PART II

Winning KPIs Methodology

CHAPTER 6

The Great KPI Misunderstanding

Many companies are working with the wrong measures, many of which are incorrectly termed key performance indicators (KPIs). As mentioned in Chapter 2, it is a myth to consider all performance measures to be KPIs. There are four types of performance measures (see Exhibit 6.1):

1. Key result indicators (KRIs) tell you how you have done in a balanced-scorecard perspective or critical success factor.
2. Result indicators (RIs) tell you what you have done.
3. Performance indicators (PIs) tell you what to do.
4. KPIs tell you what to do to increase performance dramatically.

Many performance measures used by organizations are, therefore, a mix of these four types.

An onion analogy can be used to describe the relationship of these four measures. The outside skin describes the overall condition of the onion, the amount of sun, water, and nutrients it has received, as well as how it has been handled from harvest to the supermarket shelf. The outside skin is a key result indicator. However, as we peel the layers off the onion, we find more information. The layers represent the various performance and result indicators and the core of the onion represents the key performance indicator.

Key Result Indicators

What are KRIs? KRIs are measures that often have been mistaken for KPIs. For government and non profit agencies, *Key Result Indicators* would include:

- Availability of the major services we offer—average waiting time for service.

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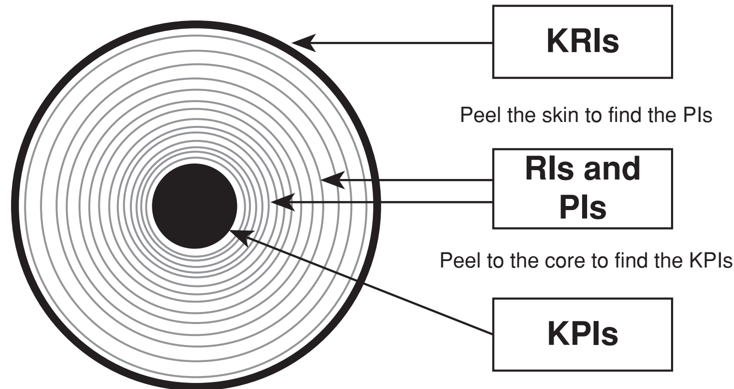

EXHIBIT 6.1 Four Types of Performance Measures

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- Customer satisfaction (by customer group, showing the trend over an 18-month period).
- On-time implementation of infrastructure projects.
- Membership numbers (for professional organizations).
- Employee suggestions implemented (by groups showing the trend over an 18-month period).
- Employee satisfaction (by groups showing the trend over an 18-month period).

For the private sector, these measures would also include:

- Net profit before tax.
- Profitability of key customer groups.
- Return on capital employed.

The common characteristic of these measures is that they are the result of many actions. They give a clear picture of whether your organization is traveling in the right direction. They do not, however, tell you what you need to do to improve these results. Consequently, KRIs provide information that is ideal for the board or government official (i.e., those people who are not involved in day-to-day management).

KRIs typically cover a longer period of time than KPIs; they are reviewed on monthly/quarterly cycles, not on a daily/weekly basis as KPIs are. Separating KRIs from other measures has a profound impact on

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reporting, resulting in a separation of performance measures into those impacting governance and those impacting management. Accordingly, an organization should have a governance report (ideally in a dashboard format), consisting of up to 10 measures providing high-level KRIs for the board, and a balanced scorecard comprising up to 20 measures (a mix of RIs, and PIs) for management reports at month-end or a couple of times during the month. The KPIs are reported immediately outside the scorecard.

In between KRIs and true KPIs are numerous performance and result indicators. These complement the KPIs and are shown on the monthly scorecard for the organization, as well as on the relevant division, department, and team scorecards.

Performance and Result Indicators

The 80 or so performance measures that lie between the KRIs and the KPIs are the performance and result indicators (PIs and RIs). The performance indicators, although important, are not crucial to the business. The PIs help teams to align themselves with their organization's strategy. PIs are nonfinancial and complement the KPIs; they are shown on the organization, division, department, and team scorecards.

For government and non profit agencies, *Performance Indicators* that lie beneath KRIs could include:

- Abandon rate at call center—caller gives up.
- Number of media coverage events planned for next month, months 2 to 3, and months 4 to 6.
- Number of initiatives implemented from the staff survey.
- Date of next customer focus group.
- Number of staff innovations implemented, by team.
- Number of training hours booked for next month, months 2 and 3, and months 4 to 6—in both external/internal courses.

For the private sector, these measures would also include:

- Number of visits to key customers last month.
- Customer complaints from key customers.
- Sales calls organized for the next week, two weeks, and so forth.
- Late deliveries to key customers.

The RIs summarize activity and all financial performance measures are RIs (e.g., daily or weekly sales analysis is a very useful summary, but it is a

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result of the effort of many teams). To fully understand what to increase or decrease, we need to look at the activities that created the result.

For government and non profit agencies, *Result indicators* that lie beneath KRIs could include:

- Number of initiatives completed from the recent customer satisfaction survey.
- Number of employees' suggestions implemented in past 30 days.
- In-house courses scheduled to be held within three weeks where attendee numbers are below breakeven.
- List of abandonments by team in past month (reported monthly).
- Number of managers who have attended leadership training (reported quarterly, by manager level).
- Staff trained to use specified systems.
- Number of initiatives implemented to improve customer satisfaction.

For the private sector, these measures could also include:

- Net profit on key product lines.
- Sales made yesterday.
- Customer complaints from key customers.
- Weekly hospital bed utilization.

Key Performance Indicators

What are *KPIs*? KPIs represent a set of measures focusing on those aspects of organizational performance that are the most critical for the current and future success of the organization.

KPIs are rarely new to the organization. Either they have not been recognized or they were gathering dust somewhere unknown to the current management team. KPIs can be illustrated by two examples.

Example: An Airline KPI

This example concerns a senior British Airways (BA) official in the 1980s, who reportedly set about turning the airline around by concentrating on one KPI. He was notified, wherever he was in the world, if a BA plane was delayed. The BA manager at the relevant airport knew that if a plane was delayed beyond a certain threshold, he would receive a personal call from the BA official. It was not long before BA planes

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had a reputation for leaving on time. This KPI affected all six of the balanced-scorecard perspectives. Late planes:

1. Increased cost in many ways, including additional airport surcharges and the cost of accommodating passengers overnight as a result of planes being curfewed due to noise restrictions late at night.
2. Increased customer dissatisfaction and alienation of people meeting passengers at their destination (possible future customers).
3. Increased contribution to ozone depletion (environmental impact) because additional fuel was used in order to make up time during the flight.
4. Had a negative impact on staff development as they learned to replicate the bad habits that created late planes.
5. Adversely affected supplier relationships and servicing schedules, resulting in poor service quality.
6. Increased employee dissatisfaction, as they were constantly fire-fighting and dealing with frustrated customers.

Example: A Distribution Company

A distribution company's chief executive officer (CEO) realized that a critical success factor for the business was for trucks to leave as close to capacity as possible. A large truck, capable of carrying more than 40 tons, was being sent out with small loads because dispatch managers were focusing on delivering every item on time to customers.

Each day by 9 A.M., the CEO received a report of those trucks that had been sent out with an inadequate load the previous day. The CEO called the dispatch manager and asked whether any action had taken place to see if the customer could have accepted the delivery on a different date that would have enabled better utilization of the trucks. In most cases, the customer could have received it earlier or later, fitting in with a past or future truck going in that direction. The impact on profitability was significant.

In a scenario similar to the airline example, staff members did their utmost to avoid a career-limiting phone call from the CEO.

(Both these examples are provided in greater detail in my webcast, "Introduction to Winning KPIs," which can be accessed via www.davidparmenter.com.)

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Seven Characteristics of KPIs

From extensive analysis and from discussions with over 3,000 participants in my KPI workshops, covering most organization types in the public and private sectors, I have been able to define what are the seven characteristics of KPIs:

1. Are nonfinancial measures (e.g., not expressed in dollars, yen, pounds, euros, etc.).
2. Are measured frequently (e.g., 24/7, daily, or weekly).
3. Are acted on by the CEO and senior management team (e.g., CEO calls relevant staff to enquire what is going on).
4. Clearly indicate what action is required by staff (e.g., staff can understand the measures and know what to fix).
5. Are measures that tie responsibility down to a team (e.g., CEO can call a team leader who can take the necessary action).
6. Have a significant impact (e.g., affect one or more of the critical success factors and more than one balanced-scorecard perspective).
7. They encourage appropriate action in the right direction (e.g., have been tested to ensure any potential dark side is minimal and that they have a significant positive impact on performance).

When you put a dollar sign on a measure, you have already converted it into a result indicator (e.g., daily sales are a result of activities that have taken place to create the sales). The KPI lies deeper down. It may be the number of visits to contacts with the key customers who make up most of the profitable business. As discussed in Chapter 2, it is a myth of performance measurement that KPIs can be financial and non financial indicators. I am adamant that all KPIs are non financial measures.

KPIs should be monitored 24/7, daily, or perhaps weekly for some. As stated in Chapter 2, it is a myth that monitoring monthly performance measures will improve performance. A monthly, quarterly, or annual measure cannot be a KPI, as it cannot be key to your business if you are monitoring it well after the horse has bolted. KPIs are current- or future-oriented measures as opposed to past measures (e.g., number of key customer visits planned in the next month or a list by key customer of the dates of the next planned visits). Most organizational measures are very much past indicators measuring events of the last month or quarter. These indicators cannot be and never were KPIs.

All KPIs make a difference; they have the CEO's constant attention due to daily calls to the relevant staff. Having a career-limiting discussion with the CEO is not something staff members want to repeat, and in the airline example, innovative and productive processes were put in place to prevent a recurrence.

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A KPI should tell you what action needs to be taken. The British Airways late-plane KPI communicated immediately to everyone that there needed to be a focus on recovering the lost time. Cleaners, caterers, ground crew, flight attendants, liaison officers, and air traffic controllers would all work some magic to save a minute here and a minute there while maintaining or improving service standards.

A KPI is deep enough in the organization that it can be tied to a team. In other words, the CEO can call someone and ask, "Why?" Return on capital employed has never been a KPI, because it cannot be tied to a manager—it is a result of many activities under different managers.

A KPI will affect one or more of the critical success factors and more than one balanced-scorecard perspective. In other words, when the CEO, management, and staff focus on the KPI, the organization scores goals in all directions. In the airline example, the late-plane KPI affected all six balanced- scorecard perspectives. As mentioned in Chapter 2, it is a myth to believe that that a measure fits neatly into one balanced-scorecard perspective.

Before becoming a KPI, a performance measure needs to be tested to ensure, it creates the desired behavioral outcome (e.g., helping teams to align their behavior in a coherent way to the benefit of the organization). There are many examples where performance measures have led to dysfunctional behavior. There are two examples discussed in the section, "Unintended Behavior: The Dark Side of Measures," in Chapter 1.

For government and non profit agencies, *KPIs* could include:

- Number of CEO recognitions planned for next week or two weeks.
- Staff in vital positions who have handed in their notice on a given day. (The CEO has the opportunity to try to persuade the staff member to stay.)
- Key position job offers issued to candidates that are more than 48 hours outstanding. (The CEO has the opportunity to try to persuade acceptance of offer.)
- List of late projects, by manager, reported weekly to the senior management team.
- Number of vacant leadership positions at an in-house training course (reported daily to the CEO in the last three weeks before the course is due to run).
- Emergency response time over a given duration (reported immediately to the CEO).
- Number of initiatives implemented after the staff satisfaction survey (monitored weekly for up to three months after survey).
- Number of confirmed volunteers to be street collectors for the annual street appeal (monitored daily in the four to six weeks before the appeal day).

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Difference between Key Results Indicators and KPIs

During workshops, one question emerges time and time again: "What are the differences between KRIs and KPIs, and RIs and PIs?" Exhibits 6.2 and 6.3 clarify the differences.

A car's speedometer provides a useful analogy to show the difference between a result indicator and a performance indicator. The speed the car is traveling is a result indicator, because the car's speed is a combination of what gear the car is in and how many revolutions per minute the engine is doing. Performance indicators might be how economically the car is being driven (e.g., a gauge showing how many miles per gallon), or how hot the engine is running (e.g., a temperature gauge).

EXHIBIT 6.2 Difference between KRIs and KPIs

KRIs	KPIs
Can be financial and nonfinancial (e.g., Return on capital employed, and customer satisfaction percentage)	Nonfinancial measures (not expressed in dollars, yen, pounds, euros, etc.)
Measures are performed mainly monthly and sometimes in a quarterly time period	Measured frequently (e.g., 24/7, daily or weekly)
As a summary of progress in an organization's critical success factor, it is ideal for reporting progress to a board	Acted on by the CEO and senior management team
It does not help staff or management because nowhere does it tell what you need to fix	All staff understand the measure and what corrective action is required
Commonly, the only person responsible for a KRI is the CEO	Responsibility can be tied down to a team leader
A KRI is designed to summarize activity within one critical success factor	A KPI impacts more than one of the critical success factors and more than one balanced-scorecard perspective
A KRI is a result of many activities managed through a variety of performance measures	A KPI is a unique measure that encourages appropriate action in the right direction
Normally reported by a monthly trend graph covering at least the last 15 months of activity	Normally reported by way of an intranet screen indicating activity, person responsible, past history, so a meaningful phone call can be made

EXHIBIT 6.3 Difference between RIs and PIs

RIs	PIs
Can be financial and nonfinancial	Nonfinancial measures (not expressed in dollars, yen, pounds, euros, etc.)
Measured daily, weekly, every two weeks, monthly, or sometimes quarterly	Measured daily, weekly, every two weeks, monthly, or sometimes quarterly
Cannot be tied to a discrete activity	Tied to a discrete activity and thus to a team
Does not tell you what you need to do more or less of	All staff understand what action is required to improve performance
Designed to summarize *some activity* within a critical success factor/success factor	Specific activity impacts on one of the critical success factors/success factors
Result of more than one activity	Focuses on a specific activity
Normally reported in a team scorecard	Normally reported in a team scorecard

Lead and Lag Confusion

Many management books that cover KPIs talk about lead and lag indicators; this merely clouds the KPI debate. Using the new way of looking at *performance* measures, we dispense with the terms *lag* (outcome) and *lead* (performance driver) indicators. At my seminars, when the audience is asked "Is the late-planes-in-the-air KPI a lead indicator or a lag indicator?" the vote count is always evenly split. The late plane in the sky is certainly both a lead and lag indicator. It talks about the past and it is about to create a future problem when it lands. Surely this is enough proof that *lead* and *lag* labels are not a useful way of defining KPIs and should be counted among the myths of performance measurement.

KRIs and RIs replace outcome measures. KRIs typically look at activity over months or quarters, whereas RIs can have a shorter time frame (e.g., sales made yesterday). PIs and KPIs are now characterized as past-, current-, or future-focused measures. *Current measures* refers to those monitored 24/7 or daily (e.g., late/incomplete deliveries to key customers made yesterday). *Future measures* are the record of a future commitment when an action is to take place (e.g., date of next meeting with key customer, date of next product launch, date of next social interaction with key customers). In your organization, you will find that your KPIs are either current- or future-oriented measures.

In workshops, I ask participants to write a couple of their major *past* measures in the worksheet shown in Exhibit 6.4 and then restate the

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EXHIBIT 6.4 Past/Current/Future Performance Measures Analysis Worksheet

Past Measures (last week/2 weeks/ month/quarter)	Current Measures (real-time/ today/yesterday)	Future Measures (next week/ month/quarter)
E.g., number of late planes last week/ last month	E.g., planes over 2 hours late (updated continuously)	E.g., number of initiatives to be commenced in the next month/2 months to target areas that are causing late planes

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measures as *current* and *future* measures. Take time out now and restate three measures.

The lead/lag division did not focus adequately enough on current or future-oriented measures. Most organizations that want to create alignment and change behavior need to be monitoring what corrective action is to take place in the future. Examples of future measures include the following:

- To be an innovative organization, we need to measure the number of initiatives that are about to come online in the next week, in two weeks, and in a month.
- To increase staff satisfaction, we need to monitor the number of planned celebrations in the next week/next two weeks. This measure will be maintained weekly by each manager.
- To develop leadership skills, we need to ensure in-house courses are being planned and staff are registering to attend. We should record the date of the next leadership program and the list of attendees registered to date (reported weekly to CEO).
- To maintain the profile of our CEO, we need to monitor the public relation events that have been organized in the next one month to three months, four months to six months, and seven months to nine months.
- To maintain staff recognition, the CEO needs to monitor the formal recognitions planned next week/two weeks by the CEO and senior management team.

All these future measures would be reported in a weekly update given to the CEO. Although CEOs may let a couple of weeks pass with

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gaps appearing on these updates, they will soon start asking questions. Management would take action, prior to the next meeting, to start filling in the gaps to ensure they avoided further uncomfortable questioning.

10/80/10 Rule

Kaplan and Norton recommend no more than 20 KPIs. Hope and Fraser[1] suggest fewer than 10 KPIs. The 10/80/10 rule is a good guide. That is, there are about 10 KRIs, up to 80 RIs and PIs, and 10 KPIs in an organization (see Exhibit 6.5). Very seldom are more measures needed, and in many cases, fewer measures will suffice. As explained in Chapter 2, it is a myth that the more measures there are, the better performance measurement will be. In fact, as has no doubt been witnessed by many readers, the reverse is true.

For many organizations, 80 RIs and PIs will at first appear totally inadequate. Yet, on investigation, you will find that separate teams are actually

EXHIBIT 6.5 10/80/10 Rule

Types of Performance Measures (PMs)	Number of PMs	Frequency of Measurement
1. Key result indicators (KRIs) give an overview on the organization's past performance and are ideal for the board as they communicate how management have done in a critical success factor or balanced-scorecard perspective.	Up to 10	Monthly, quarterly
2. Result indicators (RIs) give a summary on a specific area and they tell staff what they have done (e.g., yesterday's sales). 3. Performance indicators (PIs) are targeted measures that tell staff and management what to do (e.g., number of sales visits organized with key customers next week/biweekly).	80 or so. If it gets over 150, you will begin to have serious problems	24/7, daily, weekly, every two weeks, monthly, quarterly
4. Key performance indicators (KPIs) tell staff and management what to do to increase performance dramatically (e.g., planes that are currently over two hours late).	Up to 10 (you may have considerably less)	24/7, daily, weekly

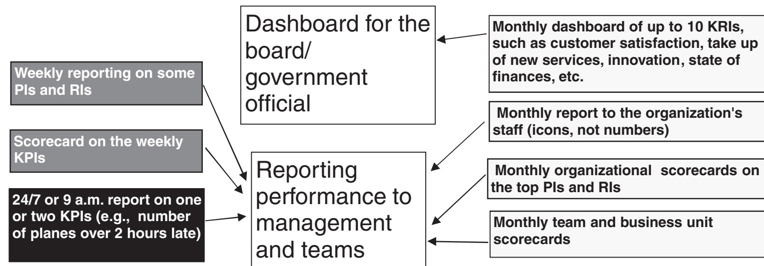

EXHIBIT 6.6 Suggested Reporting Framework

working with variations of the same indicator, so it is better to standardize them (e.g., a "number of training days attended in the past month" performance measure should have the same definition and the same graph).

Many KPI project teams will also, at first, feel that having only 10 KPIs is too restrictive and may wish to increase KPIs to 30. With careful analysis, that number will soon be reduced to the 10 suggested, unless the organization is composed of many businesses from very different sectors. If that is the case, the 10/80/10 rule can apply to each diverse business, providing it is large enough to warrant its own KPI rollout.

Importance of Timely Measurement

Before proceeding further, we will look at the importance of timely measurement. It is essential that measurement is timely. Today, a KPI provided to management that is more than a few days old is useless. KPIs are prepared in real time, with even weekly ones available by the next working day. The suggested reporting framework of performance indicators is set out in Exhibit 6.6. Frequently, staff working for government and non profit agencies tell me that we do not have any measures that we need to monitor frequently. I beg to differ. Review Appendix F for examples of common measures that will be useful for government and non profit agencies.

Some of the KPIs will be updated daily or even 24/7 (as in the British Airways case), whereas the rest of the KPIs will be reported weekly. Performance measures that focus on completion should be included. In organizations where finishing is a problem, a common weekly KPI is the reporting of projects and reports that are running late to the senior management team. Such reporting will revolutionize project and task completion in your organization.

The RIs and PIs will be reported in various time frames from daily, weekly, and fortnightly to monthly. The KRIs, which are best used to report

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performance to the board, will, therefore, be based around the timing of the board meeting.

Note

1. Jeremy Hope and Robin Fraser, *Beyond Budgeting: How Managers Can Break Free from the Annual Performance Trap* (Cambridge, MA: Harvard Business Press, 2003).