when they are widely understood, broadly adopted, and used as an organizing principle for business decision making. Sources consistently report that the finance function—from the CFO on down through business unit finance directors and managers—plays a central role in carrying the message of value creation to the organization.

Abstract aspirations for creating value become truly useful tools for driving business performance when they are widely understood, broadly adopted, and used as an organizing principle for business decision making. And the finance function plays a central role in carrying the message of value creation to the organization.

Unsurprisingly, no prescriptive structure emerges as the orthodox model for the role of the finance team in executing strategy. However, finance executives consistently say that they have an expanding role as neutral, analytically minded counselors to business leaders and as stewards of the process through which companies deliver value. Similarly, sources affirmatively reject the notion of finance managers as mere technicians who prepare tables of numbers that business leaders feel free to ignore.

Pete Wilver, the finance chief at Thermo Fisher Scientific, a $9 billion manufacturer of scientific equipment and lab gear, says his finance managers within business units are "part of the management team—they're not sitting back in the office adding things up. I expect them to be forming and helping to make decisions alongside leaders of R&D, business units, marketing, sales, and so on." Mr. Wilver also speaks about finance's role as a collaborator with business managers in setting performance goals and targets: "In terms of developing the performance goals, it's a partnership role, but a strong partnership. I think of the business leader—the president or general manager of a business, depending on what level you are in the organization—and the finance leader as the two people who come up with a lot of the goals and drive them. Goals don't strictly come from finance, but certainly we're a key part in developing them."

This collaboration, says Mr. Wilver, extends far beyond finance executives' role as quantitative technocrats who produce spreadsheets that no one else is willing—or able—to make. When crafting the company's three-year outlook, he says, "My feeling is that it's not so much a financial exercise as it is really a strategic thinking exercise that focuses on what we are going to do differently with customers, geographic markets, acquisitions, and products. It's a lot more about how are we going to grow the business. Just about any finance person who's worth his salt can come up with a really great financial model for three years that looks beautiful. Too often, however, such models are just numbers on a piece of paper, and the precision really goes down as you go out into time. So, we focus a lot more on strategic thinking: What a new product might be able to bring to us, for example, or what if we built a new plant in China?"

Finance as analytical skeptic

Finance executives don't offer just analytical help, however. Their expanded role, say sources, is seldom simply a matter of finance staff aiding business managers with another set of hands to execute formidable business planning tasks. Rather, finance teams serve to verify and validate the strength of business analyses prepared by line managers. Stuart Grief says Textron's strategy execution and finance teams serve an oversight as well as counselor role in business planning and target setting: "Together we work very closely with the businesses to ensure that their plans not only meet objectives, but that they're also strategically grounded. So, for example, if a business puts forth a plan that has growth that's three percentage points higher than the industry and has margins that are six points higher than the industry, our obvious question is, 'Why? What is it that you're going to be delivering to your customers that's going to provide that kicker of growth and profitability?' We get into the dialogue and the businesses understand that they really need to make sure that the plans are grounded in the realities of their industries. If they can point to the real differentiation in their offerings, how they will both gain share and realize better prices, or to an operating model that's lower cost than the competition, that's great. But if they can't, then we've got to push back on them and learn more about what the plan is going to deliver and whether or not there are additional growth initiatives that will be needed in order to meet our value growth objectives."

Maintaining focus through organizational design

Mr. Grief reveals the prospect of tension in the relationship between finance and business unit management when they collaborate on business planning. Such tension is commonplace, say sources, and can be diffused through a combination of close working relationships and organizational structures that preserve the independence of finance from the business. At Anglo Irish Bank, for example, CFO Matt Moran says the company "runs finance as a central team that works in the business, so we don't have separate finance teams across the various business units. Those people are in the heart of the business, but we're also retaining their independence by having them report direct to finance as opposed to the businesses themselves. That way they're partners [with the business units] and drive controllership around the business at the same time."

"The whole strategy is built around the business itself—the actual customer interface," says Hans Ola Meyer, Atlas Copco's finance chief. "There's seldom a clear distinction that says, 'This is business, and this is finance.' Rather, we're creating a seamless connection between finance and the operations of the business."

High-performance companies blend business partnership and more traditional roles, say sources. For example, the finance function at KBC Group, the $9.6 billion Belgian bank, is in the midst of a reorganization to help its controllers become "business enhancers."

"The right metrics drive the right strategy, and if finance isn't taking an active role in this link, they're not only jeopardizing the execution, but they're also jeopardizing the strategy," says the CFO of a $21 billion U.S. health insurer.

Herman Agneessens, KBC's CFO and chief risk officer, explains, "In the finance function, we used to report on what had happened and then leave it to the business unit to explain it. We want to start talking to the business units before we flag something. From the moment we see something that isn't ideal, we can analyze together what might be done about it."

Almost 30 individual initiatives are involved in the project, which began 18 months ago and is expected to be completed in 2009. The goal, Mr. Agneessens says, is for controllers to go from 80 percent controller and 20 percent "business enhancer" to a 50-50 split.

Finance also balances its role as a source of business counsel to operating management with its mission to provide core finance and accounting processes to the entire company efficiently and effectively. At Sweden's Atlas Copco, a $6.7 billion maker of industrial and construction equipment, the company and its finance team balance the needs for centralization, standardization, and efficiency in core finance and accounting processes with its need for local finance expertise in its various markets. It does so through a combination of shared services centers coupled with finance staff (called business controllers) embedded within its businesses in more than 70 countries around the world. "The whole strategy is built around the business itself—the actual customer interface," says Hans Ola Meyer, Atlas Copco's finance chief. "There's seldom a clear distinction that says, 'This is business, and this is finance.' Rather, we're creating a seamless connection between finance and the operations of the business."

Accordingly, the company has become more decentralized by "creating divisions whose managers know the business as well as our demanding customers want us to know it." And, says Mr. Ola Meyer, "we have never regretted it and will never change." But amid this decentralization, the company also sought greater efficiency and process quality in "the [administrative] things that have nothing to do with the competency requirements of each division—the day-to-day operations of finance and accounting, administration, IT and IS support, payroll and so on." By doing so, he says, it has improved the quality of those particular processes and allowed the divisions to focus on their customer-focused mission. In addition, the company has lowered administrative costs and reduced risk in routine business processes that could result from "one-person dependencies and problems with segregation of duties," he says.

Finance as measurement expert

Thus, at top performing companies, the corporate finance team plays a central role in setting the tone and context for executing business strategy. This role of the finance team is a key determinant of business success, say sources. Ambitious targets and aspirations may go unmet until companies instill a clear link between how they generate value for shareholders and the business activities that deliver this value. As Jim Bloem at Humana says, "A good CFO isn't necessarily a front person, but is the person who makes sure that the execution is good. And the execution is usually very good if the information is good. If the information is lousy, then you risk the execution, and if you risk the execution, then you're risking the business."

Mr. Bloem is among the strongest advocates of high-quality performance metrics we spoke with for this study. To a person, executives consistently cited measurement of business activities—both internal and external—as the means by which they link goals and objectives with the real-world activities that will deliver results. "The right metrics drive the right strategy, and if finance isn't taking an active role in this link, they're not only jeopardizing the execution, but they're also jeopardizing the strategy," he says.

II. Value aspirations become real through targets and measurement

Executives say they measure business activities and generate transparent information on progress toward strategic goals. By doing so, they are able to link business decisions to outcomes that will drive value.

A clear sense of value and its drivers and a sound business strategy are surely sources of high performance. Finance executives, however, say that by measuring the business—both operating activities and financial results—in ways that are explicitly linked to business strategy, they are able to navigate their strategic path and make course corrections quickly enough to reach their performance targets.

Stuart Grief at Textron says, "In a lot of companies I've seen, a strategy gets put forth, but then it doesn't get connected to finance targets and to metrics. We've gotten past that at Textron by having the strategy function and strategy execution very closely connected to the finance function." At Reynolds American, Inc., an $8.5 billion U.S. tobacco company, CFO Dianne Neal offers a complementary assessment of how finance should contribute to managing performance. "You talk to CFOs throughout the country, and you'll hear business partnering over and over again—that finance people can no longer just sit on the sidelines and do the accounting, internal controls, and compliance. We must also make sure that the company is using its resources wisely and for maximum return. That feeds right into setting objectives, measuring progress against those objectives, and continuously looking at opportunities to improve our results."

After discussing performance management and the role of finance at top performers in Europe and the U.S., it seems hard to overstate the value of explicit linkage between measurement of operating activities and their contribution to performance management. While a common understanding of value and an intellectually ambitious finance team are clearly present at high-performance companies, this research study finds that well-articulated performance metrics and their consistent application are the fulcrum for leveraging truly high performance.

Using metrics to guide performance recovery

In selecting the sources for this study, we chose companies that had outperformed their peers in recent years. Thus, almost by definition, our source list includes several companies that have dramatically improved their performance. In some instances, they have gone through an explicit turnaround that is guided by performance management principles; in other cases, they've reacted to stagnation with a concerted, disciplined effort to manage performance using similar principles.

Finance executives say that by measuring the business—both operating activities and financial results—in ways that are explicitly linked to business strategy, they are able to navigate their strategic path and make course corrections quickly enough to reach their performance targets.

Finance's trust-but-verify role ensures that the human element in decision making —optimistic, pessimistic, or otherwise—is counterbalanced with analysis and scrutiny. "It's not about trust. It's about knowing, transparently, how results are going to be achieved," says the CFO of a large North American bank.

When total shareholder returns slipped into the second quartile among its global peers, Royal Bank of Canada, an integrated financial services company with C$572 billion in assets, responded by making a clear statement of the company's aspiration: to restore its top-quartile ranking over the medium term. This was coupled with a near obsession with transparent, high-quality performance metrics. RBC had "a top-down commitment process" for business performance, "but we didn't have transparency into where the growth was going to come from," says the bank's CFO, Janice Fukakusa, "We were experiencing marginal results in some businesses, but we didn't know about it until results were in."

The bank tracks a broad array of performance metrics that link back to the core drivers of the business—on the revenue side, financial market information, loan volume, spreads, and so on. On the cost and efficiency side, the company uses, for example, "an operating leverage metric, which is the spread between the rate of revenue growth and cost growth," among many other metrics, says Ms. Fukakusa. Now, two years into the performance-management-driven turnaround, she is well positioned to explain how the "sense of urgency about the target" and "our commitment to transparency" have made the turnaround work.

Ms. Fukakusa says the bank's five-stage performance management cycle—setting enterprise targets, translating them into individual business targets, tracking initiatives, monitoring performance, and formally reviewing each line of business—is among the finance team's core responsibilities. "When it gets down to the brass tacks of the target setting and transmission into goals, initiative tracking and monitoring—that's how the finance team adds value in our performance management process." Finance's role, says Ms. Fukakusa, is to "run the performance management cycle on behalf of the businesses. The owner of the process is really the finance function, and it's up to finance to have the engagement with business unit management." And as the steward of the performance management cycle, the finance team provides both support for business decision making and validation of how business units are going to achieve their objectives.

Finance's stewardship of this process becomes clear in Ms. Fukakusa's description of how the company sets targets for performance with business unit management, monitors and reacts to change, and makes investments. "When we're having a period of good results, business leaders are often tempted to say, 'I told you I'd deliver X, and I've delivered X-plus. So why do I have to tell you I'll deliver Y next year? Trust me. I've done it and I'm proven.'" Such negotiations are commonplace, she says, attributing the managers' behavior to "'recency'—that is, whatever's happening currently affects how you're projecting into the future." Amid this behavior, the performance management methods and finance's trust-but-verify role ensure that the human element in decision making—optimistic, pessimistic, or otherwise—is counterbalanced with analysis and scrutiny. "It's not about trust," she says, "it's about knowing, transparently, how results are going to be achieved."

Similarly, in overseeing operating performance, RBC's commitment to transparent metrics yields the ability to sense and respond to changes in business conditions quickly—before the changes affect the bank's overall performance. Says Ms. Fukakusa, "Transparent performance metrics give us enough information so that when situations change, we know it and we know which levers to pull." Citing an example from the commercial banking business, she says, "We need to have fully transparent metrics so that, for example, if the economy is falling off a bit, if we see our loan-loss ratios ratcheting up, then we can stop spending to drive revenue growth, manage in a different environment, and still have earnings growth because we've managed our costs."

"Transparent metrics have a direct relation to resource allocation" at RBC, says Ms. Fukakusa. "Transparency gives us a line of sight into what we should continue to invest in and what's not working and when we should stop." Business managers, she continues, "are optimists, and they are tempted to say, 'If I just go this extra stage, I'll be successful.'" Finance's oversight of performance management offers "a top-down, objective view that can say, 'Maybe we should stop doing this.' And for us at RBC, we've been quite successful at driving the right behavior."

Thermo Fisher has used a new commitment to performance management to deliver results in its migration from well-known incubator and technology innovator to a high-performance operating company. "Over the last six years," says Pete Wilver, CFO at Thermo Fisher, "we've restructured Thermo from being a holding company composed of 24 separate public companies that had been spun out of a corporate parent into a single operating company." The combination of brutal equity markets in the earlier part of the decade and a strong desire to obtain more repeat business through better customer relationships drove the company to recast its corporate structure and to merge with Fisher-Scientific, a vendor of laboratory equipment, in 2006. This new operating structure and merger, says Mr. Wilver, allows the company to deliver its analytical technology and lab equipment across all its customer relationships like no competitor can.

Thermo Fisher's transition has been managed in large part through the company's use of "goal trees"— a company-wide set of metrics for revenue growth, earnings growth, cash flow and working capital improvements, employees, and customers. "Each year the senior leadership comes up with the company-level goal tree of what we're going to drive in the current year to achieve what results, and what we're going to do to achieve our financial goals. These then flow down throughout the company—down to each of the segments, groups, and divisions, down all the way to the functional level at one of our 400 locations," says Mr. Wilver. At each level, these goals reflect what they need to do to achieve the companywide targets. "It's really a conversion process," says Mr. Wilver, "in which we pick out the things that make sense for you and translate them into business-unit-specific goals that support higher-level goals. It goes all the way down to the hourly ranks on the manufacturing floor."

At Thermo Fisher, setting performance goals is "a conversion process in which we pick out the things that make sense for you and translate them into business-unit-specific goals that support higher-level goals. It goes all the way down to the hourly ranks on the manufacturing floor," says the company's CFO.

The company uses scorecards that run parallel to its goal trees and reflect financial and operating performance. These are reviewed in monthly, quarterly, and annual business performance and risk reviews. Thermo Fisher's scorecards are "financially focused," says Mr. Wilver, and contain "all the key elements of the P&L, margins, working capital metrics like inventory and receivables. We also track, for example, what we call product vitality, which is the percentage of our product revenue that comes from products introduced in the last 24 months. We see this as a good measurement of our ability to commercialize new products."

Thermo Fisher's metrics of non-financial business performance include a "net promoter score" which it uses to gauge its ultimate non-financial business goal—customer satisfaction. Explains Mr. Wilver: "We track customer allegiance scores by asking our customers, 'On a scale of one to ten, would you recommend Thermo Fisher to a friend or colleague as someone to buy a product from?' We call the nines and tens promoters, and the ones through sixes are called detractors; and the sevens and eights, they're kind of ambivalent, I guess. So we take the promoters less the detractors and come up with a score to determine whether or not we're doing better with our customers. It gives us a realistic view of customer allegiance, and it's a pretty tough score, honestly. To get a nine out of ten out of somebody is quite difficult—it's certainly hard to get [it] out of me!" says Mr. Wilver.

Other non-financial metrics of business performance on the company's scorecard include headcount and employee-related metrics. "We look at a contributed-value-per-employee productivity metric at a high level," says Mr. Wilver. The same thinking that drives Thermo Fisher to examine its customer satisfaction performance appears in its measurements of employee satisfaction. "We've implemented what we call a talent allegiance score, a similar survey in which we ask our employees whether they'd recommend Thermo Fisher to a friend as an employer. So far we think we're the only company doing this."

Mr. Wilver reports that the surveys and employees' written comments help the company see how well managers are helping their employees' career development: "It's been pretty insightful to us on what employees' hot buttons are, what they like, what they don't like. We have the ability to track those answers by different levels of the organization, location, function, and so on. So we get granular information on where the problem areas are. One thing we've come to understand though this work: there's a strong link between people's respect for their managers and how high they score. If people respect their managers and view them as strong leaders, they're a lot more likely to score a nine or a ten. And if they don't like their situation, they're a lot more likely to score a fairly low number. And I think it's about a lot more than simply what you get paid."

"Our stock price went from $6 to about $40 now. We took our operating margins way up and revived our growth. In the finance function, we took a substantial role in performance management and strategy, especially productivity, efficiency, and then having a way of taking the savings and driving it back to investment to help grow the company," says Autodesk's CFO.

Like Thermo Fisher, the design automation software company Autodesk faced a difficult turnaround earlier in the decade, as declines in high-tech spending, economic conditions, and equity markets converged to batter software and services companies. Al Castino, the company's CFO, says, "There's been a pretty substantial turnaround in the company" and attributes much of the company's success to a renewed focus on performance management. "Our stock price went from $6 to about $40 now. We took our operating margins way up and revived our growth. In the finance function, we took a substantial role in performance management and strategy, especially productivity, efficiency, and then having a way of taking the savings and driving it back to investment to help grow the company."

Mr. Castino attributes much of his company's success to its focus on and measurement of the drivers of shareholder value—which he says are growth in revenue and operating margin. In addition to tracking these and a great many other financial metrics, of course, Autodesk measures the operating metrics that will determine the company's success or failure in meeting shareholders' expectations. As a market-share leader in design automation software, says Mr. Castino, the company had to seek growth through converting its current customers from 2-D products to more sophisticated 3-D and digital prototyping applications and to closer relationships with the company. "So our other core performance metrics are more operational. We have metrics for the percentage of customers that have a maintenance contract and measure the percentage of our sales that are coming from 3-D versus 2-D products."

Using metrics to sustain high performance

While many top performers are recent turnarounds, others deliver sustained returns for investors without first enduring dramatic disruptions or sustained stagnation in growth. Finance executives at such companies report a similar approach to performance management—an approach tied to measuring the business activities that drive shareholder value, and to carrying the message that these are the numbers that matter to top management and to shareholders alike.

British American Tobacco, says Michael Barnett, now links business performance metrics more explicitly to long-term targets. "Previously, the only measures that we were particularly clear on were earnings per share and total shareholder return," says Mr. Barnett. "These were the only measures for which we could honestly say we had defined long-term objectives. But in 2004, we became much more explicit about them. We said, 'If we are going to deliver earnings per share growth of 8 percent per year or higher, how will we get there? We'll need to deliver profit growth of 6 percent, in which case we need some revenue growth and cost savings. In order to get revenue growth, we'll probably need volume growth as well.' So, the difference was being much clearer about the long-term goals for volume, revenue, cost savings, and profit."

Mr. Barnett concedes that optimizing this basic volume, price, and cost equation might seem obvious. But he attributes some of the company's success to the exercise of linking business performance metrics to long-term value, and gaining a more complete understanding of how business operations and basic operating performance will drive shareholder returns. "We needed to get the organization confident in the financial aspects and to make sure that everything was logical—to show how a volume growth of one percent per year has a measurable, bottom-line result," says Mr. Barnett. "Yes, if you get a bit of volume growth, some mix improvements, and a bit of pricing, you'll get a bigger turnover growth. If you get a better turnover growth and a few cost savings, you'll get some profit growth. It seems logical, but we made sure that it was clear and consistent to management throughout the company."

Becton, Dickinson and Company, the U.S.-based $5.8 billion maker of syringes, diagnostic tests, research tools and instruments, and drug delivery systems, has a similar view on business performance and metrics. Like many sources we spoke with for this study, John Considine, the company's finance chief, calls for strategic simplicity in a complex environment. "While you can always tweak it a bit, our broad strategy—to drive revenue increases through innovation and R&D, paid for with operational effectiveness efforts—is pretty simple and it has stayed that way." This simplicity, he says, is especially important as the company expands around the world. Having one strategy, one story, for one company, makes executing a global strategy possible. "It's complicated to do," says Mr. Considine, "but nonetheless everybody as we go around the globe—and we're 50 percent international—has this same outlook on our strategy and core values."

"We needed to get the organization confident in the financial aspects and to make sure that everything was logical, to show how a one percent volume growth has a measurable result," says Michael Barnett of British American Tobacco.

Of course, simple should never mean simplistic, and BD's straightforward strategy message is supported by many financial and non-financial metrics. "It's very detailed as you dig into it," says Mr. Considine. Beyond just pure financial expectations for the P&L, for instance, there are explicit metrics and expectations for operating effectiveness, such as inventory turns and back orders. And we have research expectations to support product launches and for acquisitions that we've made—how well they're doing in relation to the plans that had been approved by the board when we made the acquisition."

Mr. Considine sees this brand of metric-driven performance management as highly successful, but "not just because we've hit our numbers." In addition to ensuring the delivery of expectations, "this gives us great visibility into the elements of the plan, and we get the whole company looking at them. Everybody knows the direction we're taking and there's not a lot of confusion among the managers," he says.

The link between performance metrics for more discrete projects—as opposed to day-to-day operations—and strategy is not always perfectly clear at many companies, say those we interviewed. "Even on large-scale projects where the return on investment has been scrutinized, there traditionally hasn't always been a clear link between the investment and its impact on volume growth, turnover growth, and profit growth," says Mr. Barnett. Rather than linking project performance to enterprise-level performance targets, many high-performing companies often rely on a qualitative assessment of the project's alignment with strategy paired with economic analysis of projected and actual returns.

Investments should be linked closely to business strategy—"People don't think up a project and then ask, 'does it fit with our strategy?' The strategy generates the projects," says one CFO interviewed for this report. Sources also insist on both alignment between projects and business strategy and on disciplined demonstration of their economic return. Janice Fukakusa explains how both financial return and strategic alignment govern project investments at the Royal Bank of Canada: "The return on a project, of course, has to exceed our cost of capital, so we evaluate the project investment using economic metrics—internal rate of return, net present value, cash flows, etc. We consider accounting metrics as well, because the accounting is sometimes different than the economics. We also ensure that the project or initiative aligns with our larger business strategy—first, we consider how the project aligns with strategy, and then we look at whether it's economically feasible."

When results fall short of expectations, say sources, top performers reallocate resources dynamically to fix a problem or to stem the flow of good money after bad—or they alter the performance objectives of other units to ensure the enterprise as a whole meets its targets. Perhaps most important is the ability to do so quickly.

Finance and business management intervene—together

By measuring, monitoring, and keeping "everyone's eyes on the ball" in the words of one CFO, managers know what matters and make better decisions. Nonetheless, when results fall short of expectations—and inevitably, they sometimes do—finance teams at companies in this study renew their personal engagement with managers. More analysis and planning, say sources, is seldom the solution to performance shortfalls. Rather, companies reallocate resources dynamically to fix a problem or to stem the flow of good money after bad—or they alter the performance objectives of other units to ensure the enterprise as a whole meets its value creation targets. Perhaps most important, say sources, is the ability to do so quickly, while there's still time to overcome near-term shortfalls.

At Autodesk, for example, a new product was losing ground to a competitor in the Americas, but, as CFO Al Castino relates, the combination of nimble finance and business unit collaboration and discretionary investment allowed the company to prevail. "The CEO and finance worked with the unit's general management team on why it was struggling and came up with some specific investments for that product line." After Autodesk made a substantial and unbudgeted midyear investment, the product recovered its lost ground, and, says Mr. Castino, "in the last six months we no longer have this deficit in the Americas versus our competitor; we're beating them again."

Autodesk's CFO says the lesson is to measure and manage performance metrics aggressively. But, he says, "A lot of this success is based on making very well-timed, well-chosen investments and insuring we had a payback on them. So we in finance try to be very responsive to what's happening in the business and our business is healthier because we do so."

Planning for contingencies by allocating discretionary funds may, of course, seem contrary to disciplined investment decision making and strict accountability for managers. Nonetheless, Mr. Castino says, Autodesk prefers the flexibility and responsiveness that the company's policies allow, and he reiterates the care and scrutiny such investments receive: "We put aside an investment fund in every budget so that the CEO has money he can allocate to respond to initiatives, opportunities, or issues that come up during the year."

At Becton Dickinson, the medical technology maker, Mr. Considine says his finance team seeks to identify problems as early as possible and then to craft a response to negative outcomes that are within its operating and ethical model. He related this anecdote of how the company's sales in Japan were suffering as the Japanese population enjoyed a very light flu season in 2006: "Sales for our rapid manual flu test were off by about $24 million on a year-to-year basis," says Mr. Considine, "and it's a good margin business for us."

After identifying the shortfall, BD's finance and business unit leaders worked to find a way to meet overall company performance objectives. "We would never try to fix a problem by pushing sales," says Mr. Considine. "In fact, if somebody wanted to offer any deal outside of standard practice, they'd need my signature. And in my seven years here, no one's come to me yet for that sort of thing." Instead, the company looked elsewhere within its business to make up the shortfall.

Amid this sort of operating risk, BD has changed its investor guidance policy. "We've helped ourselves somewhat," says Mr. Considine, "because starting this year, we'll guide for the year but not by quarter any longer. Now, I'm not saying that analysts won't judge us that way—that's fine—but within the company we really look at delivering the whole year's results."

All metrics are not equally useful, say executives, and as the number of metrics increases, information clutter and mixed messages can interfere with high performance. Sources call for simplicity and clarity in financial and operating performance measurement.

Fortum's performance management system is based on a three-step "agree, execute, and follow-up" process, according to Juha Laaksonen, CFO of the $4.6 billion Finnish electricity provider. "In the center of the process is dialogue," Mr. Laaksonen says. An example is a series of rolling management meetings conducted throughout the year. Once a quarter, the CEO and his management team meet face-to-face with business unit managers in sessions that can last up to a day-and-a-half each. "It takes a lot of time for the CEO and his team, but that's how we see whether we are implementing and executing as we agreed. Corporate management gets a hands-on view of what's happening, the problem issues, what might be coming around the corner, and a feeling for whether the business unit is on top of the situation."

Reviewing results and intervening effectively call for close scrutiny, timely information, and also difficult decisions about both the business and the managers who run them. Marcel Smits, CFO of Koninklijke KPN, the $16.2 billion Dutch telecommunications provider, advocates a "back them or sack them" approach to managers who aren't meeting their numbers. "You make up your mind whether you support your senior management. If you support them, you're in it together," he says. "If you don't support them, you hire a new management team. The riskiest thing you can do is to get into a halfway [situation], where you give them all sorts of signals that you don't trust them to resolve the situation, but you don't do anything about it. So it's an issue of trust. 'Back them or sack them' sounds very unpleasant, but it is actually a basic principle of decency."

Siegfried Mayrhofer, the head of strategic controlling at Telekom Austria, a $6.3 billion wireless and wire-line carrier, says the company's commitment to meeting free cash-flow targets is very firm, and there are well-established ways—in both its culture and formal processes—of addressing performance shortfalls. "Everything is non-negotiable," he quips, and continues more seriously, "If we see that we run into a problem in, say the operating free cash flow in October, we'll bring together the people, tell them what's happening—starting from the first- and second-line management—and introduce a discussion of how to reduce costs, make cutbacks, or push additional revenues." Telekom Austria has a culture of measurement and meeting performance expectations that is able to react and overcome such shortfalls. Says Mr. Mayrhofer, "It's the straight link to [employees'] bonuses. Nobody is happy to hear that he has to cut another few million of his line budget. That's not a happy task, but the acceptance is okay."

Elsewhere in Europe, Volvo AB, the $30 billion Swedish truck maker, cites cross-functional task forces as its method for finance and other management functions to intervene in response to performance shortfalls. Queried on how the company and its finance team intervene when targets are at risk, CFO Pär Östberg says, "We create from time to time task forces from corporate finance or under the authority of the head office of finance which would be likely to involve staff from corporate finance, business control, and strategy [which is global and reports into finance]. This group would combine efforts and work with the business area where we see the performance is perhaps lagging."

Such corporate-level interventions are not common at Volvo, however. "We avoid them in general since we have a very decentralized way of operating in the group," Östberg says. Managers are responsible for operating and income cash flow. As long as everything is working fine, then there's very little intervention from head office. When we see that [an important metric] is not in line or actual numbers are not in line with plans, then of course there might be questions asked."

Task forces are used more often in integrating acquisitions. A cross-functional team of managers is formed from product planning, and corporate functions such as finance or strategy. "If we combine the different expertise in functional areas into a focused project team, that adds value," Mr. Östberg says. "In a fairly short period of time we can do many things."

Caveat ratiocinator: Complexity can compromise focus

Sources at high-performance companies throughout this report solidly endorse an expansive view of internal and external performance metrics. Such metrics, if well-articulated, transparent, and commonly shared, align business activities with business strategy, leading to further creation of value. But all metrics are not equally useful, say executives, and as the number of metrics increases, information clutter and mixed messages can interfere with high performance.

"The challenge is to keep it simple, and not overburden the process with too many metrics or confusing metrics that managers don't understand or feel they can't affect. I think that keeping it simple and fostering open communication among the executive team, the board of directors, and the operating managers is one of the keys to a successful performance system," says the CFO of Hilton Hotels.

Robert La Forgia, EVP and CFO of Hilton Hotels Corporation, the $8 billion hotel chain, cautions that all companies need to focus on the factors that drive success, without the distraction and cost wasted on unnecessary managerial activity. He says, "One of the challenges in any organization, including Hilton, is to ensure that management stays focused on the key drivers of success. Hilton has many opportunities for continued growth in its various businesses, particularly in the area of international expansion, and we want to continue to provide the right incentives based on a limited and well-understood set of performance metrics. The challenge is to keep it simple, and not overburden the process with too many metrics or confusing metrics that managers don't understand or feel they can't affect. I think that keeping it simple and fostering open communication among the executive team, the board of directors, and the operating managers is one of the keys to a successful performance system."

Similarly, simplicity and commonality are vital for Sweden-based SKF. The company is composed of more than 300 business units around the world, with 40,000 employees, only 2,000 of whom work in the head office. "It's important to have very simple and clear messages and not complicate things," says CFO Bertilsson. "We try to repeat and repeat and repeat information and requests."

Simplicity and common understanding of performance emerged consistently in our conversations with CFOs at high performance companies. To do so, say executives, companies standardize and simplify their reporting for internal and external purposes. In 2002, $20.2 billion German automotive supplier and tire manufacturer Continental AG implemented an SAP-based data warehouse for reporting and controlling. From then on, numbers quoted internally were the ones released to the public. "Our externally published numbers are also the internal numbers," says CFO Alan Hippe. "The ROCE we give to the outside world is also the ROCE we use for our internal controlling. We get a lot of buy-in from our managers when they find that their numbers are provided to the outside world."

The CFO at Renault echoes this focus on simplicity and shared focus, as the $56 billion French carmaker pursues its four-year commitment to raise its operating margin to 6 percent and its dividend per share from 1.8 euros per share in 2005 to 4.5 euros per share by 2009. He reports that there are 31 KPIs that are linked to this goal, with responsibility for meeting them dispersed throughout the company. However, there is one metric that applies across the board: operating profit.

"It is very important that everyone has a link with operating profit," says Renault's CFO, Thierry Moulonguet. "It's the best metric to get everybody working in the same direction, and it allows finance to clearly monitor the results. We've found it to be a very efficient tool."

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Telekom Austria's Siegfried Mayrhofer offers further illustration of the risk of complexity. After considering economic value added as an organizing principle for performance management, the company rejected it, says Mr. Mayrhofer, because "it's an enormous communication [problem] for people to understand how they can influence this figure. As an intellectual concept, EVA is brilliant, but I don't know any company where the first and second-line managers really get how they can influence EVA directly." Accordingly, the company uses free cash flow from operations as a primary gauge of business performance.

Through formal training, close collaboration, and ad-hoc communication, top performing companies and their finance teams carry a clear, unified view of how to generate value. Coupled with suitable performance metrics and good working relationships with finance, say sources, this view helps ensure strong performance.

Training to build and sustain focus on performance management

In an effort to share, understand, and collaborate on performance management, some companies have created ambitious internal training programs, while others rely on communications programs and more informal collaboration between finance and business unit staff.

Becton Dickinson, the medical technology company, has invested heavily in training for finance and non-finance managers through "BD University," says John Considine, the company's CFO. "We have a number of courses that everybody takes that are closely tied to performance management: leadership development, advanced leadership development, managing for performance, and so on. There are some that are more specific to the sales group and some more to manufacturing."

Such formal internal university programs are rare among large companies, it seems, but the spirit in which BDU offers its programs is present in many of the companies in the study. Dianne Neal, CFO at Reynolds American, explains that management training focuses on developing leadership skills through internal programs and those offered by third parties. "We utilize heavily the Corporate Executive Board's individual classes and the online research tool," she says. "To us, it's very important in finance that people stay on top of emerging practices."

The need for such programs for business unit management could hardly be made clearer than by one source's remarks about how managers rely on performance reporting and metrics. E. Follin Smith, the CFO of Constellation Energy Group, a $19.3 billion energy company in the United States, observes that performance reporting, metrics, and the basics of business performance are often opaque at large companies. "When I first got to Constellation, management reporting and GAAP reporting were so 'de-linked' that some business managers could not explain GAAP results," she says. Unsurprisingly, Constellation moved to new management reporting to support operating decisions which has clear linkages to GAAP results and which is supported by metrics used for incentive compensation.

At Becton Dickinson, says Mr. Considine, the company "thinks that training and development are a big part of performance management. It's not only limited to defined classroom education. We spend a lot of time on HR planning to try to move people around and use that 'zigzag strategy' to give people different experiences. In my personal view, other than the basic educational stuff you need to get in here, 70 percent of it is learned on the job. There's about 20 percent special experience [from special projects] and then there's 10 percent more defined learning, as I would say, within BDU that we do. But, no matter how you parse up that educational side, it's a big part of what we do."

Mr. Considine's peers at other top performing companies would likely concur with his assessment of 70 percent on the job training, and sources consistently report a great many ways to ensure employees learn new skills. Steve McAdam, director of finance and control at SABMiller, a $15 billion brewer based in London, says it's essential to train finance and business management to collaborate effectively. Such training may be better delivered through informal group meetings and conferences than through a didactic classroom setting. "It's important to build up strong relationships among the divisional finance directors by visiting them and by encouraging them to visit the UK," says Mr. McAdam. He organizes two finance executive conferences every year, one in South Africa and the other in the UK or in North America. These bring together the 25 most senior finance people, including the group treasurer, group tax manager, and head of internal controls. A broader three-day conference for the top 90 finance executives at the company is held every two years, along with a great many smaller ad-hoc social gatherings.

SABMiller is a decentralized global company, says Mr. McAdam, which counts on its group finance teams to serve as "the key interface with the businesses." He continues, "It's important to have people in the center who are commercially oriented and intellectually strong but also capable of building good business relationships. We encourage them to visit their businesses and try to get close to them and understand the issues. We're trying to get this message across: we are a team working together with our operational colleagues to get the right results and to give the right information and service to our customers."

While classroom training may well carry many of the core factual messages that managers of all levels need to hear, Mr. McAdam's strategy of training through collaboration and shared time together builds as much relationship capital as knowledge capital. "We in finance in the center regard our colleagues in the operations as both suppliers and customers," he says. "They are suppliers, they do provide us obviously with a great deal of information, but they're also customers. We provide them with a number of services, including technical support, training, and, when required, professional support. So, I think that's how you build up this open culture of communication based on mutual trust, by regular contact, by regular visits, by getting to know people both in the office and on the social side, thereby generating a sense of team spirit and camaraderie."

At $4.2 billion Nexen, a Canadian oil company with operations around the world, the finance team cultivates a similar esprit de corps among business unit and finance staff. The company relies on broad communication to carry the performance management message to managers in finance and the lines of business.

"We spend a lot of time framing and thinking about our messages to our employee population at large," says CFO Marvin Romanow. "Finance will have employee meetings, divisional guys have employee meetings, we have senior leaders who will meet with 20 or 30 employees at a time and answer all kinds of questions." Such informal dialogue, he says, supplements "the formal channels that our strategic documents and other documents create. We use a lot of informal communication that allows people to just talk about stuff that we're working on."

He continues, "I think the biggest thing about communication is having a variety of channels to appeal to [employee preferences]. Some people prefer to read things, some people just want to go see our CEO once a year and shake his hand, and some people want to know every six months what's going on. Some people want to be in a small group so they can ask their leader a question or a series of questions." Amid these diverse requirements, the company ensures that managers get the information, relationships, connections, and experiences they need to manage performance fully.

At Atlas Copco, Mr. Ola Meyer affirms the value of training and shared understanding of business performance and its measurement. "We had a student doing some research a few years ago who found that the expression and understanding of financial and performance targets were accurate and well understood on the shop floor in factories." Thousands of the company's employees, he says, "express performance exactly the way I do."

III. Achieve targets, receive rewards

There's little question that paying for performance drives managers to work harder than they would otherwise. And if well equipped with knowledge and information—with value principles and sound metrics of performance—their performance and that of their organizations will rise. Finance executives report linking variable compensation company performance to a combination of enterprise, business unit, or workgroup results, over which employees have more direct control.

Bonus plans tied to business performance are broadly adopted among the high performance companies in this study. In some cases, however, employees' variable compensation plans are linked explicitly to the non-financial metrics that drive value. At The Sherwin-Williams Company, the $7.8 billion paint manufacturer based in Cleveland, Ohio, the company compensates more than 80 percent of employees with some form of bonus plan "with sales goals, gallon goals, and operating profit goals," says CFO Sean Hennessy. These dimensions of variable compensation align with the company's broad objectives of increasing shareholder value through top-line growth and also boosting market share.

Similarly, at Reynolds American, Dianne Neal reports that the company's bonus plan uses similar metrics as its corporate performance management plan. Reynolds' plan "has two primary components—an earnings growth component that's 50 percent and share of market measures that are the other 50 percent," says Ms. Neal. The operating companies within the larger enterprise have similar plans. In the longer term, says Ms. Neal, Reynolds has a "three-year long-term incentive program that has an earnings component and also has metrics and measures for dividends and total shareholder return."

Becton Dickinson offers a compensation plan that's tied to the objectives of the company's enterprise performance management scheme as well. Says Mr. Considine, "When we build our budgets and plan for the year and they've been blessed by the board, they then become part and parcel of the way we compensate people in the short term. This is the incentive side of performance management." He continues, "We have targets by countries and regions on their operating income before taxes, which are things that they can control in the short term." In the longer term, says Mr. Considine, the company offers a more complex variable compensation structure composed of options, performance shares, and long-term vesting shares.

"We were giving 10-year free calls on the stock, which wasn't the best way, in anyone's mind, to drive performance. We had to look at revenue growth and also look at how much investment we were returning on the capital we employed to generate that revenue growth," says Becton Dickinson's CFO on the company's variable compensation plan.

The granting of these rewards is tied to more complex, value-oriented goals—long-term revenue growth and return on invested capital, says Mr. Considine. Why discard a pure options model in favor of this more complex multi-tiered model? Says Mr. Considine, "On the longer-term basis, we didn't want to just do options. From the company's point of view, options alone weren't the best way, in anyone's mind, to drive performance. We had to look at revenue growth and also look at how much investment we were returning on the capital we employed to generate that revenue growth. We believe this achieves a balance of revenue growth and profitable returns on investment of our capital."

"We only have one group of shareholders, so we try to reinforce the ideal that the competitor is outside our four walls, not inside," says the CFO at Nexen. "So the company designs its incentives to encourage people to share information, to share capital," and other assets.

This concern for how variable compensation affects individual behavior weighs heavily on finance executives. At Nexen, the Canadian oil exploration company, variable compensation has to be tied most closely to enterprise performance, not to individual oil exploration projects, Mr. Romanow says. "Getting people to share capital is probably more important than rewarding someone for a great outcome and punishing someone else for a bad outcome." Why? "Because in the exploration business, the most talented people can run into a string of dry holes, but you don't want to punish them because you really haven't fully exploited or evaluated that strategy. They may have just a string of bad luck," Mr. Romanow explains. This variability in results makes the rewards of the oil exploration business look more like a lottery ticket than a business venture that rewards hard work and good ideas.

With this in mind, says Mr. Romanow, the company's compensation is structured to reward companywide success. "Our stock option programs, for example, are designed around corporate success. We only have one group of shareholders, so we try to reinforce the ideal that the competitor is outside our four walls, not inside." By doing so, he says, "We get people to share information, to share capital," and other assets. Yes, there are payouts for large oil finds, but "the amount of direct-drive compensation in our business—where a group of 10 people discover 100 million barrels of oil—they'll get a special recognition for that. But most of our broad strategy recognitions are more shared recognition programs."

Similarly, Telekom Austria designs its variable compensation to encourage effort and creativity, of course, but also collaboration among decision makers. Siegfried Mayrhofer says the variable compensation plan is designed by finance in close collaboration with HR. Then the board signs off on the metrics on which bonuses will be granted for the first, second, third, and additional levels of management. Says Mr. Mayrhofer, "A large portion of what's specified is non-negotiable, absolutely not." But this firm commitment is supplemented with what Mr. Mayrhofer calls a "corridor"—a tightly managed span of latitude in the bonus plan that actually reinforces (rather than compromises) the bonus plan and its link to performance metrics.

"If, for example, the objective is 115,000 additional [telephone] lines, there is a corridor that says, 'If you are five percent below, you get 80 percent of your bonus. If you're straight on target, you get 100 percent of the bonus. If you are, say, 10 percent above, you get 120 percent of your bonus.'" This non-linear corridor has strict limits, says Mr. Mayrhofer: "The corridor in which you get in the bonus is between 80 percent and 120 percent. So if you miss the 80 percent level, you go down to zero. There's no 75 percent or 60 percent or anything like that."

The advantage of such a system, says Mr. Mayrhofer, is that it encourages employees to achieve at least the lower end of the targeted metrics. In addition, many of the metrics are achieved collaboratively among several managers. Accordingly, "the downside limit goes down immediately from 80 percent to zero, so there's a lot of willingness especially on the cost side, to sit down and make some additional effort," he says.

IV. Conclusion

Finance executives at top performing companies define and instill a clear sense of how their companies generate value, say sources interviewed for this report. They say that increasingly, an excellent finance team—highly collaborative, analytical, commercially oriented, and outward looking—works closely with business management to embed value principles into setting targets, making decisions, and reaping the rewards of success. To do so, companies embrace financial and operating metrics that link business activities tightly to executing business strategy and to their value creation activities.

Research among finance executives reveals that top performing companies often have their own interpretation of this progression of value principles, goals and metrics, finance function mandates, and reward systems. One source was particularly optimistic on the impact of performance management discipline and its longer term effects on companies and the broader competitive landscape. Jim Bloem of Humana argues that performance management discipline makes successful companies even more so. The secondary effects of this improvement will in the long term alter the competitive dynamics within industries and the finance function as a profession.

"Because all good companies are getting better, they're generating more capacity to do what they do," says Mr. Bloem, CFO of Humana. "Because they're generating so much more capacity, they're making the marketplace more competitive. People are consolidating, dropping out, or dropping lines of business. We're seeing companies go private so that they don't have to do this in a fishbowl. There are lots of different things going on, but they're all about performance metrics and increased capacity."

Mr. Bloem suggests that in addition to building great companies, performance management helps generate more capacity, with less investment and less labor—which in turn affects prices, labor markets, and a host of other factors that are outside any particular firm.

Says Mr. Bloem, "Only the management [groups] that work well as teams, using that kind of value vocabulary, will build truly successful companies in the long run. I view finance as having the responsibility to support that and help the upward directional pull going forward."

One source argues that in addition to building great companies, performance management helps generate more capacity, with less investment and less labor—which in turn affects prices, labor markets, and a host of other factors that are outside any particular firm.

Strategy execution

The need for performance management

(Provided by Deloitte Consulting LLP, a subsidiary of DTT Member Firm Deloitte & Touche USA LLP)

In an environment of intense competitive pressure from high-growth, low-cost developing and transitioning economies, and rising demand from increasingly transparent and global marketplaces, an organization's performance results usually hinge on its ability to deliver its strategy.

We believe, in order to fulfill today's market expectations, companies need to execute value generating strategies faster than ever. Developing these strategies in itself is not a simple task, but it's the ability to turn strategic ambition into operational reality that differentiates outperforming companies from their peers.

The finance executives interviewed for this report spoke of a range of individual business strategies, including technical innovation, product differentiation, customer intimacy, social responsibility and brand intimacy. The common emerging theme, however, was the ability of these outperforming organizations to deliver a sustained and consistent execution of their strategic intentions.

It is our hypothesis that the fundamental instrument that enables companies to execute their strategies is a commitment to performance management, and this can be driven most effectively through the CFO and the finance function.

Outperforming CFOs have common insights into performance management

For this reason we have collaborated with CFO Research Services to investigate the key aspects of performance management in top performing companies. We believe the results are clear and compelling. As you have read in this report, outperforming organizations demonstrate a clear linkage from strategic intent through value aspirations, target setting, measurement and rewards to delivering results. Competitive advantage can be achieved through innovative strategies, but consistent market out-performance requires a sustained ability to deliver on strategic intent.

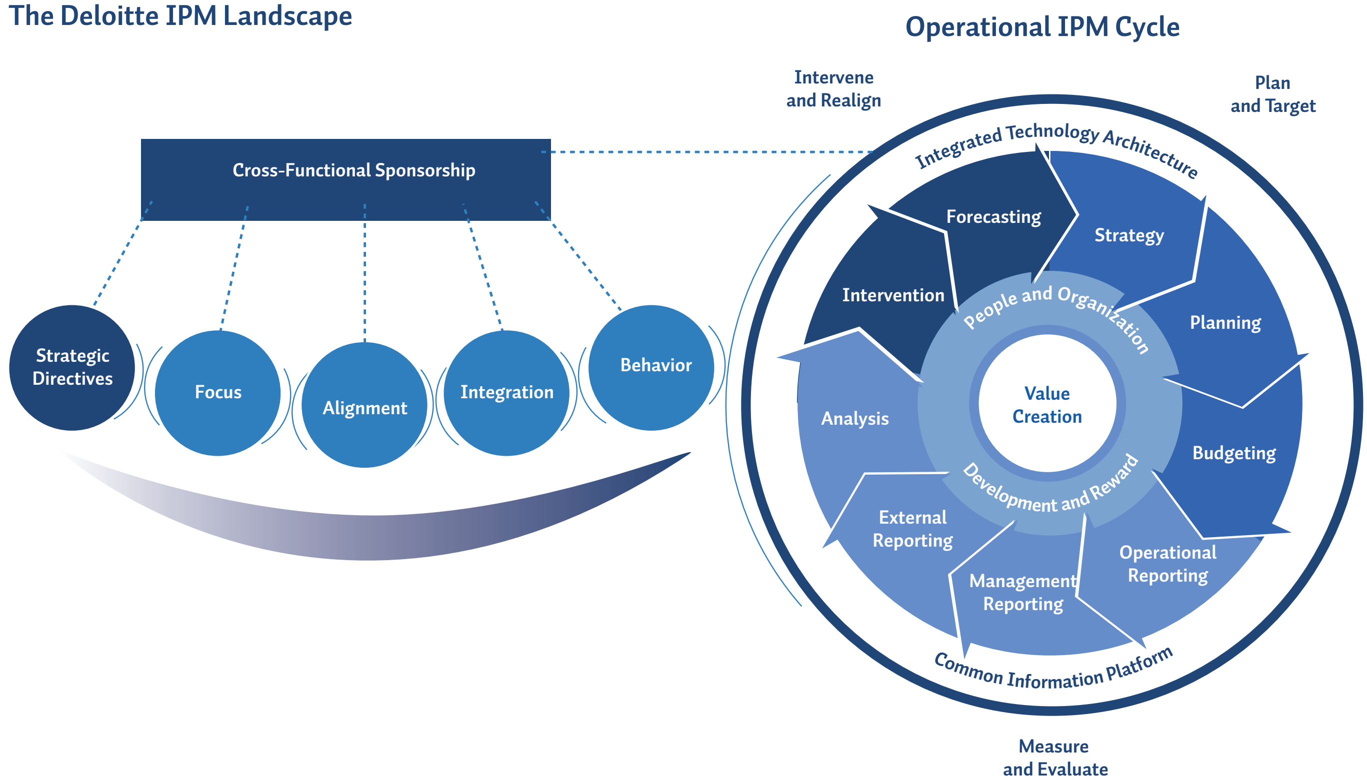
Additionally, the report described experiences the CFOs shared as to how effective performance management can contribute towards executing strategies and ultimately delivering value. These insights focused less on optimizing the efficiency of the processes in the performance management cycle but rather highlighted how to unlock the effectiveness of performance management to deliver strategy. We believe this is accomplished by developing an understanding of value and translating this into metrics to monitor and reward performance.

For example, tuning the budgeting or reporting cycle may make you more efficient in your performance activities but alone it will not make you more effective. Defining the set of measures that underpin your most important strategic initiatives and aligning responsibility for delivering these to key personnel can have a far more powerful effect. We believe that by focusing on driving the effectiveness of the performance management cycle, this finance-led process can become a differentiator that leads to out-performance of peers.

The Deloitte Consulting LLP response is Integrated Performance Management

The views Deloitte Consulting LLP (Deloitte Consulting) has developed are based on the services we have provided to an extensive number of performance management related projects and are strongly supported by the insights of the CFOs interviewed. To help companies on their journey towards harnessing the performance management cycle to enable effective strategy execution, we recommend an approach which we call Integrated Performance Management.

The Deloitte IPM Landscape



We have identified four guiding principles: focus, alignment, integration and behavior, which we believe to be at the heart of effective strategy execution through Integrated Performance Management.

- To deliver on strategy, companies should **focus** efforts on activity consonant with their strategic intentions. In order to know where to focus, they need to understand the metrics that underpin their strategic objectives and drive value so they can plan, execute, and measure only what matters most.

- Organizational **alignment** is dependent upon a common understanding of the value focus at all levels of the company. Clear lines of management control and accountability should be established against which targets can be cascaded throughout the organization. Strategic change is delivered through the company's portfolio of projects, which also need to be tied back to the drivers of value.

- Performance management **integration** requires the planning, measuring and intervention processes in the performance management cycle to be interlinked. Against this backdrop of integrated processes, it is important to design a business-partnering finance team structure and establish a common business language of performance.

- Finally, the **behavior** of the workforce needs to be addressed so that the individuals in the organization are committed to achieving their targets. This requires incentivization of people based on performance and a commitment to the development and deployment of talent.

Sponsor's perspective

Delivering performance management change requires broad sponsorship

In recent years, we have seen organizations mainly address aspects of performance management in isolation, predominantly from an efficiency angle. While these efforts have been effective in reducing cycle times and associated cost, our experience from working with top-performing organizations and the findings of this report suggest that by first covering the bases of focus, alignment, integration, and behavior, companies can deliver a more immediate capability improvement in the ability to deliver strategy. Furthermore, once these guiding principles are in place, they can form a longer-term foundation for delivering the efficiency changes.

Performance management is a broad topic, and while we believe the CFO is the ideal catalyst for such an initiative, it is necessary to secure support from not only within finance but across the organization. This includes building sponsorship across functional, geographic, and organizational boundaries.

This report has shown the pivotal role that performance management can play in the creation of value through effective execution of strategic directives. Integrated Performance Management is Deloitte Consulting's answer to transforming the capability of companies to achieve this. We believe it is the CFO who is ideally placed to take the lead in making this happen.

Talk to Us

We look forward to hearing from you and learning what you think about the results and ideas presented in this study.

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