# Stakeholder Analysis: The Key to Balanced Performance Measures

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## The Need for Balanced Performance Measures

Traditional business performance measures – such as return-on-assets or earnings per share – focus on the overall financial results achieved by a company in a given time period. While important, they give little insight into why particular results were achieved. By themselves, they provide little guidance for where or how improvements can be made. Additional "in process" measures are needed, the better to assess particular contributions to the end performance.

But there is also a growing awareness that the traditional financial measures are uni-dimensional – that a modern company seeks to be more than financially successful; that financial success in the short term does not guarantee it in the long term; and that there are other, more complete, yet fundamental aspects of performance that can be measured to give a more balanced picture of the health of the enterprise. These metrics can then be tracked over time to complement financial performance measures and perhaps give some independent, early, and insightful signs of performance problems.[1]

A focus on financial measures reflects an ownership view of the company: The owners (stockholders) are concerned with the return on their investment. Interestingly, the owners themselves have little direct impact on the performance of the company. A more balanced view would measure performance in terms of all the major constituents who directly influence the company's performance. We call these groups of constituents the "stakeholders" of the company; they always include customers and employees, in addition to the owners, but may encompass other key groups as well. Stakeholders are individuals or groups who expect certain things from the company, and at the same time have a considerable influence on its success.

Measuring how well the expectations of each of the company's stakeholders are met yields a more balanced and holistic picture of performance that can provide critical insight and guidance for action. For example, a company with steadily rising earnings per share, but whose customer satisfaction has dropped three years in a row, is not performing at a healthy level.

Interestingly, the very process of establishing such a balanced stakeholder-based measurement approach has often proven to be an opportunity for real organizational learning, resulting in insights about the fundamental mission and vision of the company, as it proceeds to ask questions such as:

- Who are our customers? What do they want from us? How well do we really satisfy them?
- Who are our owners? What do they expect of us? How well do we meet these expectations?
- Who are our employees? What do they want from their work experience? What do they really think about working here?

## Acme Electric: A Case Study

Acme Electric is a publicly owned electric utility, considered to be a successful private enterprise within its economic sphere. For many years the Company focused on technical and engineering

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excellence and early adoption of modern technological improvements. Like most utilities, it enjoyed a monopolistic situation and its rate of return was predictably steady. Yet the management at Acme felt that the focus on financial measures was not providing a well rounded picture of overall performance; it wanted to compare itself with other utilities and with less regulated businesses, and to understand how it was perceived by outsiders in comparison to other enterprises. Management also planned to embark on a performance improvement program for key business processes but had little idea where to begin; the current financially oriented measurement system provided no guidance as to where the priorities for improvement might lie.

Acme decided to embark on an effort to broaden and balance its performance measures. It decided that these measures needed to reflect how well the Company was satisfying the expectations of all its important stakeholders, not just the shareholders. Shortly after reaching this decision, Acme management came to three critical realizations:

- There was basic, but not total, agreement as to who the stakeholders of the business were;
- There was a wide disparity of views as to what the stakeholders actually expected of the Company; and
- There was almost no agreement as to how well the Company was actually meeting these expectations.

In itself, this shared level of understanding about what was known and what was not, and what was agreed upon and what was not, had a galvanizing impact on the senior management team.

## Stakeholders and Their Expectations

A stakeholder is an individual or group that can heavily influence the performance of the business – i.e., whose support the business needs if it is to be successful. These people, in turn, have certain expectations from the company, and assessing the degree to which these expectations are currently being satisfied in a balanced fashion provides a valuable indicator of current and future performance.

Stakeholders will almost always include the "big three": Customers, Employees, and Owners. For most commercial enterprises, these three are by far the most important, and the scope of the performance measurement is usually focused on them. In other situations, the scope may need to be broadened.

Stakeholders should be clearly defined, particularly if there is any potential question of who is included or excluded in each group. For example, here is the list of stakeholders that Acme decided upon:

- Customers (both users of electricity and land developers)
- Employees (both full and part time, at all levels)
- Owners (stockholders)
- Suppliers
- Regulators
- Local Communities (specifically mayors and city councils, as well as people who influence public opinion)

Again, the process of deciding upon the list of stakeholders proved to be a valuable and insightful learning experience for Acme's management team. The fact that suppliers (and particularly the smaller, local suppliers) were important stakeholders in the Company was not previously recognized; understanding the interdependencies between the Company and these suppliers eventually led to significant policy changes in the way the Company dealt with them.

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One of the key tenets of the balanced approach is that over the long run, you cannot satisfy one stakeholder at the expense of another. Yes, customers are very important, but in the long run if your employees are disgruntled, they will not provide the levels of service necessary to satisfy the customers. Similarly, merely lowering prices to attract more customers may not be sustainable from the owners' viewpoint.

The next step is to determine the expectations, or "satisfaction attributes," of each stakeholder. The most important aspect of this analysis is that it must be objective and fact-based, not based on preconceived judgments or assumptions. The expectations of customers, employees, and owners need to be empirically verified by survey, focus groups, or through other methods. Many organizations, including Acme, make the serious mistake of assuming they know and understand the stakeholders' expectations when in fact they do not. This is particularly true of employees: Senior management frequently assumes it knows what the employees want from their jobs, and they are often quite mistaken. Moreover, as the external world changes (e.g., competitors begin to satisfy more of the customer's expectations; other companies in the area offer improved working conditions; etc.), stakeholder expectations change.

Certain satisfaction attributes may be more important to the stakeholder than others. In this regard, the ideas of Kano often prove useful [2]. Kano distinguishes between threshold, performance, and excitement "attributes" of a product. A threshold attribute looses importance after a certain level is reached (e.g., the maximum speed of an automobile must be 90 miles per hour, but increasing it much beyond that is not valuable to the customer), while improvement in a performance attribute continues to be proportionately valued (e.g., the fewer defects the better). An excitement attribute, on the other hand, would have a disproportionately greater impact than a performance improvement, and, hence, be of greater value to the stakeholder (e.g., the ability to avoid accidents automatically).

The relative importance of stakeholder satisfaction attributes can also reflect strategic decisions of the company. To take an oversimplified example, if price and quality are of equal importance to customers, a strategy that emphasizes competing on the basis of quality will raise the importance of quality expectations to the targeted set of customers.

Typically, it is best to focus attention on 3 to 5 satisfaction attributes for each stakeholder; a scheme involving hundreds of performance measures will not prove workable.

For example, at Acme, a survey was conducted to establish the following expectations among the employees:

| Satisfaction Attribute | Importance |
|---|---|
| Competitive compensation | High |
| Safe work conditions | High |
| Pleasant work environment | Medium |
| Career development | High |

## Performance Metrics and Measurements

How do you actually measure how well you are meeting the expectations of the stakeholders? Here again there is a tendency on the part of some to assume they know how well they are performing; this must be avoided (e.g., of course, our customers are happy; our benefits package is as good as any other company in the area; our delivery service is second to none; etc). Instead, performance metrics must be defined that can be used to **measure empirically** the degree to which the stakeholder expectations are being met.

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Each stakeholder satisfaction attribute can have one or more metrics behind it. For example, in Acme's case the customer expectation for high quality electric service is measured in terms of two metrics:

- maximum percentage voltage fluctuation (+ and -) during the month, and
- average outage time per customer during the month.

These metrics can be empirically determined and are not subject to interpretation. While the numbers themselves are important, the ***trend*** is even more telling. So it is vital to agree on the stakeholder expectations and the associated metrics and then to put in place an ongoing reliable measurement and reporting scheme.

Some satisfaction attributes might appear difficult to measure on a quantifiable basis, for example, career development. However, it is usually possible to find appropriate metrics after a little thought; for example, one might measure the number or percentage of staff promoted from within, and the number of employees taking career development training. Another possibility is to quantify the results of surveys, e.g., percentage of employees who rated their career development opportunities as above average or excellent on the annual employee survey.

The general idea is that all stakeholder expectations must have one or more quantifiable metrics that can be tracked over time, so that the effect of performance improvement programs can be measured. Typically, the company will already have collected data of some sort relative to measures of performance appropriate to the satisfaction attribute (e.g., customer surveys, employee surveys, etc.). This source of data can be particularly useful in establishing a trend of performance over time.

Several methods are available to determine actual current levels of performance, depending on the type of metric:

- Empirical observation: e.g., counting the number of minutes of electric outage, or observing the actual voltage fluctuation
- Sampling: similar to empirical observation but for a sample of the entire population
- Questionnaire: asking the stakeholders in a survey
- Focus group: a smaller sample than a survey, but perhaps yielding more insight (good to do the first time around)

Surveys or focus groups tend to be subjective; they measure the **perception** of performance against the expectation. Of course, the perception is as important as the actual performance. A good practice is to incorporate both subjective and objective measures into the scheme; e.g., number of minutes of electric outage vs. customer's opinion as to electric reliability. When these measures are moving in opposite directions, further investigation is warranted to determine the reasons (e.g., the customer's definition of reliability is different or has changed).

## Setting Targets and Reporting Performance

How are targets established for performance improvement? Certainly one way is to benchmark how you compare with others. Frequently, industry or trade organizations will publish relevant statistics that can be used for comparison purposes. Acme might decide, for example, to aim to be in the top 10% of electric utilities in terms of voltage fluctuations: the industry statistics will show that this target translates into no more than .4% fluctuation over an entire year.

Corporate strategy is another source of insight to help set performance targets. Specific elements of the business strategy may well suggest an aggressive target for cost reduction or customer service, for example.

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Once the basic elements of a balanced performance measuring scheme are established, the last step is to implement a periodic assessment and reporting process. The outcome can be used in various ways – as an informal report to the stakeholders themselves (e.g., printed in the company newsletter), as a report to the board of directors, as part of the formal annual report, and so on. Typically, such a formal report would be issued on an annual basis. More frequent tracking of some measures might also be appropriate.

If appropriate targets can be set for several years in the future and then tracked, year by year, a useful trend can be produced.

Based on the current level of performance and the target set for the various metrics of a satisfaction attribute, an overall "gap" is assigned. The gap is a reflection of how far the current level of performance is from the desired or targeted level. Consider expressing the gap in terms of percent of target to be achieved (using a simple example, if there were one metric for the attribute that had a current performance level of 60 out of a target of 100, then the percent gap would be 40). One of the benefits of a percent gap (i.e., 0% = reaching the target levels in all metrics) is that an overall "report card" can then be prepared showing which attributes are farthest from their targets on a comparable basis.

At Acme, a balanced stakeholder performance report is compiled and published on an annual basis, along the lines shown in Figure 1. Some measures are updated more frequently. The current measures, targets, and gaps are made available to senior management as part of Acme's Executive Information System (EIS), as are definitions of the stakeholders, their expectations, and the metrics.

| Stakeholder | Expectation<br>As measured by metric | 2000 | 2001 | 2002 | 2003 | Target |
|---|---|---|---|---|---|---|
| Customers | **Quality of Electric Service** | | | | | |
| | No of times voltage varied >+/- 3% per year | 17 | 13 | 15 | 12 | 8 |
| | Average minutes outage per customer per year | 22 | 41 | 27 | 25 | 18 |
| | **Quality of Customer Service** | | | | | |
| | No of complaints per 1000 customers per year | 48 | 36 | 38 | 32 | 24 |
| | Percent customers ranking service very good or excellent on survey | 68 | 76 | 78 | 81 | 97 |
| | Average time to install service | 4.2 | 3.5 | 3.2 | 2.8 | 1.5 |
| | **Fair Price** | | | | | |
| | Percent of family budget spent on Electric service | 4.3 | 4.6 | 4.7 | 4.7 | 4 |
| Employees | **Fair Compensation** | | | | | |
| | **Safe Work Conditions** | | | | | |
| | **Pleasant Work Environment** | | | | | |
| | **Career Development** | | | | | |
| Owners | **Return on Investment** | | | | | |
| | **Liquidity of Investment** | | | | | |
| | **Stability** | | | | | |
| | **Attention** | | | | | |
| Suppliers | **Good Business Relations** | | | | | |
| | **Fair Price for Goods** | | | | | |
| | **On-time Payment** | | | | | |

**Figure 1. Balanced Stakeholder Performance Report**

The analysis of gaps in meeting stakeholder expectations as depicted in the balanced performance report have been utilized at Acme to focus business process redesign (reengineering) efforts on high priority opportunities. First, the relative importance of each attribute was multiplied by the gap in actual performance to yield a need for improvement

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weighting scheme. Then a correlation matrix was established between the stakeholder satisfaction attributes and the business processes to understand the degree to which each process influences each attribute.

For example, the process "Supply Electric Energy" might have a high influence on Quality of Electric Service and receive a base score of 3 in this cell of the matrix, while the same process has little influence on Career Development, resulting in a base score of 0. When these base scores are combined with the attribute weighting scheme the result is a chart similar to the one in Figure 2. This chart clearly shows which processes must be improved in order to close the most important gaps in meeting stakeholder expectations.

| Stakeholder | Satisfaction Attribute | Relative Importance | X | Current Satisfaction Gap | = | Need for Improvement | Business Processes | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Supply Electric Energy | Serve the Customer | Manage Human Resources | Manage Financial Resources | Provide Materials & Supplies | Provide Infrastructure |
| Customers | Quality of Electric Service | 3 | | 60 | | 180 | 3.4 | 0.4 | 2.3 | 1.7 | 3.2 | 2.8 |
| | Quality of Customer Service | 2 | | 80 | | 160 | 0.4 | 4.5 | 4.3 | 0.8 | 0.4 | 1 |
| | Fair Price | 2 | | 40 | | 80 | 2.2 | 0.3 | 0 | 2 | 0.7 | 1 |
| Employees | Fair Compensation | 3 | | 60 | | 180 | 0 | 0 | 2.9 | 3.4 | 0 | 0 |
| | Safe Work Conditions | 2 | | 20 | | 40 | 0.5 | 0.6 | 1.6 | 0.6 | 1.6 | 1.3 |
| | Pleasant Work Environment | 1 | | 50 | | 50 | 0 | 0.8 | 0.6 | 0 | 0.5 | 0.8 |
| | Career Development | 2 | | 70 | | 140 | 0 | 0 | 4.2 | 0.3 | 1 | 0 |
| Owners | Return on Investment | 3 | | 20 | | 60 | 2.1 | 0.5 | 0.5 | 2.4 | 0.6 | 1.3 |
| | Liquidity of Investment | 2 | | 30 | | 60 | 0 | 0 | 0 | 0.8 | 0 | 0 |
| | Stability | 2 | | 40 | | 80 | 2 | 0.9 | 2.1 | 1.8 | 0.9 | 0 |
| | Attention | 1 | | 60 | | 60 | 0 | 0 | 2.8 | 0 | 1 | 0.2 |
| Suppliers | Good Business Relations | 2 | | 40 | | 80 | 1 | 0 | 0.5 | 1.5 | 0.8 | 2 |
| | Fair Price for Goods | 3 | | 50 | | 150 | 0 | 0 | 0 | 0.7 | 3.8 | 1.8 |
| | On Time Payment | 2 | | 80 | | 160 | 0.3 | 0 | 0.2 | 0.8 | 1.3 | 0.6 |
| | | Priority for Improvement | | | | | 11.9 | 8 | 22 | 16.8 | 15.8 | 12.8 |

**Figure 2. Correlation of Business Processes with Need for Improvement**

## Summary

Traditional financial measures do not provide a well balanced picture of the performance of a company, nor do they help to identify where performance improvements need to be focused. A more balanced approach considers the expectations of all the important stakeholders of the enterprise, and measures the degree to which these expectations are being met. We have reviewed here an approach to defining stakeholders, identifying their expectations, and then measuring the gaps that exist in actual versus targeted performance levels in meeting these expectations.

Objectivity is perhaps the most important aspect in identifying stakeholder expectations and then measuring actual stakeholder satisfaction. The balanced performance measures must be based on actual data compiled from empirical studies and surveys if they are going to have real value in tracking company performance over time and in focusing performance improvement efforts.

## References

[1] Kaplan, Robert and David Norton "The Balanced Scorecard - Measures that Drive Performance," *Harvard Business Review*, January-February 1992

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