

# Five Pitfalls to Avoid When Writing Performance Analysis

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*Without measuring, you can't manage. Put another way, without useful performance analysis, you can't put to use all those measurements your organization works so hard to gather. Written performance analysis is the foundation of the strategy review process, and yet, observes David McMillan, it is generally not very good. Here are the five biggest pitfalls to avoid.*

The 1990s saw the rise of risk reporting by financial institutions, and with it the growing popularity of a high-level risk indicator called *value at risk* (VaR). VaR is an aggregate measure that reflects the probability that a portfolio of assets will lose a specific value in a given time frame, assuming that markets are normal and that there is no trading. By the turn of the millennium, many financial firms had come to rely on VaR (among other risk measures).

Then, in 2007, the subprime mortgage crisis hit. Banks lost billions in write-downs; some collapsed, others were sold off or rescued through government funding. Did VaR fail as an indicator? Not at all. Did banks put too much trust in it? Perhaps. They also may not have given sufficient attention to supporting analysis.

I'm not suggesting that overconfidence in VaR was a cause of the crisis. Obviously, I'm oversimplifying the role of a risk indicator in a financial crisis with deep and complex causes. But I use this example to make a point: measures alone don't tell the story. Relying on them exclusively in monitoring organizational performance without analysis—without qualification and context—can lead to serious misperceptions about performance, if not to disaster.

Measures are limited by their scope and assumptions, and by the attributes of their underlying data. They need qualification. An aggregate, for instance, is not always composed of equally weighted

components; consider banks' overexposure to mortgage-backed securities. That is something that neither VaR nor any aggregate could possibly show. Measures need context, as internal and external forces don't exert constant or equal impact.

In the classic Balanced Scorecard (BSC) methodology, performance analysis happens at two levels: at the measure level and at the objective level. Although this article addresses writing analysis at the objective level (which certainly

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incorporates insights on measures), many of the concepts presented here can also be applied to writing analysis at the measure level.

Written objective-level performance analysis—analysis that describes the recent and past performance of a business objective and projects future performance—is essential for turning measure data into valuable, actionable information. Analysis also provides insight into the important aspects of a business that are difficult to measure. Finally, written performance analysis examines the risks as well as the opportunities associated with a strategic objective. Without such analysis, all the effort in monitoring strategy performance is for naught.

Despite its value, though, most organizations' written performance analysis is not very good. Most analysis doesn't explain the data, discuss its underlying causes and implications, or integrate it into a broader discussion of strategic performance and environmental trends. My recent reading of strategy review reports of a handful of Palladium Hall of Fame organizations showed that even exemplars of strategy execution sometimes fall short in their written performance analysis, thus missing valuable opportunities. Fortunately, this problem can be remedied. Writing insightful, actionable performance analysis is a skill that can be learned.

Through our work guiding dozens of organizations in strategy reporting, we've identified five common pitfalls in performance analysis. Avoid them, and you'll be well on your way to producing performance analysis that can truly guide decision makers in making sound strategy management decisions.

## **Pitfall #1: Focusing Only on the Measure Data, Without Explaining or Interpreting**

Often, performance analysis merely regurgitates what the data already show, or simply explains the components of the corresponding measure(s). What good does that do?

Consider the problem with drawing inferences from jobs data—a key indicator of the nation's economic health—without any explanation. Imagine that the next jobs report shows a gain of 150,000 jobs. Does that number alone tell us that the economy is recovering? Or that job growth will be a steady trend? Now, let's drill down to the industry breakdown level. Suppose we see that nearly all new jobs for the

month came from the energy sector. Was the increase triggered by the stimulus plan? Why didn't other industries see an increase? We can't answer these questions based on the measures alone. If we want to understand trends, market or economic developments that might impair job growth, the extent to which seasonality is affecting the data—any of the issues that form our expectations and *drive our decisions*—we need to dig deeper for more contextual data that might explain the performance. We need to ask:

1. *What is the reason for the last period's measure performance?* How do we explain any period-to-period trends? Don't restate the obvious (e.g., sales are down 3% because ABC division's sales fell 4% and XYZ's 2%). Look for information that will explain why sales are down for each division. Are both divisions suffering from the same problem, or are their numbers down for different reasons?
2. *What does the measure's outcome tell you about the performance of its corresponding objective?* Do the trends in measure performance correspond to the perceived trends in objective performance (i.e., is this measure still valid for the objective)? Are future expectations of the measure's performance sufficient to achieve desired performance at the objective level?

### **Pitfall #2: Omitting Qualitative Information**

Numbers are concrete and apparently objective, and therefore they make people (analysts and their audiences) more comfortable and confident. But numbers don't tell the whole story. And they can mislead, whether inadvertently or not. (Think of all the ways statistics can be presented to support any side of an argument.) Qualitative information can often reveal the reasons behind the numbers better than the deepest dive into the detailed data can.

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It seems self-evident that qualitative information is a critical element for understanding what drives performance. Yet too often such information is absent from written analysis.

Many innovation-oriented companies use a BSC measure that monitors progress in the stages of their R&D efforts. Usually this measure tracks only whether projects are on schedule. At some companies, the performance report might go so far as to also note the reason a particular major project is behind schedule. However, it doesn't answer the questions that company leaders really need to know: What are the scheduling pressures that all the behind-schedule projects share? And what general risks need to be better mitigated? For example, for a toy manufacturer, obtaining feedback from focus groups of children may be consistently taking a month or two longer than anticipated.

For some objectives and measures, the only way to understand performance is to talk with people throughout the organization whose activities or decisions are connected with the objective or measure at hand. Discussions with colleagues will help get a full and accurate analysis of root causes and future expectations. If the objective relates to the organization's efficiency in innovation, talk to the R&D project leaders; they'll know what factors routinely lead to cost overruns. If the objective concerns customer service, talk to those who most often interact with customers to find out why customers are complaining about the service they receive. If the objective is about workforce skills, seek out managers who direct employees so that you can learn how training can be improved.

Avoid relying on a single source, since an individual may have a particular bias (such as a personal agenda) or his experience may represent an anomaly. Try to get input from multiple, varied sources with relevance to the objective. It may not always be feasible to talk to multiple people, but it is a good idea, especially when biases are likely or hypothesis is involved.

Getting accurate qualitative information is a key reason for the performance analysis writer to confer with the objective owner before starting to write and after a draft has been completed. Often we've seen this step overlooked, making the objective owner unprepared at the next strategy review meeting and causing her to stumble through her presentation or discover errors in the analysis. For example, suppose the analysis writer concludes that changes in productivity at a manufacturing facility were caused by a supplier's inability to deliver on time, when in fact the supply plan called for scaling back production due to an inventory surplus.

Here again, though, the writer (usually the objective coordinator) should not rely exclusively on the objective owner's opinion. Writers shouldn't feel obligated to trust the executive as the sole source of information about possible causes underlying performance. Seek other views from appropriate sources with relevant knowledge and access to relevant information.

### **Pitfall #3: Avoiding Interpretation When the Data Are Ambiguous**

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forgo explanation altogether. For decision makers, there is little that is more unsatisfying (or more irksome) than to ask “why” and be told, “I have no idea.” Offering a thoughtful educated guess will at least get the conversation started.

Some objectives do not naturally lend themselves to concrete explanations. For example, identifying why customer loyalty has declined is generally quite difficult. Did your biggest competitor roll out a new advertising campaign? Did your company recently run a big promotion or change its pricing? Or did Steve Jobs or Lady Gaga mention your product? There are many possible reasons, and surveying a statistically significant sample of customers can be too expensive.

Even if the hypothesis isn't on target, it will promote speculation by leaders. And it could—and should—invite those reading the analysis who are knowledgeable about the situation to further elucidate performance. This can only help deepen understanding of organizational performance. No matter what, an informed hypothesis is always more actionable than no hypothesis at all.

### Pitfall #4: Avoiding Any Discussion of Risk

No one likes to be the messenger of bad news, but addressing risk openly and accurately is the key to avoiding unexpected declines in performance and greater risk.

Today, many companies have a chief risk officer—a peer of the chief strategy officer and chief financial officer. Yet even in our age of heightened risk awareness, risk and strategy are still often viewed as separate areas—one involving all that could go wrong, and the other all that an organization hopes to achieve. In reality, the two are inextricably linked. The strategy represents a hypothesis of the way the business operates and the ac-

tivities that are crucial to attaining the ultimate desired outcome. Each strategic objective is achieved by successfully managing its performance drivers. Because it's a given that there are specific risks that can impede each performance driver, why would such risks not be part of the strategic conversation?<sup>1</sup>

When writing performance analysis, the writer needs to consider not only the key drivers of the objective and the set of actions that can lead to its successful execution, but also the major risks that could affect each key driver. For example, if your scorecard has the objective “Increase the efficiency of our R&D process,” you might identify three main drivers: (1) speed of market analysis, (2) quality of the idea pipeline, and (3) effectiveness of relationships with regulators. For each of these drivers, there are undoubtedly risks that must be monitored. For example, the propensity to track the same competitors all the time might skew your market analysis. A work environment that frowns on failure might stagnate idea generation. Turnover of key employees might significantly weaken your organization's relationships with regulators. By identifying these risks, you can now actively track and mitigate them. The organization's successes—or difficulties—in mitigating these risks can then add constructively to the analysis of the objective.

### Pitfall #5: Focusing on Details at the Expense of the Bigger Picture

For any number of reasons, performance analysis writers often delve into one aspect of an objective's performance, overlooking the objective-level view. This “can't see the forest for the trees” syndrome does not give decision makers the information they need. Imagine analyzing the economy's health solely through the unemployment claims numbers. Besides the fact that a drop in claims doesn't necessarily mean a drop in the number of unemployed,

<sup>1</sup> Robert Kaplan articulates the need for managing risk and strategy in an integrated fashion in “Risk Management and the Strategy Execution System,” BSR November–December 2009 (Reprint #B0911A).

there are many other indicators that, in combination, provide a big picture, such as job growth, trade data, sales of existing homes, and consumer spending and confidence. Or imagine analyzing monthly sales at ABC division solely on the basis of the number of sales calls made. What about the impact of sales personnel changes (reductions or reassignments)? Changes in the sales commission structure? Customer service issues?

Often performance analysis contains abundant detail about one particular performance driver and neglects the other drivers of an objective's performance. In fact, it is common for performance analysis not to even indicate whether the objective is being achieved. For example, analysis that goes into depth about, say, the speed with which one R&D project is progressing, does not in any way answer the question, "Is the organization becoming more efficient at R&D in general?"

Writers must step back from all the quantitative and qualitative data they have collected and approach objective-level performance analysis by first drafting a summary statement about the objective's overall performance. For example, "In general, we have several indications that our R&D process continues to gain efficiency." Or, using the color coding system as a point of reference, "Overall, skills development was yellow in July because of a convergence of challenges that hit in Q2."

### Create a Basis for Action

Avoiding these five pitfalls isn't all that difficult. It starts with being conscious about the result you want in your performance reporting: a solid, substantive assessment of the big picture, and answers to the "why," not just to the "what," or, if answers are not easy to come by, some plausible hypotheses.

Executives should help create the right environment by showing they value truth and transparency (and don't punish failure), by encouraging collaboration and information sharing, and by appointing the right people for the task. The data geeks who own the measure data play an important role in providing input to the analysis process, but they're probably not the best choice for writing analysis because they are less likely to have the skills or knowledge necessary to cultivate sources and gather, integrate, and write up the necessary information with insight.

Performance analysis that offers context, fact-based explanations, and sound hypotheses about more ambiguous performance results gives decision makers information and insight far beyond what measures alone can indicate. Solid written performance analysis enables leaders to test the hypothesis of the strategy they've worked so diligently to implement—and to adjust goals, targets, and expectations for the future with assurance. ■



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### To learn more

See D. McMillan, with B. Donlon, "How to Write Performance Analysis That Truly Enhances Decision Making," BSR November–December 2008 (Reprint #B0811C).

### Continue the dialogue

Continue the discussion with David McMillan on XPC at [www.thepalladiumgroup.com/mcmillan](http://www.thepalladiumgroup.com/mcmillan)

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## Five prerequisites to good performance analysis

If you can answer yes to the following questions, your organization is well equipped to avoid the five major pitfalls described in this article.

**1. Are your performance analysis writers inquisitive?** The most important question on their minds must be "Why?" Answering that question may sometimes be daunting, but that should never deter a good writer. Also, are they able to see the big picture?

**2. Do the players involved in strategic performance analysis and decision making share strong cross-functional relationships?** Since good performance analysis requires qualitative and anecdotal information, no one individual (objective owner or coordinator) can possibly have all the information needed to present a balanced, substantive picture. Having a network of strong relationships can make a big difference for the writer in everything from explaining risks common to all the objective's drivers to offering plausible hypotheses for an unexpectedly sharp change in performance.

**3. Do your writers understand the business? Do they know the objective's performance drivers?** Understanding, or at least being familiar with, the performance drivers of the objective gives the performance analysis writer a solid starting point for investigating the whys of performance. It also helps the writer validate—or challenge—the mental model of how the business works.

**4. Is your organization a learning organization?** Good performance analysis requires an environment in which mistakes can be admitted and learned from. If excuses always disguise the reasons for relative and absolute failure, performance analysis will miss the mark—and the organization will miss the opportunity to leverage those lessons.

**5. Are expectations and standards high? Do your leaders expect performance analysis to reveal insights?** If leaders accept anything less, they may as well just look at measures and not bother trying to manage objectives.

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