

# Chapter 1

## Introducing Key Performance Indicators (KPIs)

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### *In This Chapter*

- ▶ Understanding KPI basics
  - ▶ Identifying the most common errors
  - ▶ Identifying the key business areas to measure
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**S**o what the heck are Key Performance Indicators (KPIs) anyway?

KPIs help organisations understand how well they are performing in relation to their strategic goals and objectives. In the broadest sense, a KPI provides the most important performance information that enables organisations or their stakeholders to understand whether the organisation is on track toward its stated objectives or not. In addition KPIs serve to reduce the complex nature of organisational performance to a small, manageable number of key indicators that provide evidence that can in turn assist decision making and ultimately improve performance.

If you think about it, this is the same logical approach we use in our daily lives. Say you are not feeling very well and decide to visit your doctor. She may ask you what is wrong but she's immediately searching for evidence to qualify your subjective opinion. She may, for example, take your blood pressure and measure your cholesterol levels, heart rate and body mass index as key indicators of your health. With KPIs we are trying to do the same in our organisations. And without them we are flying blind, relying on the often subjective assessment and opinion of key personnel.

In practice, the term KPI is overused and misunderstood. Too often, KPIs are assumed to be financial in nature or simply the numerical measures we can most easily count. However, such a definition is much too narrow. The data for KPIs can come from myriad sources, providing the best possible answer to your most important business questions. Anything, even the most esoteric or intangible elements of business can be measured simply by tracking the difference between one thing and another. If you can observe a move from

one state, situation or element of performance to another that is strategically or operationally important to the success of your business then you can measure it. And if this is helping you to answer a critical business question then that measurement is a KPI.

Unfortunately there is often a disconnect between whether something *can* be measured and whether it *should* be measured. Instead of clearly identifying the information needed, and then carefully designing the most appropriate indicators to assess performance, businesses too often implement KPIs using what I call the 'ICE' approach:

- ✓ Identify everything that is easy to measure and count
- ✓ Collect and report the data on everything that is easy to measure and count
- ✓ End up scratching your head thinking, 'What on earth does this all mean and what are we going to do with all this performance data?'

This opening chapter is designed to cover the basics of KPIs, explain what they are and why companies need them, and offers as a brief glimpse into what I'll cover in more detail in the rest of the book.

## *Why Every Company Needs KPIs*

KPIs act like navigation tools for your business and allow you to know where you are against where you think you are or where you want to be in the same way a compass would guide a fishing voyage.

### *The Fishing Analogy*

As long as there have been fish, human beings have been fishing. Initially our efforts were probably pretty basic consisting of a net, a line and a stick! Over time we progressed to small boats and were able to search for fish further afield. By the 16th century fishermen had much larger boats capable of going to sea in search of bigger and bigger catches. Initially the ships would set out using little more than a compass, a sextant and some 'inside knowledge' passed down generations of fishing families. If they were sailing at night they would use celestial navigation techniques and plot a course by the stars in order to arrive in the right vicinity. When the fishermen arrived at the fishing grounds they would cast their nets and hope for the best.

Modern fishing, however, is very different. Huge trawlers, capable of travelling enormous distances and processing the fish on board, are also technology-rich, using high-tech navigation systems and GPS. Although shipbuilding

technology helped, what really transformed fishing into the lucrative industry we see today was access to relevant information that allowed fisherman to know where they were on the ocean, where the fish were, where they would be tomorrow and when to cast their nets for maximum yield. Fishing has used KPIs to improve revenue and performance for centuries, and businesses must do the same if they are to prosper in an increasingly competitive world.

Just as GPS helps fishermen to navigate the ocean and find the fish in enough numbers to make money and be successful, KPIs, if used effectively, can help business leaders navigate the often treacherous waters of business to make better evidence-based decisions and implement their chosen strategy successfully.

Centuries or even decades ago an abundance of fish made success possible regardless of navigation tools. But that is no longer the case. And the same is true for business. Business must also go further – not just physically to new markets and territories opened up by globalisation but they must go further across the board including improved customer experience, quality control and efficiency. KPIs make that possible because they shine a light into the business, letting you see what's really happening.

Businesses need a way to assess where they are and whether they are on or off course against their strategy. They need to be able to correct quickly and adapt to the changing conditions of the market. The days where good enough was good enough and competition was minimal so everyone prospered regardless of quality or customer satisfaction are long gone. In the years following WWII for example countries needed to re-build so there was often no competition and quality was poor but it was better than nothing. Hopefully those days will never come again. If you want to succeed in a fiercely competitive market you need a way to measure progress (or otherwise) in real time not just after the fact. If your business doesn't have or use the right KPIs then, like the fisherman of old, you are effectively casting your nets and hoping for the best.

## *The Datafication of our World*

The pressure to identify and perfect business navigation tools is only going to intensify as we get more and more access to more and more data. As in the previous section, the fishing analogy is useful in understanding the implications of the datafication of our world. If a fisherman is competing for fish in a lake, the information he needs is finite and restricted to information about the lake. But once he goes to sea the amount of possible data he could or should have access to increases exponentially.

Most modern businesses compete globally. Within those businesses and within those markets the amount of information we now have access to is truly mind-boggling. The massive uptake of social media, smart technology

and quantum leaps in computer storage and computer power collectively means that we are now generating more information and more data than ever before. It is said that we are now producing five exabytes or billion gigabytes of data every two days! Behind closed doors many business leaders are already stressed about the amount of data they probably have in their business but don't have adequate or meaningful access to and that situation is only going to get worse if we don't start managing that data effectively.

When you identify and use the right KPIs for your business you can cut through the oceans of data that exists, could exist or should exist and get timely access to the nuggets of wisdom that you need to make better decisions and improve performance.

Without the right KPIs to navigate the swelling oceans of data that already exist and is increasing all the time you can so easily find yourself all at sea.

## *KPIs as vital decision support tools*

When used effectively, KPIs provide the evidence and information required to make better, faster decisions without stress. Business experience matters, and clearly you sometimes need to make decisions when all the facts are not available but KPIs provide a vital decision support tool across the business that can reduce those occasions and minimise error and anxiety.

### *Using KPIs to answer your most critical business questions*

Your business needs KPIs because they help to answer your most critical business questions. Depending on your strategy you will have a series of important business questions that you need to answer in order to work out if your business is doing what it needs to do to achieve that strategy or is moving away from it or going off course.

Once you know what those questions are you can work out what information you need in order to answer them. Once you know the information you need you can design the right KPI that will deliver that answer and use the KPI to guide the strategy.

Essentially KPIs allow you to measure performance accurately, which in turn allows you to:

- ✓ Learn from past outcomes and improve results in the future
- ✓ Report externally and demonstrate compliance
- ✓ Focus effort and monitor output

### ***Using KPIs to learn and improve performance***

When you have access to the information you need you are better able to make better, more informed decisions. These allow you to learn what's working and not working quickly, so you can improve performance.

KPIs also provide the real-world evidence that can be used to challenge strategic assumptions and ensure the business is always heading in the right direction.

### ***Using KPIs to report externally and demonstrate compliance***

KPIs can also be used to inform external stakeholders and comply with external reporting regulations and information requests.

When measuring for these purposes, any reports and associated indicators can be produced on a compulsory basis such as for annual financial statements, accounts, or performance reports for regulators or they can be produced on a voluntary basis such as environmental impact reports.

### ***Using KPIs to focus effort and monitor output***

KPIs can also be used to focus employee's behavior and effort and monitor their output. Although this may sound a little Machiavellian, KPIs can be extremely positive in opening dialogue up and down the company. Say you have a manager who is hell-bent on a particular approach even though his staff are not supportive – KPIs allow both sides to see the facts and make decisions about where to focus effort based on evidence, not assumption or opinion. Equally, if a member of your team is not pulling his or her weight then KPIs provide feedback on any unwanted variance between achievements and goals. It's not opinion or assumption: the KPI tells the story, which tends to defuse potentially difficult situations and allows both parties to move straight into solution mode.



The word *indicator* is deliberate – KPIs are not targets to pin reward and punishment on. They are indicators, guides that can help a business or individual know where they are in relation to where they should be.

## ***Making KPIs Work in Your Business***

Although the term KPI is common, the effective application and use of KPIs in business is not.

What normally happens is that there will be a KPI champion who will struggle to engage the rest of the group about the relevance of KPIs. Even if by some

miracle that individual does garner support, if he or she leaves the whole KPI framework quietly disappears and everyone goes back to business as usual.

Alternatively too many KPIs are introduced without any real regard for how the information will be used. Over time the people collecting the data become disillusioned because nothing comes of their KPI collection and reporting. And when people are already busy it won't take long for the KPIs to fall by the wayside. See Chapter 2 for more on common errors in implementing KPIs.

This chapter is designed to give you quick overview of KPIs, how to decide on the right ones and organise them for maximum impact. as well as a sneak a peek at a few. For more detail on organising KPIs, check out Chapter 4.

## *Create a KPI culture*

KPIs are incredibly effective navigation tools that can inform decision making and give you almost real-time access to what's actually happening in your business. However, they won't ever deliver on that promise until you take steps to shift the culture inside your business to embrace KPIs and see them for a positive, inclusive and collaborative way to understand and improve performance – without finger pointing and blame.

You don't need to instigate radical cultural change programs, though – the necessary culture shifts will come about naturally. The worst thing you can do when it comes to KPIs is to announce their arrival. Instead, initiate a subtle approach where you start with a few key KPIs, explain their relevance and what the information is going to allow you to do. Collect that data, and most importantly use the data to make new choices. When people begin to see that the data you are collecting is being used in the decision-making process and to inform choices instead of being jammed in a folder and forgotten about then the culture will change.

When that change begins, lock it in through regular and semi-regular KPI-focused meetings. Chapter 3 gives you more on creating an evidence-based culture in your business.

## *Decide on the right KPI framework*

As you will see as you read the rest of this book, there are a huge number of KPIs to choose from. Even the ones mentioned in this book represent a handful of the possible KPIs that you could theoretically choose from.

Getting KPIs right is as much about how you choose and present them as it is about the ones you choose. You need to present the KPIs in context, otherwise they are just numbers and data. Most decision makers are already busy; they don't want to have to wade through mountains of information to scratch out the insights. They want to be able to get the information they need in a way that makes sense to them already.

As a result the best way to present your KPIs is to use an existing or familiar performance framework. For example if your business already uses the *Balanced Scorecard (BSC)* or *Six Sigma* then people inside the business are already familiar with that methodology. Adding KPIs around the already familiar framework makes it much more likely that managers and decision makers will use the KPIs and derive meaningful benefit from them very quickly.

There is absolutely no point re-inventing the wheel so wherever possible, piggy back on an existing framework – be that a project management framework, quality framework or the BSC.

## *Develop the right KPIs*

So which KPIs should you use? Well that depends on what you need to know. Too often people get excited about KPIs and go overboard. So they go from zero to hero and wonder why KPIs don't stick.

If you currently don't use any KPIs, or measure a few but don't really use them to inform strategy and decision making then plucking the sexiest 50 out of a KPI book – even this one – is going to fail.

You need to start with the questions you most need answers to in order to improve performance. If you are worried about staff turnover then you need to know the answer to 'How many people are leaving the company?' But that alone won't really tell you if you have a problem or not. You may want to revise that question to, 'How many of the people leaving the company do you regret leaving?' If you are only losing people you want to lose then you need to tighten up your recruitment process to ensure you don't recruit those people in the first place. If you are losing vital members of your team then you need to find out why and do all you can to rectify the problem.

The guiding principle for successful KPI selection is – only measure what matters. And in this context that means only measure what you need to measure in order to deliver your strategic objectives, improve performance and stay on track. Chapter 5 gives you the meat on developing effective KPIs.

## *Analyse and report*

Even once you've decided on the right KPIs for you and they all service a purpose and help you answer performance critical questions you need to analyse the KPIs and make sure the people that need the information get the information in a way that makes sense to them.

Too often companies will decide to use KPIs and collect them all together in a big fat folder or distribute all the KPIs to all the managers and decision makers. The resulting document is often overwhelming so no one uses the information.

Remember KPIs are navigation tools. They need to be put in context and they need to be turned into insights that can direct strategy and decision making. KPIs also allow decision makers to identify and test assumptions that can improve performance. Ultimately a KPI is only useful if it's used in the course of normal business operations. And they are only useful if the analysis reaches the right people. Chapter 6 tells you how to turn KPIs into business insights, and Chapter 7 shows you how to communicate them effectively.

## *Assessing Your Financial KPIs*

Financial KPIs are the most common type of KPI in most businesses. Whether a business is considered a success or not is largely measured by financial performance which is measured via a number of financial KPIs.

### *Revenue and profit*

Business exists primarily to make money – that's the objective. There may be other objectives but commercial organisations are driven to create revenue and more importantly profit.

It's essential therefore that you understand the different types of profit – gross, net and operating and how to measure the various margins so you can figure out how much money is really being made by the business.

Revenue is considered a key metric for success and is especially important to investors or potential investors. Chapter 7 has the inside track on developing KPIs for revenue and profit.

## *Liquidity and cash flow*

The biggest reason for business failure is not lack of sales, poor products or bad management. Most of the time businesses fail because they simply run out of money. They don't keep an eye on cash flow and liquidity and underestimate the inflows and outflows of cash from the business.

In any business cash is king. The more cash you have or the more cash you have access to quickly (*liquidity*), the more flexibility you have in how you run and grow the business. A cash-rich business doesn't have to borrow money or attract investors to grow. Debt finance and equity finance can be expensive options and dilute the control of the business, so knowing how much cash you have today and how much you will have tomorrow is critical for long term survival and growth. Chapter 8 introduces you to the key KPIs for liquidity and cash flow.

## *Shareholder value*

In business, the shareholders wear the trousers. Whether they are the owners of a privately-owned business or the shareholders in a publicly-owned company, the owners are watching and they want to know how their investment is doing.

Shareholder KPIs allow owners, managers and investors to know how attractive a company is and how much value they can expect.

For publicly-listed companies, shareholder metrics are critical. If a share price is too low but the earnings are good then it leaves the company open to a takeover. Competition is harsh in the stock market and shareholders will go where they believe they will get the best return – you need to know whether that's you or not. Chapter 9 tells you what you need to know about shareholder and value-added KPIs.

## *Financial efficiency*

Profit is a direct result of how efficiently you run your business. How well do you use the resources you have? What sort of returns are you getting on the capital you employ? Are your assets working hard enough? These are just some of the questions you need to know the answer to. Chapter 10 shows you how to get a handle on financial efficiency.

## *Assessing Your Customer KPIs*

Your business isn't a business without customers. If you want to grow and prosper moving forward you need to know what your customers think about you and you need to know how about your market share.

### *Customer satisfaction and loyalty*

Competition is fierce in most markets. Customers for the most part are much more discerning than they used to be. If you don't give them what they want when they want it then they are much more likely to jump ship and buy from your competitor.

Business has recognised the importance of at least trying to keep their customers happy for a long time but research has demonstrated that happy customers don't necessarily translate into loyal customers. Plus, just because a customer is loyal doesn't always mean that customer is profitable. You need to be able to classify your customers so you know who is making you money and who is costing you money.

You need to find the raving fans and encourage them to spread the word still further but you can't do that unless you implement some meaningful customer focused KPIs. Chapter 11 shows you how to measure customer satisfaction, and how to enhance your chances of keeping those customers loyal.

### *Market share*

Do you currently know much about your market? Is it shrinking or expanding? How do your products and services fit into that market? Do you know your market share? All of these questions are important if you are to stay relevant to your customers and adapt to changing demands. Chapter 12 takes you through what you need to do to measure your market and your place in it.

## *Assessing Your Operational KPIs*

How your business produces its products and services also have a very clear and direct link to revenue, profit and growth. Do you know how operationally efficient your projects and processes are? Are you aware of how much waste is built into your processes? Do you know how many defective products you produce and why? The answers to these questions are critical as you seek to minimise wasted time, resources and customer dissatisfaction.

## *Project performance*

Most strategic objectives are broken down into projects to ensure that the strategy is executed. Without these projects strategic objectives can easily remain aloof.

It makes sense therefore that you wrap some key KPIs around those projects to ensure that they deliver what they were instigated to deliver. Without clear milestones and measurement protocols projects can easily fizzle out and come to nothing.

If a project is critical to the overall implementation of the corporate strategy then you need to measure performance using key project KPIs. Chapter 13 has the essentials on measuring project performance.

## *Efficiency and quality*

There are two ways to create more profit – sell more products or make your products more efficiently. It makes sense to focus on both sides of the equation and that means understanding what is happening in your business on a daily basis and how your products or services reach your customers.

Do you know what level of quality your customers expect? It may be that you have built in levels of quality that are commercially irrelevant or you may be missing the mark too often. Whichever it is you need to know. Chapter 15 gives you what you need to handle efficiency and quality control.

## *IT*

Information Technology (IT) is deeply embedded into most businesses – whether that is through accounts software, customer management software or the ordering system. There is no escaping the reach and importance of IT.

Like most things in life IT is a double-edged sword. On one hand it provides huge benefits in efficiency, data analysis and communication. At the same time the omnipotence of IT leaves us vulnerable to threats. Most businesses are hugely dependant on IT, and any failings in systems can cause havoc.

IT is an important business area that requires monitoring and the use of KPIs. Chapter 16 helps you out with assessing IT performance.

## *Assessing Your Employee KPIs*

Your people are your greatest asset. For most businesses employees also represent the biggest cost. It makes sense therefore to know what's happening with your staff. Are they leaving in unusual numbers? Are they are productive as you would like them to be? Do you even know?

### *Employee engagement*

There is a strong, recognised link between happy employees and happy customers, and another one between happy customers and profit. After all, if employees are happy they are much more likely to interact with customers in a positive, helpful manner. When customers experience pride and loyalty from the employees of a business they are much more likely to believe and trust that business.

Making sure your people are engaged and satisfied therefore makes a lot of commercial sense. Chapter 17 takes you through the metrics you need to understand your business's most important resource – its people.

### *Talent retention*

We are experiencing an ongoing war for talent. Every business needs talent to execute its strategy, and competition to secure that talent is fierce.

Whether you win or lose the war often comes down to recruitment and training. How successful are you at attracting that talent in the first place? And once you have the talent how successful are you are keeping it? Talented individuals want to know that they are going to be developed further and they often expect high quality training once they are in the position so they can improve and develop.

Wrapping some KPIs around recruitment and training can help you answer these and other important HR questions. Chapter 18 covers those KPIs.