riman
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RISK Tips

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Helping You Understand Risk Management

Risk "If the metrics you are looking at aren't useful in optimizing your strategy - stop looking at them. '
– *Mark Twain*

Preventing Metrics from Replacing Your Strategy

Every day, at almost every company, strategy is being hijacked by numbers. Because strategy is abstract, employees often mentally replace it with the hard metrics meant to assess whether the organization is succeeding at it. This tendency is called *surrogation,* and it destroys a lot of value. Take Wells Fargo. Executives there decided to track cross-sales to customers to measure performance on the bank's strategy of building long-term customer relationships. The focus on cross-selling goals led employees to open 3.5 million accounts without customer consent, which, with brutal irony, severely damaged the long-term relationships the bank sought.

Though it's easy to fall into the surrogation snare, firms can take steps to avoid it. For instance, they can involve the people who'll implement a strategy in its formulation, so they'll be more likely to grasp it and less likely to replace it with a metric. Tying financial incentives to a metric is usually a *mistake:* It only increases the focus on the numbers. Using multiple yardsticks is very helpful, however; that highlights the fact that no single metric captures the strategy and makes people less apt to surrogate.

Tying Performance Metrics to Strategy

Over the past few decades, many organizations have adopted the linkage of performance metrics to strategy as an accepted best practice. Metrics give strategy form, allowing us to overcome the abstract nature of strategy and have the greatest chance to achieve organizational objectives.

Replacing Strategy with Metrics

Across almost every organization, strategic thinking is commonly being dominated by numbers. This tendency to mentally replace strategy with metrics is known as surrogation. In a scenario where customer survey scores are utilized to measure a strategic objective, employees are inclined to focus on maximizing survey scores, instead of delivering an exceptional customer experience. Surrogation is particularly destructive to an organization when the metric and the strategy are inadequately aligned. The greater the disparity, the more exposed the entity is to significant adverse consequences.

The Wells Fargo Scandal

When it was revealed to the public that Wells Fargo employees were opening fraudulent savings and checking accounts without the consent of clients, the company's integrity and reputation were called into question. Many conclude that the organization's incentive system is to blame for this catastrophe. The incentive-compensation program provided motive for employees to participate in subversive sales practices. Incentives, combined with the pressure to meet quotas and the overarching sales culture at Wells Fargo, required the rigorous tracking of and emphasis on sales numbers over the importance of the underlying strategy.

Preventing Surrogation

Studies have shown that people are more inclined to surrogation whenever metrics are present, creating a subconscious bias. This type of substitution is produced when the following conditions are present and integrated:

- The objective or strategy is fairly abstract.
- The metric tied to the strategy is objective and distinct.
- The employee accepts, at least on a subconscious level, the substitution of the metric for the strategy.

Summary

To provide an active approach for implementing strategy, organizations will continue to link performance metrics to strategy, in an effort to measure its effectiveness. Management must be diligent to ensure that metrics do not supersede the emphasis on the strategy itself, as it often leads to unethical and deceitful business practices. This can be detrimental to an organization's brand and reputation.

Source: RIMAN, NCSU, Harvard Business Review