

HCM Viewpoint

# What is Success?

Not All Has to be Sharply Defined in  
Performance Assessments



## What is success?

The central challenge of this question lies in the agency theory. The agency dilemma arises when the capital provider (principal) is separated from the management (agent). This leads to an unequal distribution of information, as the capital provider often has only incomplete information about the company's performance. Such situations occur, for example, when the founder of a family business steps back to the Board of Directors («Board») and hands over the management to an external, non-family manager. This creates information asymmetries between the owner and the new manager. There are various ways of reducing these asymmetries, such as control, monitoring and financial incentive systems.

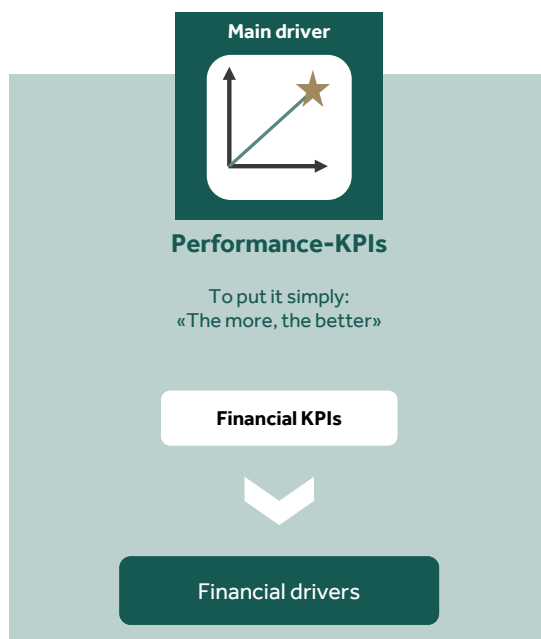
The company performance is of central importance in incentive systems. This raises the question of how the owner or the Board can conduct a comprehensive and systematic assessment of the company's performance. Is the observed performance good or bad? How should non-financial factors be included in the performance assessment?

The starting point to determine «What is success?» is the purpose of the business. If executive team members are asked individually, the chances of getting a range of very different answers are high: Ensuring customer satisfaction, providing secure jobs, creating added value for shareholders and customers, making a positive contribution to society etc. All these factors are relevant, but with so many financial and non-financial interests, goals and intentions, the question arises: What priorities should be set?

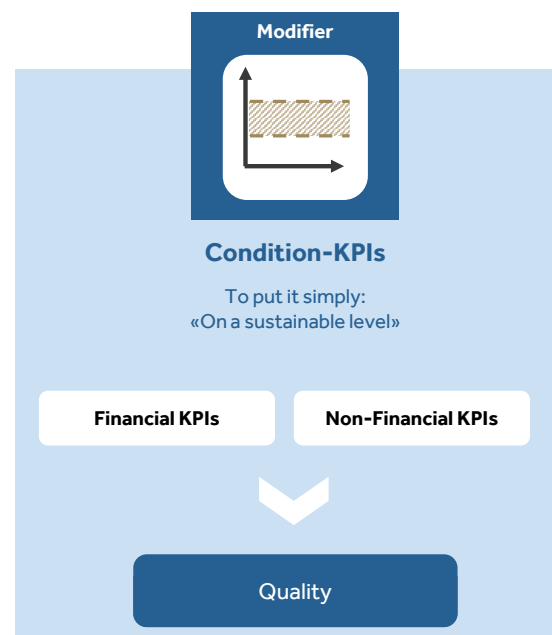
In the last decades, prioritisation was set according to the shareholder value maximisation approach. Put simply: «If the shareholder is doing well, everyone benefits». However, the implementation of this construct often resulted in losing the focus on important long-term aspects of the company's development. Since the financial crisis of 2008, it has become clear that a one-sided focus on the share price and key financial figures is not sufficient to reflect sustainable corporate development. There is a growing realisation that, besides the financial indicators, other aspects such as quality, long-term supplier relationships, employee and customer satisfaction, etc. are important for the top-level steering of the company. However, these aspects are often neither sufficiently nor systematically included in the performance assessment.

Another challenge is the conflicting objectives between the KPIs: Should prices be reduced in order to increase customer satisfaction? Should employee satisfaction be improved, or should costs be reduced? Such trade-offs are common in everyday business life. But how can one KPI be weighed against another? Often, numeric weightings are introduced to address this issue. However, this does not solve the dilemma, as many KPIs are not truly performance drivers per se, but rather represent conditions and prerequisites for sustainable performance. Therefore, we differentiate between Performance-KPIs and Condition-KPIs; for example, in profit-sharing schemes.

## Performance-KPIs vs. Condition-KPIs



**Performance-KPIs** reflect the philosophy «the more, the better». They are usually highly industry- and company-specific in terms of the company's life cycle and degree of maturity. Examples: Sales, EBITDA, EBIT, operating profits, margins, return ratios or economic profits, etc.



**Condition-KPIs** reflect the philosophy «at a sustainable level». They define the framework within which the company should operate and show the quality of performance. Examples: Employee turnover between 5% and 15%, investment of at least 1% of turnover in communal cultural activities, production waste of maximum 0.2, etc.

The Condition-KPIs act as a «modifier» to the overall performance assessment derived from the Performance-KPIs. In other words, the underlying firm performance is assessed based on Performance-KPIs, while the financial and non-financial Condition-KPIs serve as a modifier. Typically, the modifier can lead to an adjustment of the Performance-KPIs by around plus/minus 20% to 30%.

Condition-KPIs are often mistakenly treated like Performance-KPIs, meaning that targets are set, and deviations are measured. However, this is an inappropriate approach for Condition-KPIs. This is because they represent framework conditions and,

therefore, need to be treated differently. Measuring deviations is not suitable for Condition-KPIs, as deviations suggest that more or less is automatically better or worse, which is not necessarily the case. For Condition-KPIs, it is much more important to be for example within a range. This range helps to ensure that small changes do not have immediate consequences. The principle is as follows: As long as the Condition-KPI is within the range, it is good enough. Thinking about quality in terms of ranges, minimum and maximum requirements enables entrepreneurial performance discussions without conflicting objectives.







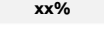
## «Quality Scorecard»

How do owners, Boards and management determine the «conditions» for long-term profit? It is often mistakenly assumed that a large and almost unmanageable number of topics and factors are relevant. In practice, however, the Condition-KPIs can be summarised in five to six main topics, such as growth and strategy, innovation, customers, balance sheet and sustainability. These main topics differ only slightly between small and large companies.

Owners who are actively involved in the company's operations have a good grasp of the relevant information and can quickly assess whether the financial performance is robust and sustainable. But how can Condition-KPIs be made more

understandable and tangible for the Board members who are less involved in the company and not operationally active? Summarizing Condition-KPIs in a «Quality Scorecard» is one way of addressing quality factors systematically and effectively. It also makes Condition-KPIs easier to understand for the Board and the management. Additionally, it establishes a common language between operational management and the Board about what constitutes «success» in the organisation.

The «Quality Scorecard» is designed as follows: Firstly, the focus topics are collected and consolidated. The focus topics are then assigned to the main topics and supplemented with corresponding ambitions.

Main Topics	Focus Topics	Ambition Level	Current situation	Evaluation	
				Assessment	Comment
Growth & Strategy	Strategic Projects				
	...				
Innovation	Portfolio				
	...				
Customers	Customer satisfaction				
	...				
Employees	Employee satisfaction				
	...				
Balance sheet	Debt-equity ratio				
	...				
Sustainability	Sustainability goals				
	...				
Proposal Overall Assessment					
Proposal Overall Assessment				xx%	

It should be noted that the strategic relevance of the focus topics and their ambitions should be reviewed periodically, while the main topics remain rather constant. This is followed by a compilation of certain information on the current status, and lastly, the company's performance is commented and assessed by using a slider on a colour-coded bar. Focus topics that cannot be measured quantitatively should also be included in the «Quality Scorecard», as they are

often not «measurable» but can be «assessed». This creates the necessary scope for owners and the Board to systematically address such topics.

The «Quality Scorecard» should be summarised so that it fits within a single page. It also makes sense to take up the topics, for example, at quarterly Board meetings and provide a brief update. This will prevent the Board from an information overflow during

the annual performance review at the end of the year. «The Quality Scorecard reduces complexity. Formulating a few but concise objectives is very important,» says Josef Felder, Chairman of Zurich Airport, Vice Chairman of AMAG and member of other Boards.

It is also important to emphasise that a «Quality Scorecard» with a slider on a coloured bar intentionally avoids mathematical calculations. For example, there is no assessment with a numerical scale between 0 and 1. Instead, the slider is moved to the red area for poor performance or to the green area for good performance. It is done for each main topic and for the overall performance, resulting in a non-mathematical overall assessment without weighting.

Furthermore, this leads to a comprehensive presentation of the company's qualitative performance. According to Michael Bruggmann, Head of Rewards & Engagement at Swisscom: «The Quality Scorecard provides a holistic view of success and ensures a robust process for a fair assessment of the company's performance.»

### **Courage for intentional blurriness in performance discussions**

The «Quality Scorecard» deliberately avoids the mechanistic interdependence of measured values, targets, deviations from targets and the associated consequences via, for example, Excel calculations. Such mechanisms often lead to undesirable results, as they tend to distort the overall performance of the company and are also complex, requiring more effort.

The «Quality Scorecard» thus introduces an intentional blurring, in particular through the following three omissions:



**No exact indication of target achievement degree:** A bar with signal colours and a slider are used for «measurement». The slider can be set in a colour gradient between red and green.

At first glance, this may seem «nebulous» due to its blurriness. However, it has the advantage of avoiding a discussion about deviations (e.g. «the target is 93.5 % vs. 94.7% achieved»). The reason for this is that as soon as you start discussing percentages, you end up in a complicated debate about deviations in points and percentages, while the original content of the discussion is usually lost.



**No weighting:** There is a deliberate decision not to weigh the main or focus topics. Such weightings can give the impression of a false prioritisation and send the wrong signals, for example, that customers are more important

than employees. It can also happen that a single reputational case in the current year causes considerable damage. Although this incident may appear proportionally insignificant in the «Quality Scorecard», it can be highly relevant in assessing the overall performance from an owner's point of view.



**No automatic consequence:** The «Quality Scorecard» is not about determining what automated and «hard-wired» effects a green or a red assessment has on the overall performance. It is much more about initiating important

discussions and assessing the overall situation instead of «calculating» the consequence.

The intentional blurriness of the performance discussion has its advantages but also presents certain challenges. Michael Bruggmann comments: «I do not believe that you can simply delegate the assessment to an Excel spreadsheet. Even with an arithmetic system, an assessment has to take place, namely when you determine the evaluation mechanism for the individual non-financial variables. At the same time, the blurriness offers room for criticism because it is not quantifiable in the aggregate and, therefore, requires more effort in terms of communication.» This room for criticism also increases the responsibility of the Board. Roger Schoch, General Secretary of the Board of the Swiss Post, comments: «The approach of the Quality Scorecard has proven itself. The Board assumes a great deal of responsibility with the comprehensive overall assessment.»

Despite the challenges, a certain degree of blurriness provides the basis for a comprehensive performance discussion, instead of evaluating it solely on numbers. This is also shown by Josef Felder's experience: «Detailed calculations are risky because they could lead in a wrong direction with a false precision. The Quality Scorecard leaves room for «gut feeling», which plays an important role in entrepreneurial decision-making. Especially in times of uncertainty, resilience is key, and it is particularly important to avoid an «accounting machine». This also helps to build resilience – morally, financially and organisationally.»

## Conclusion

In many companies, owners, Board and management lack a standardised and reliable understanding of success. In this respect, a separation between Performance-KPIs and Condition-KPIs is crucial. Summarising and systematically processing Condition-KPIs, e.g. in a «Quality Scorecard» can improve the orientation and help maintain an overview. Additionally, allowing for a certain degree of blurriness facilitates an entrepreneurial dialogue about the company's performance.

To get back to the initial question «What is success?», a possible answer could be: «Long-term profitable growth, but only under certain conditions.»

## About the authors



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## About HCM

Founded in 2002, HCM International AG is a leading independent management consultancy in the areas of compensation, leadership and corporate governance. With 25 employees, HCM has cross-industry experience with a client portfolio of over 450 companies, from start-ups, family businesses, public law institutions to listed corporations. HCM is also a founding member of the GECN Group, providing global reach and international expertise across five continents.

*Note: For readability, gender-specific language forms have been omitted. All personal designations apply equally to all genders.*

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