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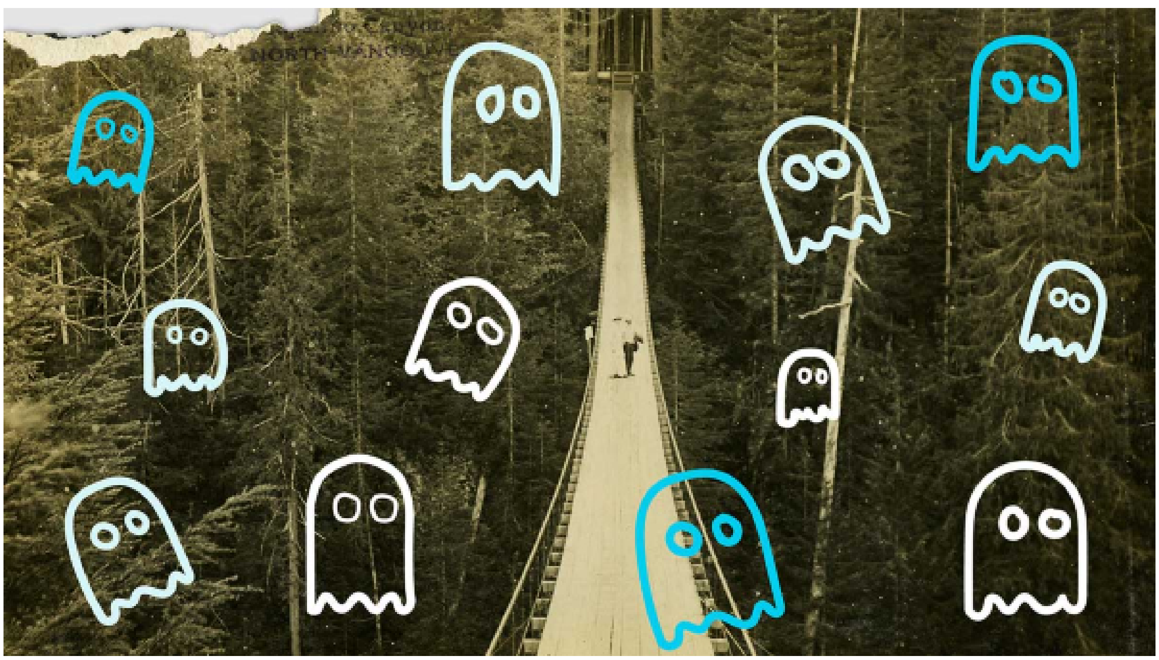

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Many business leaders are fond of the spurious Peter Drucker quote that “you can’t manage what you can’t measure.” This attractive, apocryphal quote breaks down upon inspection. While effective metrics are essential for focusing attention and achieving results, they can also overpower better sense. Mismeasurement can lead to mismanagement.

Most industries cower to a few central metrics, the yardsticks that define the winners and losers. For example, same-store sales or sales per square foot measure success in the retail industry, and various volume measures do it in commodity industries. Metrics tried and proven over years become a guide to what's important, driving resource allocation. But these metrics can become tyrants. When things change, outmoded metrics can threaten a firm's survival.

Consider the automotive industry. The entire industry obsesses each year, even each week, with reports of unit sales of cars, influencing the behavior of auto producers, suppliers, channel partners, industry analysts, and investors. For years, U.S. automotive manufacturers owned rental car companies in the hopes of maintaining strong unit sales figures by captive fleet purchases (which were also to maintain volume to fulfill their onerous union obligations).

In a future dominated by autonomous vehicles and ride-sharing schemes, a typical family might decide to own fewer cars or none at all — meaning lower unit sales, all else equal. And yet the utilization rate of each individual vehicle will likely increase. The resulting higher asset utilization should mean more service and replacement parts requirements, traditionally higher margin businesses than selling the original vehicle. But to thrive in that future, the auto industry will have to get over its obsession with unit sales.

Companies in industries facing change have to change their key metrics, often before the new reality is clear. As Carlos Tavares, chair of PSA Peugeot Citroën, explained to me, "Unit sales will remain important, but this shouldn't be our driver....To be ready, we must experiment and learn as markets change."

Over the past year, I've discussed with Tavares and many other business leaders how core metrics impact behavior and performance over the near and long terms. From these conversations and other research and consulting, I've come to believe that companies can and must protect themselves from the tyranny of metrics by taking the following four actions on an ongoing basis.

Know your metrics and the behaviors they drive. Everyone at your company should understand which metrics drive the business, and what behaviors they encourage. Joe Nigro, CEO of energy company Constellation, told me, "Everyone needs to know how each metric fits into the big picture... why and how we're measuring something, and how it's relevant to performance." (Constellation and its parent company, Exelon, are clients of my firm, Clareo.)

Core metrics naturally acquire power in an organization, but people might not be aware of how they can bias decisions. "In-store experience" has long been a core metric for retailers, and for good reason. However, as online commerce rose in importance, traditional retailers were slow to shift focus to online experience metrics. Brands such as Borders Books and Best Buy spent enormous funds and attention on enhancing in-store capabilities.

Even when major retailers committed to their online presence, the dominant bricks-and-mortar business requirements circumscribed what their online businesses could do. Walmart entered online retailing relatively early, in January 2000, but the world-leading merchant took perhaps a decade to reconcile the friction between competing "click and brick" metrics. Former Walmart.com CEO Carter

Cast recalled to me, “Back in the early 2000s there were many things we wanted to accomplish with our online business but had a hard time doing because of the perception that we’d interfere with the well-oiled efficiency of the physical stores. For example, while we were one of the early companies to develop an ‘order online, pick up in store’ service capability, it took us years to launch because of the fear we’d slow down store operations. I understood the concern of our store operators, but customers were asking for the service.”

A key word here is *perception*. New business models *can* hurt a company’s existing businesses; however, if they work, they can enhance overall performance. The questions become, what should we measure, and who gets the credit? Even though an “order online, pick up in store” offering might increase same-store sales — a crucial traditional metric — who benefits from the lift, the online business unit or the store? To what extent is online ordering cannibalizing sales from the traditional store? Meanwhile, before a store sees increased sales volume, the new capabilities and resources (e.g., floor space, staff attention) required to fulfill in-store pick-up can impair performance. Who takes the hit?

Track metrics at your peripheries. The big threats and opportunities usually come from the periphery of your industry, rather than from your core competitors. They start in other markets, with other customers, or with stealth incursions into the edges of your market. These new entrants often bring new business models, and thus measure performance differently than incumbents. It’s a good idea to pay attention.

Against which metrics are they building their businesses? Consider how those metrics relate to your incumbent businesses, or might enable your company to pursue new opportunities. For instance, digital media has evolved rapidly since measuring “eyeballs” during the first dot-com boom of the late 1990s. From click-throughs to conversions, metrics have reflected what has been possible to achieve, and in some cases has defined entire businesses. Meanwhile, most traditional media companies spent far too long addicted to circulation numbers and prime-time ratings.

Companies should also learn from innovators in other markets, considering how those metrics might translate to their own businesses. For years, Rackspace built an industry-beating IT hosting business by focusing on customer satisfaction in an industry dominated by competitors obsessed with low costs. Rackspace emphasized different metrics than its competitors and achieved differentiated results. The company’s founders set out to build the “Lexus of hosting,” a radical concept at the time. Measuring customer service and satisfaction in ways similar to a luxury products or hospitality company played a significant role in Rackspace’s success.

The company’s experience also emphasizes that metrics can’t afford to be static; the signals at the periphery are always changing. Today Rackspace and all IT-focused companies are being challenged to define their roles in a world dominated by cloud computing models, which is upending metrics across the industry. This didn’t happen overnight. In the late 1990s forerunners to today’s cloud services were known at application service providers, or ASPs. This concept evolved to software as a service, or SaaS models, followed later by cloud computing. While cloud is a more advanced notion, both ASP and SaaS provided foresight to where the industry might trend. Companies paying attention could envision future business models and accordingly shift their success metrics. Those that remained focused on traditional measures are playing catch-up, and some won't survive.

Prioritize metrics that reflect value to customers, rather than simple volume or efficiency. New business models don't only come from new entrants; sometimes, incumbents introduce new ways to add value and track performance. Properly motivated and led, incumbents can be particularly dangerous, as they already have scale and credibility. For decades aircraft engine manufacturers focused on unit sales. In the 1960s UK manufacturer Bristol Siddeley introduced "power by the hour," charging for safe, effective operations rather than individual aircraft engines and parts. Bristol's acquirer, Rolls-Royce, upgraded this approach in the 1980s. The power-by-the-hour metric tracks performance in terms of a company's value-add for customers, rather than purchase volumes. Bruno Esposito, an industry veteran and entrepreneur, lamented to me, "It took some companies decades to overcome their focus on selling more aircraft engines, even though what airlines wanted was safe, efficient operations and predictability of costs. Power by the hour aligns customers and suppliers. Unit sales don't."

Many traditional commodity or product-focused industries, such as mining, oil and gas, or chemicals, tend to focus on the volume of product purchased and shipped: tons, barrels, liters, etc. This is an obvious metric, but it biases a company toward decisions that reinforce the commoditization of its own offerings. Focusing on them means that new business concepts — ones that might decrease the volume sold but replace it with value-added services or services that better align customer and supplier incentives — can be easily missed.

Metrics that reflect the value companies bring to market provide greater insight into whether they are succeeding at their customer value mission. Note, though, that abstract metrics, such as customer satisfaction, often lack specific insight into what lies behind the results. Customer satisfaction should be an essential metric for every company, but satisfaction metrics require complementary assessments to understand the core value being provided.

Experiment with emerging, alternative metrics — and iterate. Once you see new metrics emerging, apply these new metrics to assess your current businesses. You might find ways to modify your business models to remain relevant, or you might find that your current business is on a long, slow slide to oblivion.

Most business services enterprises, such as law firms or consultancies, measure some form of "utilization" (e.g., billable hours). Investments in software or automation could hurt billable hours, especially on these firms' routine, lower-value-added offerings. Instead, introducing metrics that assess a firm's ability to efficiently resolve client problems, especially in lower-value-added offerings, might support investments that are anathema to the simple billable hours metric. As automation improves, clients will eventually move to solutions best able to serve their needs.

Even if a company experiments with a new metric rather than widely implementing it, experimenting early on can keep a firm competitive, as well as help uncover opportunities to improve alignment with technology trends and customer needs.

Conquering the tyranny of metrics requires ongoing experimentation and iteration. A one-time assessment is a good start, but it's not enough. To manage the risks of measurement biases, companies must check and recheck their core metrics. Nigro recommends challenging metrics at least annually, perhaps during a company's annual budget cycle or strategy development process. Consider not only whether the metrics you're measuring are still relevant but also whether you can do better.

Changing the ways we measure success means changing how we define success. Waiting until the market has already changed means playing catch-up. Given how companies construct themselves around optimizing against their metrics, waiting until market shifts are obvious often means waiting until it's too late.

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