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# Setting Targets for Measures used in Performance Management Systems

## *2GC Management Briefing*

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## Introduction

This 2GC Management Briefing looks at target setting within the context of performance management. Difficulties in setting targets are a common problem encountered during the creation of a performance management system, and are hard to resolve. Without target values the utility of a performance management system is massively reduced.

Using an appropriate performance management framework can help make target setting easier, for example by making sure the measures selected are relevant to objectives recognised as actionable and important by the managers designing the system. Indeed, it has been said that a key driver of the improvements to the Balanced Scorecard framework over the last 10 years has been the need to make the target setting process easier (see “**The Development of Balanced Scorecard as a Strategic Management Tool**” available from the 2GC Web Site <http://www.2gc.co.uk/resource.asp>).

Even with the use of an appropriate performance management framework, target setting is often found to be difficult. This 2GC Management briefing aims to address some of the issues commonly encountered by clarifying what performance targets are, how they get used, and providing some guidelines about what makes for a good target value.

This briefing has two components. First a discussion of some of the key issues relating to Target Setting. Second, some guidance from 2GC on ways and means of approaching the target setting activity.

Because target setting is such a difficult but important activity, we would greatly value your comments and feedback on this 2GC Management Briefing: if you have the time do let us know your views on this topic and this briefing document. Contact details for 2GC appear at the end of this briefing document.

## Discussion

### What is a target value?

Target values are used to evaluate performance measurement data, usually to assess performance achieved compared to performance expected. Discussions concerning ‘Target Setting’ normally focus on the methods used to choose a ‘Target Value’ for a measure, but it is also critically important to consider explicitly the choice of ‘processing rules’ that will describe how the performance measurement data will be compared to the Target Value.

Typically, processing rules are designed to generate an assessment of achieved performance in the form of a single value (e.g. a Traffic Light colour). The simplest form of rule is a numerical comparison between performance measure data and pre-defined target value, qualified directionally (e.g. ‘green light if value is equal to or higher than target, red light otherwise’). However in practice the rules adopted by organisations are more complex (e.g. with three or more traffic lights, or the combination of several data values into a single composite value).

### Why do targets get set?

Target setting as an activity is common within organisations, and used for a variety of purposes. For example, the broadcast communication of target values for key performance measures is sometimes used as a substitute for a richer communication concerning strategic choices made (e.g. communicating a target cost per transaction, rather than a description of a cost-effectiveness strategic choice). Similarly, operational targets can be used as a shorthand way to describe ‘best practice’ activity levels for defined activities (e.g. proportion of transactions completed without error), targets for intangibles (although often impossible to measure) can be used to describe desired attitudinal or cultural characteristics or goals (e.g. proportion of workforce who advocate

organisation's products within non-work communities).

### When do targets get set?

Because of this wide variety of potential uses, target setting is often carried out concurrently with other management activities, in particular the implicit consideration of tactical or strategic choices. The selection and communication of a performance target implies choices being made about tactical or strategic priorities. However, despite this, in our experience it is not unusual for performance targets to be adopted without explicit consideration of the underlying strategic or tactical implications and this can result in the adoption of targets that depend upon performance measures that cannot be collected, or require levels of performance that cannot be achieved. Such outcomes are clearly unhelpful. Target setting is of most value when the performance measures chosen have been selected in a way that encourages explicit and informed consideration of the underlying strategic choices, and the selection of practicable performance measures.

### How should targets be set?

The setting of target values is an important test of the design of a performance measure; the comparison of achieved performance with targeted performance is the main method by which performance measurement data alerts managers to the need to make interventions to 'improve' performance. Without a target value, performance measurement data is more difficult to appraise. By implication, targets should be set in a way that reflects the subsequent need to appraise performance data: the target value should be chosen to trigger an alert to managers if expected performance is not being achieved, but with sufficient tolerance that the alert fires only when there is likely to be an unambiguous case for intervention. In a multi-measure system of performance measures, if all the targets are firing alerts all the time the utility of targets to alert managers to significant issues will be diminished.

## Target Setting: Guidance from 2GC

### Types of Targets

Although there are thousands of potential performance measures that can be defined, the targets that can be set can be grouped into four categories, as illustrated below.

Number of measures	<b>Multiple</b>	<b>Multiple Scalars</b> (e.g. weighted average, rule based such as 3 out of 4 values over a limit)	<b>Multiple Levels</b> (e.g. 'voting' methods of assessment: Boolean and project milestones are a special case of this type)
	<b>Single</b>	<b>Single Scalar</b> (e.g. two and three stage traffic lights, value or limit based – usually linear values)	<b>Single Level</b> (e.g. subjective rating based on categories: Boolean and project milestones are a special case of this type)
		<b>Scalar</b>	<b>Level Based</b>
Measure Value Type			

A final target type is based on a mixture of scalar and level based measures. A factor to note is that for targets based on Multiple values, the basis for the combination of measure values into a 'composite' measure that can then be targeted is as important as the definition of the measures being combined. With the exception of 'weighted average' type combination rules, rule based methods are necessary for multiple-value targets.

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## Choosing a Target Value

This depends upon the type of measure, but three general types apply:

- Threshold Based (i.e. need to reach a fixed value on linear scale – one side of threshold is OK, other side not OK)
- Limit Based (i.e. 100% or 0%) – usually operational or aspirational. Operational as it may describe required operating pattern. Aspirational, as it may be impractical to achieve, but may define ‘worthy’ goals
- Rule based (i.e. multiple values – need x out of y to hit a limit or threshold type target for target to have been achieved).

## Practical issues of target setting

Knowing enough to know what target to set is particularly an issue when there is no baseline, and this is often the case when an organisation adopts a ‘new’ measure. In 2GC’s experience, about half of all measures selected for corporate performance management systems are ones that were previously un-recorded. In such cases it may be necessary to first measure current performance for some months, before it will be possible to establish what a realistic target might be.

Knowing how much activity is needed in the short-term in order to achieve long-term goals is very hard. 2GC recommends that the management team first decide on the long-term target, then decide upon the required rate of motion toward target – linear, hockey-stick curve etc...

The ‘destination statement’ component of a modern 3<sup>rd</sup> Generation Balanced Scorecard initially evolved as a tool to help managers agree on a common set of ‘long-term targets’ to aid target setting.

## Setting targets for frequently and infrequently reported measures in the same system

Often there is a need to reconcile measures that have long reporting cycles (e.g. annual) but are nonetheless the ‘best’ measure for a particular objective selected by a management team, with other more frequently reported measures that can be used as ‘surrogates’ for these ‘best’ values. The need for this substitution is clear – for without the frequent data from the surrogate measures, insufficient information may be available for the management team to identify the need for interventions on a timely basis.

Under these circumstances, the long reporting cycle data can be used to ‘calibrate’ the target values set for the more frequent surrogate data. However, the additional management effort associated with this should not be underestimated: the calibration may encourage management to think more deeply about the relationship between long term and surrogate measure, but it is quite probable that insufficient long-term data will be available to determine anything more than an intuitive relationship between the two values.

## About 2GC

2GC is a research led consultancy expert in addressing the strategic control and performance measurement issues faced by organisations in today’s era of rapid change and intense competition. Central to much of 2GC’s work is the application of the widely acknowledged Balanced Scorecard approach to strategic implementation, strategy management and performance measurement.

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