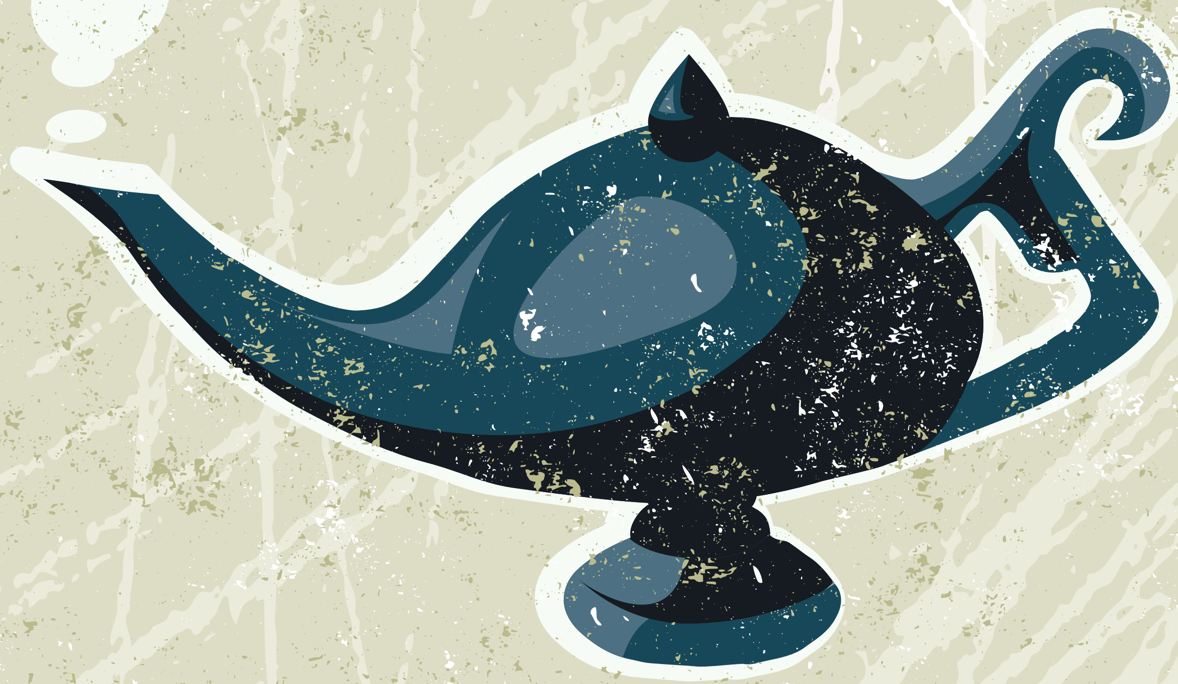
Myths surrounding performance management are limiting the effectiveness of key performance indicators in business says **David Parmenter**, who sets out the facts in the first of two articles

Abolishing the myths



I have been working with businesses to improve performance measures for over 20 years, and in that time I have seen minimal encouraging progress. For many businesses, deriving measures is often viewed as an afterthought; they are regarded as something we fill into a box to say we have achieved a goal.

But key performance indicators (KPIs) exist for a higher purpose: helping align the staff's daily actions to the organisation's critical success factors (CSFs). Here, I address the myths that influence our thinking about performance measurement and, of course, KPIs in our organisation. In a subsequent article I will talk about a radical treatment to cure KPIs.

In order to get KPIs to work, we need to challenge the myths they have been built upon. Consider these five myths of performance measurement:

1 Most measures lead to better performance.
2 All measures can work successfully in any organisation, at any time.
3 All performance measures are KPIs.
4 By tying KPIs to pay you will increase performance.
5 There is a need to set annual targets.

MYTH 1
Most measures lead to better performance

Measurement initiatives are often cobbled together without the knowledge of the organisation's critical success factors and without an understanding of its behavioural consequences. It is a myth of performance measurement that most measures lead to better performance. Every performance measure can have a dark side, a negative consequence, an unintended action that leads to inferior performance.

In order to make measures work, one needs to anticipate the likely human behaviour that will result from its adoption, and endeavour to minimise the potential negative impact. The key is to find the dark side and then tweak how the measure is used so that the behaviours it will promote are appropriate.

I suspect that well over half the measures in an organisation may well be encouraging unintended negative behaviour. Dean Spitzer's book *Transforming Performance Measurement* provides many examples of dysfunctional performance due to poor measurement.

Public sector examples

- Experienced social workers in a government agency will work on the easiest cases and leave the difficult ones to the inexperienced staff because they are measured on the number of cases closed.
- An Australian city rail service penalised train drivers for late trains, resulting in drivers skipping stations in order to achieve on-time schedules.
- A UK A&E department was measuring timely treatment of patients. The nurses then delayed the ambulances from offloading until the doctors could see them, thus achieving a zero time difference. Within hours of implementation of this measure, ambulances were circling the hospital as the ambulance bay was full. The follow-on result was obvious: ambulances arriving late to an incident.

Every performance measure can have a dark side that leads to inferior performance

Private sector examples

- A fast food restaurant manager was striving to achieve an award for zero wastage of chicken. The manager won the chicken efficiency award by instructing staff to wait until the chicken was ordered before cooking; the long waiting time that resulted meant a huge loss of customers in the following weeks.
- A company had a 100% record for the timeliness of product leaving its factory, yet 50% of customers complained about late delivery. The reason? Nobody cared about what happened once the product left the factory gates.
- Sales staff met their targets at the expense of the company, offering discounts and extended payment terms, selling to customers who would never pay. Unsurprisingly, they did it to get the bonus.
- Purchasing departments awarded for receiving large discounts started to buy in too large a quantity, creating an inventory overload.

Spitzer's statement that "People will do what management inspects, not necessarily what management expects" is telling. The greatest danger of performance management is dysfunctional behaviour. As Spitzer says, "the ultimate goal is not the customer – it's often the scorecard". Spitzer has heard executives admit, in moments of candour: "We don't worry about strategy; we just move our numbers and get rewarded."

I suspect well over half the measures in an organisation may well be encouraging negative behaviour

MYTH 2

All measures can work successfully in any organisation, at any time

Contrary to common belief, it is a myth to think that all measures can work successfully in any organisation, at any time. The reality is that there needs to be, as Spitzer has so clearly argued, a positive "context of measurement" for measures to deliver their potential.

To this end I have established seven foundation stones that need to be in place in order to have an environment where measurement will thrive. The seven foundation stones are:

1 Partnership with the staff, unions, and third parties;
2 Transfer of power to the front line;
3 Measure and report only what matters;
4 KPIs are sourced from the critical success factors;
5 Abandon processes that do not deliver;
6 Understand human behaviour; and
7 Ensure an organisation-wide understanding of what constitutes a KPI.

These seven foundation stones are explained in length in Chapter 8 of my recent book *Key Performance Indicators for Government and Non Profit Agencies*.

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MYTH 3

All performance measures are KPIs

Throughout the world, organisations have been using the term KPI to describe all performance measures. No one seemed to worry that the 'KPI' had not been defined by anyone. Thus measures that were truly key to the enterprise were being mixed with flawed measures.

Let's break the term down. Key means key to the organisation, performance means that the measure will assist in improving performance.

I have come to the conclusion that there are four types of performance measure. They have different functions and the frequency of measurement differs - see the table below.

THE FOUR TYPES OF PERFORMANCE MEASURE

The common characteristic of key results indicators (KRIs) is that they are the result of many actions. They give a clear picture of whether you are travelling in the right direction, and of the progress made towards achieving desired outcomes and strategies. They are ideal for governance reporting, for instance, as KRIs show overall performance and help the Board focus on strategic rather than management issues.

However, KRIs do not tell management and staff what they need to do to achieve desired outcomes. Only performance indicators and KPIs can do this.

KRIs are measures that have often been mistaken for KPIs, and examples of these are:

- customer satisfaction;
- employee satisfaction;
- return on capital employed; and
- plane loadings (passengers / freight).

Separating out KRIs from other measures has a profound impact on the way

A KPI IS A NON-FINANCIAL MEASURE (NOT EXPRESSED IN DOLLARS, POUNDS, EURO ETC)
It is measured frequently eg. 24/7, daily or weekly
It is acted upon by the CEO and senior management team
All staff understand the measure and what corrective action is required
Responsibility can be tied down to a team
Significant impact eg. it impacts on more than one of the critical success factors and more than one balanced scorecard perspective
They encourage appropriate action (eg. have been tested to ensure they have a positive impact on performance whereas poorly thought through measures can lead to dysfunctional behaviour)

THE FOUR TYPES OF PERFORMANCE MEASURES

The types of Performance Measures (PMs)	Number of PMs	Frequency of Measurement
1. Key result indicators (KRIs) give an overview of the organisation's past performance and are ideal for the Board (eg. return on capital employed)	Up to 10	Monthly, quarterly
2. Result indicators (RIs) summarise activities of a number of teams and thus have a shared responsibility (eg. yesterday sales).	80 or so. If it gets over 150 you will start to have serious problems	24/7, daily, weekly, fortnightly, monthly, quarterly
3. Performance indicators (PIs) are measures that can be tied back to a team but are not 'key' to the business (eg. number of sales visits organised with key customers next week/fortnight)		
4. Key performance indicators (KPIs) are measures focusing on those aspects of organisational performance that are the most critical for the current and future success of the organisation (eg. planes that are currently over two hours late)	Up to 10. You may have considerably fewer	24/7, daily, weekly

performance is reported. There is now a separation of performance measures into those impacting governance (up to 10 KRIs in a board dashboard) and those RIs, PIs and KPIs impacting management.

Probably the most controversial statement in my work has been that every KPI on this planet is non-financial. I argue that when you have a pound, dollar or Euro amount you simply quantified an activity. While financial measures are useful, they are RIs, not KPIs. Examples of KPIs are:

- Planes late by more than x hours or x minutes. This would be measured 24/7 and would focus staff on the important issue of getting a plane back on time even when it is not a problem of their own making.
- Late deliveries to key customers. By focusing only on timeliness of deliveries to key customers we are saying to staff, 'focus on these shipments first'. If you measure all deliveries staff would pick the easiest and smallest deliveries in order to achieve a high score, sacrificing the large complex orders to the key customers where organisations typically make most of their profit.

The winning KPI methodology clearly indicates that KPIs are a rare beast - these important KPIs are reported immediately and thus will never find their way into a balanced scorecard that is reported to the senior management team two or three weeks after the month-end.

GETTY

MYTH 4
By tying KPIs to remuneration you will increase performance

It is a myth that the primary driver for staff is money, and that an organisation must design financial incentives in order to achieve great performance. Recognition, respect and self-actualisation are more important drivers.

In all types of organisation, there is a tendency to believe the way to make KPIs work is to tie KPIs to an individual's pay. But when KPIs are linked to pay, they create key political indicators (not key performance indicators), which will be manipulated to enhance the probability of a larger bonus.

Because KPIs are special performance tools, they are too important to be manipulated by individuals and teams to maximise bonuses. Although they will show 24/7, daily or weekly how teams are performing, it is essential to leave the KPIs uncorrupted by performance-related pay.

Performance bonus schemes are often flawed on a number of counts:

- The balanced scorecard is often based on only four perspectives, ignoring the important environment and community and staff satisfaction perspectives.
- The measures chosen are open to debate and manipulation.
- There is seldom a link to progress within the organisation's CSFs.
- Weighting of measures leads to crazy performance agreements, for example when the message is 'find a way to manipulate these numbers and you will get your bonus'. The damage done by such schemes is only found out in subsequent years.

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MYTH 5
There is a need to set annual targets

It is a myth that we know what good performance will look like before the year starts and, thus, it is a myth that we can set relevant annual targets. In reality, as former CEO of General Electric, Jack Welch says, it leads to constraining initiative, stifling creative thought processes and promotes mediocrity rather than giant leaps in performance.

All forms of annual target are doomed to failure. Far too often management spend months arguing about what is a realistic target, when the only sure thing is that it will be wrong. It will be either too soft or too hard. I am a follower of Jeremy Hope's work. He and his co-author Robin Fraser were the first writers to clearly articulate that a fixed annual performance contract was doomed to fail.

Far too frequently organisations end up paying incentives to management when, in fact, you have lost market share. In other words, rising sales did not keep up with the growth rate in the marketplace.

As Hope and Fraser point out, not setting an annual target beforehand is not a problem as long as staff members are given regular updates about how they are progressing against their peers and the rest of the market. Hope argues that if you do not know how hard you have to work to get a maximum bonus, you will work as hard as you can.

David Parmenter is an expert in delivering winning KPIs. He is an international presenter of workshops and the author of many books