Performance Metrics

The Board's Role

- Management and the board must agree on “key” corporate activities to monitor.
- Create a scorecard of metrics with a balanced mix of financial and nonfinancial measurements.
  - Generally, the scorecard will contain between five to ten metrics.
- Metrics should go beyond management and senior executives.
- Senior managers should have their own metrics, monitored by the board.
  - These metrics should be used to create detailed metrics cascading throughout the entire organization.
- Management develops organization appropriate metrics, the board approves these metrics relative to long-term value creation.
Performance Metrics

Types of Metrics

– Qualitative vs. Quantitative
  • All metrics should be reported quantitatively.
  • Management must develop methods to extract quantifiable “hard” information from “soft” data.

– Short vs. Long Term
  • While boards should oversee both, they should place their attention on long-term performance.
  • Short term goals should position the organization to achieve long-term objectives.

– How do pay plans define “long term”?*
  • 3 years or less – 71.6%
  • 4 years – 7.9%
  • 5 years – 18.7%
  • 6 years or more – 1.8%

*Source: 2013-2014 NACD Public Company Governance Survey

Performance Metrics

Financial Metrics

– Consistent reporting and year-over-year comparisons are critical to the board’s understanding.

Nonfinancial Metrics

– Select metrics best for understanding and measuring value.

When linking pay to long-term corporate performance, how do your pay plans define “corporate performance”? (Respondents were allowed multiple answers.)

Which non-financial corporate measures do you analyze for the purposes of senior executive compensation? (Respondents were allowed multiple answers.)

Graph source: 2013-2014 NACD Public Company Governance Survey
Performance Metrics

Selecting and Using Metrics

– Basic metrics should remain consistent over several years along with strategic and compensation programs.
– Board decision-making metrics should be reviewed for effectiveness on an annual basis.
– The original “balanced scorecard” features four perspectives but boards should select metrics relevant to their organization.
  • Financial, customer, internal business processes, and learning and growth
– Desired performance outcomes must be defined to delineate success or failure against goals.
– Consideration should be given to adjustment of the performance levels.
– Various metrics should be weighted according to importance.

Presentation of Metrics

– Management should present a full scorecard of metrics but boards should highlight five or six for in-depth discussion.
– Highlighted metrics should focus on areas where deviation from expected performance level occurs.
– Red flags:
  • Metrics that may incentivize excessive risk taking or unethical behavior
  • Metrics that are not easily verifiable
  • Metrics which the management team has little or no ability to influence
Performance Metrics

Communicating to the Marketplace

– Communication of metrics should be as transparent as possible without providing competitive information.
– View communication not as just an obligation, but as an opportunity.
– Conveying the board’s focus on performance objectives will help reinforce the market’s understanding of the board’s role in enforcing pay-for-performance.
– All directors should be literate on compensation, including the ability to explain the metrics used, as well as the current and long-term performance as measured against those metrics.

Six Board Imperatives

1. Understand and agree on the company’s key performance metrics.
2. Establish company performance metrics to cascade throughout the entire enterprise.
3. Track company performance against metrics on an ongoing basis.
4. Establish consistent and appropriate executive performance metrics.
5. Reward executives based upon performance as measured by appropriate metrics
6. Communicate with shareholder regarding how the company has paid for performance.
Thank You