Overview

Every performance measure has a dark side, a negative consequence, an unintended action that leads to inferior performance. I suspect that well over half the measures in an organization may well be encouraging unintended negative behavior.

The Introduction explores the burning platform in performance management: how old, broken bureaucratic methods are being used that limit the longevity of organizations. It suggests a way forward, blazed by some modern organizations and documented by the paradigm shifters (Drucker, Welch, Collins, et al.).

Key learning points from the Introduction include:

1. Every performance measure has a dark side and why over half of your measures may be destroying value.
2. The three major benefits of ascertaining an organization's critical success factors and the associated performance measures.
3. The importance of measuring at the top of the cliff.
4. Examples of measures that are often confused as KPIs and dysfunctional measures that, if used, will damage an organization.
5. Performance with KPIs should be seen as a requirement, a "ticket to the game" and not worthy of additional reward.
6. Why a KPI project has to be run in-house.
7. The steps CEOs need to take to get performance measurement to work in their organizations.
8. The foolishness of setting year-end targets when you cannot see into the future.
9. Guidelines as to the chapters the Board, CEO, KPI team, and team coordinators should read.
10. Why owners of my previous editions should buy the fourth edition.
11. The variety of electronic material that is available for free and for a fee to help the KPI team get started.

Introduction

Why You Should Be Interested in This Book

Many organizations fail to achieve their potential because they lack clarity regarding the more important things to do. These organizations have not distinguished their critical success factors (CSFs) from the myriad known success factors. This lack of clarity means that often staff members will schedule their work based around their team's priorities rather than the priorities of the organization. As Exhibit I.1 shows, even though an organization has a strategy, teams often are working in directions very different from the intended course.

Performance, in many organizations, is thus a rather random exercise, like the weekend golfer who is lucky to win the Saturday competition every 10 years. This does not need to be the case, as truly great organizations know their CSFs, communicate them to their staff and use the CSFs, as this book suggests, as the source for all their measures.

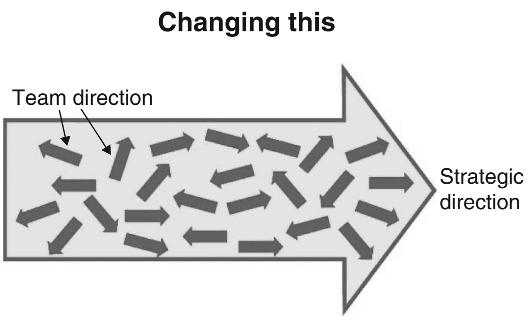

Exhibit I.1 Discord Between Teams' Efforts and the Organization's Strategy

Steve Jobs believed that few in management thought deeply about why things were done. He came up with this quote, which I want to share with you. I believe it should be on every wall and in front of every work area.

> *Your time is limited, so don't waste it living someone else's life. Don't be trapped by dogma—which is living with the results of other people's thinking. Don't let the noise of others' opinions drown out your own inner voice.*[1]

From my observations, the failure rate for key performance indicators (KPIs) and balanced scorecard projects is "off the scales." KPIs, in many organizations, are a broken tool. The KPIs are often a random collection, prepared with little expertise, signifying nothing at best, and wasteful, distracting, and counterproductive at worst.

This fourth edition is a major rewrite that incorporates: "lessons learned" from some major implementations using this methodology; a more concise KPI methodology with clear, fresh implementation guidance; insights into how other areas of performance management can be rectified.

Unintended Behavior: The Dark Side of Performance Measures

Source: NASA, https://www.nasa.gov/multimedia/imagegallery/image_feature_1633.html. Photo courtesy of Fernando Echeverria.

Performance measures are like the moon: they have a dark side, promoting an unintended action that leads to inferior performance. I suspect well over half the measures in an organization may well be encouraging unintended negative behavior.

Dean Spitzer's *Transforming Performance Measurement: Rethinking the Way We Measure and Drive Organizational Success*[2] was one of the first books to focus on the unintended consequences of performance measures.

Example: City Train Service

A classic example is provided by a city train service that had an on-time measure with some draconian penalties targeted at the train drivers. The train drivers who were behind schedule learned simply to stop at the top end of each station, triggering the green light at the other end of the platform, and then to continue the journey without the delay of letting passengers on or off. After a few stations, a driver was back on time, but the customers, both on the train and on the platform, were not so happy.

Management needed to realize that late trains are not caused by train drivers, just as late planes are not caused by pilots. The only way these skilled people would cause a problem would be either arriving late for work or taking an extended lunch when they are meant to be on duty.

Lesson: Management should have been focusing on controllable events that led to late trains. The measures that would assist with timely trains would include:

- Signal failures not rectified within __ minutes of being reported. These failures should be reported promptly to the CEO, who will make the phone call to the appropriate manager (receiving these calls on a regular basis would be career-limiting).
- Planned maintenance that has not been implemented should be reported to the senior management team on a weekly basis, keeping the focus on completion.

Example: Accident and Emergency Department

The National Health Service in the UK has set a four-hour target to treat all patients who turn up for treatment at accident and emergency (A&E). The A&E are measured on the time from patient registration to being seen by a house doctor. Hospital staff soon realized that they could not stop patients registering with minor ailments, but they could delay the registration of patients in ambulances as they were receiving good care from the paramedics.

The nursing staff thus began asking the paramedics to leave their patients in the ambulance until a house doctor was ready to see them, thus improving the "average time it took to treat patients." Each day there would be a parking lot full of ambulances and some circling the hospital. This created a major problem for the ambulance service, which was unable to deliver an efficient emergency service.

Lesson: Management should have been focusing on the timeliness of treatment of critical patients, and thus they only needed to measure the time from registration to consultation of these critical patients. Nurses would have treated patients in ambulances as a priority, the very thing they were doing before the measure came into being. Far too often we do not sort out the wheat from the chaff.

Example: Fast Food Service

A fast food chain wanted to reduce the chicken waste so they held a competition. They would fly the winning manager and their family to a well-known resort. A restaurant manager who was under performing and feeling the pressure, both at home and work, saw the competition as the opportunity to rectify both issues. The manager got the shifts to assemble and explained his plan. "I want you to take the chicken out of the freezer when you receive an order and not before." "But boss, that will lead to huge queues both in the restaurant area and in the drive through," his supervisors explained. "Do not worry, we will only do this for the week of the competition."

The manager won the chicken waste award and was hailed in the head office as a hero, and an example of what was possible. Until the next week's revenue numbers came in. All the customers caught up in the long queues had taken their custom elsewhere. When head office investigated, they were flabbergasted. "How could you think of such a change to procedure?," they asked. "I delivered your zero waste you wanted," replied the unrepentant manager.

Lesson: Tying a reward to an important measure will lead to gaming. Low chicken waste should be treated "as a ticket to the game."

Some Common Measures to Avoid

Measuring sales staff against a predetermined gross revenue target. Sales staff are legendary at meeting their targets at the expense of the company, offering discounts, extended payment terms, selling to customers who will never pay; you name it, they will do it to get the commission.

Tying pay to low inventory levels. Stores maintaining low inventory to get a bonus and having production shut down because of stockouts.

Measuring completion of case load. Experienced caseworkers in a government agency will work on the easiest cases and leave the difficult ones to the inexperienced staff because they are measured on cases closed. This has led to tragic circumstances.

Capacity utilization rate. This is an anti–lean performance measure that prompts plant supervisors to maximize long runs, producing items for stock rather than for actual customer demand.

Delivery in full on time on all deliveries. Using this measure on all dispatches no matter how insignificant they are will lead to cherry picking by staff. It is only human nature to tackle the easy, nonimportant dispatches first, putting the major, more complex, deliveries at risk.

It is thus imperative that before a measure is used, it is:

- Discussed with the relevant staff: "If we measure this, what will you do?"
- Piloted before it is rolled out.
- Abandoned if its dark side creates too much adverse performance.

"People will do what management inspects, not necessarily what management expects."

As Spitzer says, "People will do what management inspects, not necessarily what management expects."

The Three Major Benefits of Ascertaining an Organization's Critical Success Factors

There are three major benefits of ascertaining an organization's critical success factors and the associated performance measures:

1. A clarity of purpose, from aligning the daily staff actions to the organization's critical success factors.
2. Improving performance through having few and more meaningful measures.
3. Creating wider ownership, empowerment, and fulfillment at all levels of the organization.

A Clarity of Purpose from Aligning the Daily Staff Actions to the Organization's Critical Success Factors

Before measures are developed, you need to know what is important in the organization to get right day in, day out. Every organization on planet earth, seeking outstanding performance, needs to know what its critical success factors are and have these communicated to staff.

If the CSFs of the organization are clarified and communicated, staff members will be able to align their daily activities closer to the strategic direction of the organization, as shown in Exhibit I.2.

This behavioral alignment is often the missing link between good and great organizations. CSFs and their associated KPIs are the only things that truly link day-to-day performance in the workplace to the organization's strategy. In the past people thought that because monthly budgets were linked to the annual planning process, which in turn was linked to the five-year plan, which in turn was linked to the strategic plan, strategy was linked to day-to-day activities. It looked good on paper, as shown in Exhibit I.3, but never worked in practice.

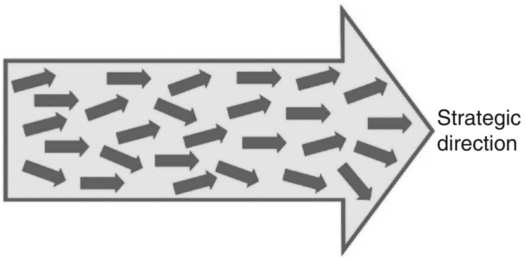

Exhibit I.2 Alignment of Teams' Efforts and the Organization's Strategy

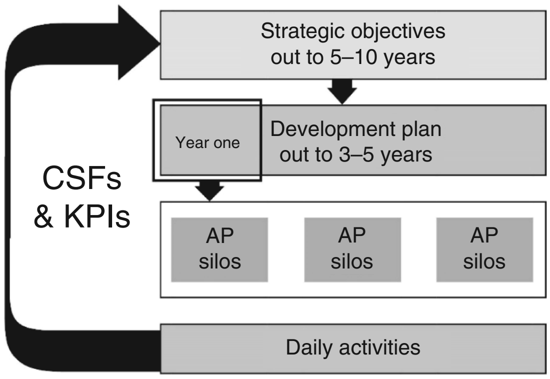

Exhibit I.3 Linkage of CSFs and KPIs to the Strategic Objectives
Note: AP= annual planning.

Measures That Help Create Alignment

I have extracted some of the measures that are included in the appendix to this book.

1. Measuring any exception that relates to delivery in full on time to key customers including:
   - Late deliveries over two hours late to key customers—reported intraday to the CEO
   - Incomplete deliveries to key customers—reported intraday to the CEO
   - Late planes in the sky over two hours late—reported intraday to the CEO

- Late projects which have passed their original deadline—reported weekly to the executive team
- Complaints from our key customers that have not been resolved within __ hours—reported intraday to the executive team
- Key customer service requests outstanding for more than 48 hours—reported intraday to the executive team

2. Measures that relate to recruiting the right people all the time
   - Key position job offers that are over 48 hours old and have not yet been accepted by the chosen candidate—reported daily to the executive team
   - Names of shortlisted candidates for whom the next round of interviews has yet to be scheduled—reported daily to the executive team
3. Measures that relate to staff satisfaction
   - Number of planned CEO recognitions for next week/two weeks—reported weekly to the CEO
   - Number of initiatives implemented after staff satisfaction survey—reported weekly to the executive team post survey
   - Key staff who have handed in their notice today—reported intraday to the CEO.

Improving Performance through Having Fewer and More Meaningful Measures

Performance measures can and should have a profound impact on performance because they:

- Tend to make things happen; it helps people see progress and motivates action.
- Increase visibility of a more balanced performance and focus attention on what matters.
- Increase objectivity—Dean Spitzer[3] points out that staff actually like measuring and even like being measured, but they do not like being judged subjectively.
- Improve your understanding, your decision making, and execution—Spitzer illustrates that you will not be able to execute well, consistently, without measurement. Measurement can improve your business

intuition and significantly increase your "decision-making batting average."
- Improve consistency of performance over the long term.
- Facilitate feedback on how things are going, thereby providing early warning signals to management.
- Help the organization become future-ready by encouraging timely feedback, looking forward by measuring future events (e.g., a CEO should look weekly at the list of celebrations, or recognitions, scheduled for the next two weeks), encouraging innovation, abandonment of the broken, and supporting winning management habits such as recognition, training, and mentoring.

Creating Wider Ownership, Empowerment, and Fulfillment in All Levels of the Organization

Performance measures communicate what needs to be done and help staff understand what is required. They enable leaders to give the general direction and let the staff make the daily decisions to ensure progress is made appropriately. This shift to training and trusting staff to make the right calls is very much the Toyota way. Any incorrect decision is seen as a fault in training rather than with the individual.

The delegation of authority to the front line is one of the main foundation stones of this KPI methodology (see Chapter 3, Background to the Winning KPI Methodology). This issue was discussed at great length in Jeremy Hope's book *The Leader's Dilemma*.[4]

I have yet to meet a person who desires failure or finds failure rewarding. Where measures are appropriately set, staff will be motivated to succeed.

The Burning Platform in Performance Management

There is a burning platform in many organizations, and it is called performance management. Old, broken bureaucratic methods are being used that limit the longevity of the organization. These dubious performance management methods enable managers to take actions that produce short-term illusionary gains at the expense of the organization's longevity. In fact, the more successful managers are at the "short-term game" the higher they climb up the corporate tree helping themselves to ever-increasing annual bonuses.

If Martians landed and inspected our methods, they would wonder how we ever managed to get to the moon, let alone land a rover on Mars. It is testament to the great people working against such a system.

Over the forty years I have been observing and studying performance management, I have come to the conclusion that the major performance management issues are not only common in most organizations, but they are also being amplified as big data and new wave technology lead us to an ever-growing reporting regime of meaningless measures. The sparse progress in those forty years indicates that these issues appear to be locked in each organization's DNA.

While the list of failed performance management practices is daunting, it is still worth understanding them and selecting a sound starting point. I will address the major performance management issues and supply a reference to explore the long-term fixes.

<table>
<tr><th></th><th>Failed performance management practices (the bolded statements have been further explored in this introduction)</th><th>Books offering workable solutions</th></tr>
<tr><td rowspan="8">A lack of clarity on performance measurement</td><td>No formal education on performance measurement</td><td rowspan="8">This book</td></tr>
<tr><td>Confusion on what KPIs are and what they can and should do</td></tr>
<tr><td>Too many of the wrong measures</td></tr>
<tr><td>Measuring far too much at the bottom of the cliff</td></tr>
<tr><td>Calling all measures KPIs</td></tr>
<tr><td>Linking measures to performance Pay Schemes</td></tr>
<tr><td>Using external consultants to deliver a KPI or balanced scorecard project</td></tr>
<tr><td>A lack of CEO and senior management commitment to KPIs</td></tr>
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<table>
<tr><td rowspan="4">A lack of clarity of purpose</td><td>Operating without ascertaining the organization's critical success factors</td><td>This book</td></tr>
<tr><td>Believing that a long-drawn-out strategy process will galvanize action</td><td>Jack Welch's Winning
Chan Kim and Renée Mauborgne's Blue Ocean Shift</td></tr>
<tr><td>Allowing a self-serving culture to override the publicly stated values</td><td rowspan="2">Jeremy Hope's The Leader's Dilemma</td></tr>
<tr><td>Allowing short-term thinking to override the greater good</td></tr>
<tr><td rowspan="5">A regime that nurtures the status quo</td><td>A failure rate with projects that matches the failure rate of race horse ownership</td><td rowspan="5">Jack Welch's Winning
Tom Peters' Thriving on Chaos
Henry Mintzberg, No More Executive Bonuses (Sloan Management Review, November 2009).
Elizabeth Haas Edersheim's The Definitive Drucker</td></tr>
<tr><td>Allowing innovation to be stifled by bureaucracy</td></tr>
<tr><td>A lack of commitment to getting recruitment right the first time</td></tr>
<tr><td>Executive salary setting and redundancy pay-outs</td></tr>
<tr><td>Reliance on outdated management practices</td></tr>
<tr><td rowspan="6">Old, broken command-and-control bureaucratic processes</td><td>Allowing growth in the layers of bureaucratic management</td><td rowspan="6">Jeremy Hope's The Leader's Dilemma

Tom Peters' Thriving on Chaos</td></tr>
<tr><td>A focus on centralization</td></tr>
<tr><td>Setting annual targets when you cannot see into the future</td></tr>
<tr><td>Fixation on annual planning processes when it should be a continuous process</td></tr>
<tr><td>A reporting regime designed to further support the top-heavy bureaucracy</td></tr>
<tr><td>A lack of trust that business unit will deliver without oversight</td></tr>
</table>

A trail of failed IT implementations	Installing a silver bullet, an untried IT system installed by a team of external consultants	Elizabeth Haas Edersheim's *The Definitive Drucker*
A misguided belief that the lean movement is only for manufacturers	A lack of understanding and adoption of continuous flow	Jeffrey Liker's *The Toyota Way*
	A lack of abandonment	Elizabeth Haas Edersheim's *The Definitive Drucker*

Reference Reading Offering Workable Solutions

The solutions to these performance management failings can be found in these great books. It is interesting to note that only two of them are recent publications for good reason. Management failings are common no matter how technology has changed and like a good wine these books have aged well.

Jeremy Hope's book *The Leader's Dilemma: How to Build an Empowered and Adaptive Organization Without Losing Control*.[5] In the book, Hope outlines how 21st-century organizations such as Whole Foods Market (United States), American Express (United States), Statoil (Norway), HCL Technologies (India), Telenor (Norway), Southwest Airlines (United States), Ahlsell (Sweden), Toyota, General Electric, W.L. Gore & Associates (United States), Swenka Handelsbanken (Sweden), John Lewis Partnership (UK), Leyland Trucks (UK), Nucor Steel (United States), and Tomkins (UK) have radically changed performance management practices.

Tom Peters' book *Thriving on Chaos: Handbook for a Management Revolution*.[6] Although written in 1987 it is just as valid today. It contains many case studies and practical steps to implement. Every chapter in the book has a summary of the key learning points on the left hand side of the first page. I have copied the technique in this book.

Jack Welch's *Winning*.[7] Where do you start to analyze the leadership traits of Jack Welch? The CEO who took General Electric (GE) from being worth $10 billion to $500 billion. *Forbes* magazine crowned him the best business leader of the 20th century. I consider Jack Welch a "paradigm shifter." His book, written with Susy Welch, *Winning* is a must read.

Chan Kim and Renée Mauborgne's *Blue Ocean Shift: Beyond Competing*.[8] This is the practical implementation book that follows on from their *Blue Ocean Strategy* and is the quintessential book on the topic of exploring new opportunities. The writers discovered it is easier to find new areas of business (blue oceans) than fight tooth and nail for a dwindling market (red oceans). Cirque du Soleil is an example of blue ocean thinking. Dance, opera, and circus were merged together into a great new spectacle where there were few competitors. If you are looking to get out of the red oceans, this book is for you.

Jeffrey Liker's *The Toyota Way*[9] explains what makes Toyota so special. How in Toyota every employee is expected to reflect each day "What could I do better tomorrow?" and come up with at least one innovation per month, no matter how small. The Toyota average, internationally, is 10 innovations per employee per year. If you want to learn more on continuous improvement (Kaizen), this is the book to read.

Elizabeth Haas Edersheim's summary of Drucker's work, *The Definitive Drucker: Challengers for Tomorrow's Executives—Final Advice from the Father of Modern Management*.[10] The greatest book ever written on Drucker's work and that includes his own books. I consider Peter Drucker to be the Leonardo da Vinci of management—I believe he will be better understood and respected 400 years from now. All managers and leaders should devour this book and refer to it constantly.

No Formal Education on Performance Measurement

Management, who have yet to receive formal education on performance measurement, are running organizations in both the private and public sectors. Unlike accounting and information systems, where rigorous processes have been formulated, discussed, and taught, performance measurement has been left an orphan of business theory and practice.

The fix: Chapter 12, Implementation Case Studies and Lessons, references the major books in performance measurement.

Confusion on What KPIs Are and What They Can and Should Do

The 2018 *MIT Sloan Management Review* and Google's cross-industry survey[11] asked senior executives to explain how they and their organizations are using KPIs in the digital era. It is probably the largest survey on this topic with more than 3,200 senior executives providing feedback and supported by in-depth interviews with 18 selected executives and thought leaders.

This study found that the measurement leaders, the highest-performing group, in the survey sample:

- *Look to KPIs to help them lead—to find new growth opportunities for their company and new ways to motivate and inspire their teams.*
- *Treat their KPIs not simply as "numbers to hit" but as tools of transformation.*
- *Use KPIs to effectively align people and processes to serve the customer and the brand purpose.*

However, this study lost its way when it confirmed a common misunderstanding by defining KPIs as:

> *The quantifiable measures an organization uses to determine how well it meets its declared operational and strategic goals.*

This definition is flawed on several counts:

1. Measuring progress on the journey to reaching the strategic goals is done by periodic reporting, which will seldom lead to profound alignment of people and processes.
2. It makes the time-honored mistake that all measures are KPIs. How can this be? In the study, the writers acknowledged that "most companies do not deploy KPIs rigorously for review or as drivers of change. In practice, KPIs are regarded as 'key' in name only; the most prevalent attitude toward them seems to be one of compliance, not commitment." The words "key" and "performance" are linked together so that the measure is one that will lead to customer delight and improved financial performance.
3. Reporting progress against goals is necessary, typically done monthly, and is not the real driver for alignment that we seek. I have yet to see

a monthly report that ever created any change. We need 24/7, daily, and weekly warning flags which encourage timely corrective action and thus the monthly progress report should only confirm what we already know.

The fix: Chapter 1, The Great KPI Misunderstanding, clarifies what KPIs are and what they are not.

Too Many of the Wrong Measures

Organizations using the balanced scorecard approach frequently end up with 200–300 measures. I believe an organization only needs up to 100 measures, around 10 KPIs and key result indicators (KRIs) and 80 performance indicators (PIs) and result indicators (RIs). These terms are explained in Chapter 1. Chapters 3 and 6 explain the need for a center of expertise to be established within the organization to design and test measures before they are used.

As has been pointed out to me by Peter Rafferty, we do not just have data lakes; we have data swamps, and his comment on this is very illuminating.

> *With ever more data (I don't like the term big data), we have ever increasing data swamps. Data "lakes" are more organized. It's VERY easy for people to wade into their swamps and pull out measures for all manner of things: activities, milestones, outputs, and a million things that aren't KPIs. Worse, these all get reported ad nauseam in reports and on cluttered dashboards. Worse yet, organizations—or their consultants making money on it—pride themselves on making up measures. Heck, I saw a bar chart two weeks ago that had a measure of number of measures, not kidding.*
>
> ***Peter Rafferty, Transport Consultant, Gannett Fleming***

Many companies are working with the wrong measures. Frequently, the task of finding measures is a task carried out at the last minute by staff members who do not have a clue about what is involved in finding a measure that will create the appropriate behavioral response. Chapter 8 discusses the rules to follow when designing measures.

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Another quote, which I received recently, sums this up beautifully.

> *KPIs should be developed as if scarcity was a key consideration; as if every KPI used comes with a high cost. Asking "If we could only measure or indicate one thing … what would it be?" is a great place to start in determining KPIs as you find what is really important. Developing KPIs is most effective if there is discussion across the business on what is essential and resist the temptation to measure too many things.*
>
> ***Michael Clark, Founder of Evergood Equestrian Association***

The fix: Organizations that have used this methodology have been able to limit the number of performance measures.

Measuring Far Too Much at the Bottom of the Cliff

For far too long organizations have relied too much on "bottom of the cliff" monthly measures that are too late to change events. It is clearly better to catch problems early on rather than measure their impact in the monthly report. Where you need change to occur, 24/7, daily, or weekly measurement has a far better chance to prompt corrective action to take place.

I do not believe there is a monthly KPI on this planet. If a performance indicator is key to the well-being of an organization, surely you would measure it as frequently as possible. This theme is further developed in Chapter 1.

The fix: Organizations that have used this methodology have been able to focus more performance measures into intraday, daily, and weekly measures.

Calling All Measures KPIs

It is a myth to consider all performance measures to be KPIs. Chapter 1, The Great KPI Misunderstanding, explains that there are four types of measures split into two groups. Here are some common measures that are incorrectly called KPIs.

> *Return on capital employed*: This measure has never been a KPI as it cannot be tied down to a manager; it is a result of many activities under different managers. Can you imagine the reaction if a GM was told one

morning by the CEO, "Pat, I want you to increase the return on capital employed today." This measure is a key result indicator and is ideal for reporting progress to the board.

Net promoter score: The likelihood of a referral is a result of the many interactions with the customer and is a good key result indicator, ideal for reporting progress to the board. However, instead of looking at this measure management we need to be measuring, on a daily basis, selected measures from the initial touch that we have from our marketing and sales engagements, the delivery and invoicing of a service or product, the service experience, and the way we maintain an ongoing relationship with them.

Revenue per employee: A useful ranking tool when comparing many retail stores with each other providing that you split the stores into leagues, the large stores in prime locations to the stores in small towns with low foot traffic. Again, it is a result indicator, a result of foot traffic, recent promotions, recent competitors' actions, season buying patterns, and the weather.

Economic value added (EVA): A measure dreamed up to take account of the opportunity cost of equity, which is useful as long as the reader understands the measure. It is used periodically and is a result indicator. To arrive at EVA requires a series of adjustments to be made to restate the net profit after tax, including charging economic depreciation and excluding certain noncash adjustments.

Customer satisfaction rate or index: A measured derived from a survey of customers. It has never been a KPI, as it is measured too infrequently, does not tell you what to fix, and often includes all customers when it should be targeted at the profitable customers.

Employee satisfaction rate or index: Like the customer satisfaction measure, it has never been a KPI as it is measured too infrequently and is a result of many events in the past. The KPI that should be measured weekly after the report is out is "How many of the survey recommendations have been implemented?" This KPI has a life of six to eight weeks, after which it is often too late to make the changes. It is far better to run these surveys three to four times a year based on a statistical sample, sharing the results with all staff.

The fix: Chapter 1, The Great KPI Misunderstanding, explains that there are four types of measures split into two groups.

Linking Measures to Performance Pay Schemes

Far too frequently ill-conceived, unfair, and dysfunctional performance-related pay schemes divert wealth into the senior management's pockets at the expense of the long-term viability of the organization.

> *But despite hundreds of research studies over 50 years that tell us that extrinsic motivation* (behavior that is driven by external rewards such as money, fame, grades and praise) *doesn't work, most leaders remain convinced that financial incentives are the key to better performance.*
>
> ***Jeremy Hope***[12]

Performance bonuses give away billions of dollars each year based on methodologies to which little thought has been applied. Who are the performance bonus experts? What qualifications do they possess to work in this important area other than prior experience in creating the mayhem we currently have?

Which bright spark advised the hedge funds to pay a $1 billion bonus to fund managers who create a paper gain that may never eventuate into cash when the stock market turns ugly? These schemes are flawed from the start; "super" profits were being paid out, there is no allowance made for the cost of capital, that in certain markets a fool can make money, and often does, and the bonus schemes are typically only "high side" focused.

A study by consultants William Mercer concluded that most individual merit or performance-based pay plans share two attributes: they absorb vast amounts of management time and resources, and they make everybody unhappy.[13]

In a recent HBR study,[14] conducted on nearly 1,300 private sector organizations, covering some targeted interviews and 14,000 completed questionnaires the survey found:

- Where there were low to medium levels of employee participation in profit-related pay, there was a lower level of job satisfaction, organizational commitment, and trust in management.
- Share ownership among staff had a direct negative relationship with job satisfaction, and no significant relationship with employees' commitment and trust in management.

Yet when we look at most profit-related pay schemes, we find they are heavily stacked toward the senior executive team, and these are often doubled up with share options that give away large, unseen sums to the executive team. One study found that the average US corporation gives around 75 percent of stock options to the top five executives.[15] There are a number of issues with this: first, around 70 percent of the stock price is driven by industry factors;[16] second, it disenfranchises most employees; and last, it distributes an obscene amount of wealth from shareholders to these executives.

Henry Mintzberg believes the incentive system cannot be fixed and should be scrapped altogether.[17] Jensen and Murphy[18] have showed that there is virtually no link between how much CEOs were paid and how well their companies performed.

A common feature of the many failed KPI projects I have heard about is that the cart was put in front of the horse; management was going for a quick fix for the wrong reasons. KPIs were being set up so management could have a hook to hang the bonus structure on. One of the greatest myths of performance measurement is that by linking pay to performance measures you will increase performance. You will merely increase the manipulation of these important measures, undermining them so much that they will become *key political indicators*.

KPIs are a special performance tool, and it is imperative that these are not included in any performance-related pay discussions. KPIs, as defined in Chapter 1, are too important to be gamed by individuals and teams to maximize bonuses. Performance with KPIs should be a "ticket to the game" and not worthy of additional reward.

The balanced scorecard has been manipulated whether it is tied to annual performance bonus or not. As Spitzer says, "The ultimate goal is not the customer—it's often the scorecard." Spitzer has heard executives, when being candid, saying, "We don't worry about strategy; we just move our numbers and get rewarded."

The fix: Organizations including American Express (United States), Dupont (United States), Southwest Airlines (United States), General Electric, Groupe Bull (France), John Lewis Partnership (UK), Leyland Trucks (UK), Marshall Industries (United States), Nucor Steel (United States), Swenka Handelsbanken (Sweden), and Whole Foods Market (United States) have transformed their performance-related pay schemes. To read more, access my working guide on the foundation stones of performance-related pay schemes from www.davidparmenter.com.

Only when the chief executive officer is passionate and knowledgable about measurement will you have the opportunity to get twenty-first-century measurement to work effectively and efficiently.

Using External Consultants to Deliver a KPI or Balanced Scorecard Project

Peter Drucker observed that many new initiatives failed as the wrong people were leading them. When we recruit a new employee or consultant to undertake a major project, there will be much uncertainty among staff and management. Staff will be wondering, What is going to happen with my job? Are my favorite tasks about to disappear? What effect is this going to have on my pay?

These doubts, along with the added insult of the Porsche Carrera in the visitors' car park, often leads to stonewalling any potential project progress. There may be some staff and management who will do their utmost to make the consultant fail. The consultant, in such circumstances, is given as much chance of success as a mountaineer solo climbing Mount Everest. It can be done but only by a freak of nature.

Instead, Drucker advised that you find a project manager in your organization who holds the highest stack of IOUs. This is one of the seven foundation stones as explained in Chapter 3. Implementing critical success factors and their associated measures has to be managed by an in-house KPI team, schooled and coached by an experienced mentor (a consultant). Where consultants outnumber in-house sourced team members failure is sure to follow.

The fix: Organizations that have used this methodology have implemented their CSFs and associated measures using an in-house team.

A Lack of CEO and Senior Management Commitment to KPIs

As Dean Spitzer[19] argues, one of the fundamental issues of the implementation of performance measurement is measurement leadership. "Only when the chief executive officer (CEO) is passionate and knowledgeable about measurement will you have the opportunity to get twenty-first-century measurement to work effectively and efficiently." Only when the CEO is prepared to be the figurehead of KPI project will it work.

I am hopeful that if you are a CEO and are reading this introduction, you may be sharing with me the opinion that traditional performance management techniques have well and truly broken down.

Like an ocean liner on a journey where the crew on the bridge are constantly measuring distance and direction, CEOs likewise need to evaluate "Are we on the right journey?" "How are we progressing?" and "What needs to be improved to aid our progress?"

Due to your workload as the chief executive officer (CEO), I doubt whether you will have time to read much of this book. That is not such a problem, as I explain in this letter.

Letter to the CEO

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30 September 2019

Dear CEO,

Re: Invitation to put winning key performance indicators in your organization

I would like to introduce you to a process that will have a major impact on your organization. It will link you and your staff to the key activities in the organization that have the most impact on the bottom line. If implemented successfully, the CSF and KPI project will have a profound impact, leaving a major legacy.

I would like to wager that you have not carried out an exercise to distinguish your organization's critical success factors from the many success factors you and your senior management team talk about on a regular basis.

I would also point out that much of the reporting you receive, whether it is financial or on performance measures, does not aid your daily decision-making process. The reason for this is because much of the information you receive is monthly data, received far too late to affect any change.

I recommend that you read the following chapters of this book:

Introduction—this covers the major benefits of getting the KPIs right.

Chapter 1, The Great KPI Misunderstanding—this explains the background to a new way of looking at KPIs, considered by many to be a breakthrough in understanding KPIs.

Chapter 2, Myths of Performance Measurement—the reasons why performance measures may not be working in your organization.

Chapter 3, Background to the Winning KPI Methodology.

Chapter 4, Leading and Selling the Change—this chapter will be useful to all managers who are trying to sell an idea.

Chapter 5: Getting the CEO and Senior Management Team Committed to the Change.

Chapter 6: Up-Skill In-House Resources to Manage the KPI Project.

Having read these chapters I am sure you will want to support the winning KPI project with commitment and enthusiasm. My KPI book, *Key Performance Indicators: Developing, Implementing, and Using Winning KPIs*, is designed to be a working manual for the KPI team.

Request your PA to access a recording of me delivering “The Late Planes in the Sky KPI” story. There are a number of recordings on my website. Please invest 20 minutes listening to it as the recording will illustrate the potential of a KPI.

I am hopeful that this book will help your KPI team achieve a significant improvement in performance. I look forward to hearing about your progress.

Kind regards,
David Parmenter
parmenter@waymark.co.nz
P.S. Please feel free to ring me +64 4 499 0007

The fix: Organizations where the CEO has shown measurement leadership and attended the two-day CSF workshop have been successful with their KPI project implementation.

Operating without Ascertaining the Organization's Critical Success Factors

When visiting an organization, I always look around at the walls. If I am unable to see posters with the critical success factors (CSFs), I know immediately that the organization does not have this clarity. I believe that not knowing your organization's CSFs is like going to soccer's World Cup without a goalkeeper, or, at best, an incompetent one.

The definition I use for the CSFs is

> *The list of issues or aspects of organizational performance that determine ongoing health, vitality, and well-being.*[20]

The fix: How to ascertain your organization's CSFs is covered in Chapter 7, Finding Your Organization's Critical Success Factors. The process has been road tested in many organizations leaving a profound legacy.

Allowing Short-Term Thinking to Override the Greater Good

As Professor Tom Johnson points out, "A finance orientated growth strategy is the belief that profitability improves by taking steps aimed at increasing revenue and cutting costs. While such steps embody impeccable arithmetic logic, they ignore the reality that long-term profitability results from satisfied customers and focused operations."[21]

Arie de Geus[22] has discovered that long-term organizations did not see themselves as primarily economic units to produce profits and value for the entrepreneur and the shareholder. They saw themselves as living systems composed of other living systems.

The drive to meet short-term sales targets and gain substantial bonuses has led to some classic problems. GM and Ford have decimated their brands by heavily discounting cars to get volume. It has become so prevalent that it is now expected by customers.

The large multinationals who drive their business each quarter to meet a predetermined target, ignoring comparing their performance to the marketplace, are like lemmings running toward the cliffs and the abyss.

In fact, it may be a natural phenomenon that organizations over a certain size are eventually doomed to fail as they suffer from many of the harmful issues listed here.

The fix: Toyota sets a shining example of how a large corporation can put the long term above the needs of the immediate future.

A Failure Rate with Projects That Matches the Failure Rate of Race Horse Ownership

Far too many projects are started in organizations due to our addiction for the new and our boredom with projects that appear to be grinding to a halt. Managers would far rather let a project die than risk committing to it and finding out they now have a failure tag around their neck.

Projects are started without an understanding of how to sell and lead change, resulting in management and staff eventually killing off the project as their "default future" vision was not challenged and changed.

The fix: How to solve the completion dilemma and selling change is covered in this book.

Setting Annual Targets When You Cannot See into the Future

All forms of annual targets are doomed to failure. Far too often management spends 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. How can you set an annual sales target unless you can see into the future?

The striving to meet the quarter-end and year-end numbers by fair means or foul, by taking on excessive risk that seldom is taken into account, has led to the demise of once noble institutions that had survived for multiple decades, such as Northern Rock, Lehman Brothers, Merrill Lynch, and Bear Sterns. These organizations would have had a different future if executives had looked at performance differently.

Far too frequently organizations end up paying incentives to management when in fact they have lost market share. In other words, rising sales did not keep up with the growth rate in the marketplace. As Jeremy Hope[23] points 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. Jeremy 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.

Jack Welch[24] when at General Electric rewarded subsidiaries who in a difficult trading year sold less than previous years but had managed to increase their market share.

The fix: Progressive organizations around the world, such as Whole Foods Market (USA), American Express, (USA), Statoil (Norway), Ahlsell (Sweden), General Electric, W.L. Gore & Associates (USA), Swenka Handelsbanken (Sweden), and Tomkins (UK), have moved away from the annual planning cycle to a rolling quarterly planning process.

The fix: The work of Jeremy Hope clearly spells out an alternative solution.

Suggested Chapter Reading by Reader Designation

This book is a resource for anyone in the organization involved with the development and use of KPIs. It is desirable that all KPI project team members, the external project facilitator, team coordinators, and local facilitators (if required) have their own copy to ensure all staff follow the same plan. Team members are expected to take the book with them when meeting staff and management, as they will be able to clarify issues by using examples from the book.

Exhibit I.4 Recommended Reading

	Section title	**Board**	**CEO and SMT**	**KPI project team, external facilitator**	**Team coordinators**
	Introduction	✓	✓	✓	✓
Stage 1: Getting the enterprise committed to the change and up-skilling an in-house KPI team					
Chapter 1	The Great KPI Misunderstanding	✓	✓	✓	✓
Chapter 2	The Myths of Performance Measurement	✓	✓	✓	✓

(*continued*)

Exhibit I.4 (*Continued*)

	Section title	**Board**	**CEO and SMT**	**KPI project team, external facilitator**	**Team coordinators**
Chapter 3	Background to the Winning KPI Methodology		✓	✓	✓
Chapter 4.	Leading and Selling the Change		✓	✓	
Chapter 5	Getting the CEO and Senior Management Committed to the Change		✓	✓	
Chapter 6	Up-Skill In-House Resources to Manage the KPI Project		✓	✓	
Stage 2: Ascertaining the operational critical success factors (the aspects that need to be done well day-in day-out)					
Chapter 7	Finding Your Organization's Operational Critical Success Factors			✓	✓
Stage 3: Determining measures and getting them to work					
Chapter 8	Characteristics of Meaningful Measures			✓	✓
Chapter 9	Designing and Refining Measures			✓	✓
Chapter 10	Reporting Performance Measures			✓	✓
Chapter 11	Ongoing Support and Refinement of KPIs and CSFs			✓	✓

Exhibit I.4 (*Continued*)

	Section title	Board	CEO and SMT	KPI project team, external facilitator	Team coordinators
Chapter 12	Implementation Case Studies and Lessons			✓	
Appendix	Performance Measures Database			✓	

Note: SMT = senior management team

The recommended reading is set out in Exhibit I.4.

Why Owners of My Previous Editions Should Buy the Fourth Edition

When I wrote the first edition, I deliberately cocooned myself from outside influences other than my experiences and the KPI manual.[25] Since 2007 I have been an avid reader of performance management and measurement literature and have met thousands of people through my keynote addresses and workshops. This additional knowledge has combined to produce this fourth edition.

With my advancing years has come, I hope, some wisdom. In writing this edition I have experienced a number of Aha! moments that I hope will add some extra clarity. The layout and structure of the chapters has gone through a substantial upgrade.

The book has been improved by:

- Simplifying and refining the Winning KPI process into three concise stages
- Reorganizing chapters to make the book easy to use and removing duplication
- Refining the "Leading and selling the change" process by incorporating more reference to the psychology of change resistance
- A list of dysfunctional measures to avoid

- A new chapter on the characteristics of meaningful measures
- Incorporating new methods I have used in more recent KPI implementations
- Developing new diagrams, templates, and exercises to assist the KPI team with the implementation
- An improved performance measures database

Since the last edition I have invested a large amount of time to advance the winning KPI methodology. It is available to you for a small investment of money and a large investment of your time. The new simplified approach is summarized in Exhibit I.5.

Exhibit I.5 A Summary of the New Simplified Approach

Task	Description
1.1 Sell the KPI project to the CEO, the senior management team, and the organization's oracles. (See Chapters 4 and 5.)	The project starts off with a well-practiced elevator pitch, followed by a compelling presentation and then a focus group workshop to get the green light from the organization's oracles.
1.2 Locate an external facilitator to mentor the KPI team. (See Chapter 5.)	An external facilitator will help guide the organization with regard to timings, selection and size of KPI team, and what needs to be abandoned to make room for the KPI project.
1.3 Train a small KPI team. (See Chapter 6.)	The external facilitator helps train a small in-house KPI team and ensures that the KPI team leader has a cluster of mentors supporting them. Working with the organization's oracles, the KPI team develops a blueprint for the implementation that will cover where the KPI project will be piloted.
1.4 Sell the KPI project to all employees to encourage their participation in the two-day performance measures workshops. (See Chapter 4.)	Employees who are to attend the two-day performance measures workshop need to be convinced that it is an important exercise worthy of their participation.

Exhibit I.5 (*Continued*)

Task	Description
2.1 Locate the existing success factors and desired external outcomes from documentation and interviews. (See Chapter 7.)	Determine what your organization's success factors and desired external outcomes are.
2.2 Run the two-day critical success factors workshop to ascertain the critical success factors. (See Chapter 7.)	Map the sphere of influence each success factor has to ascertain to understand which ones have the most significant impact. These are the critical success factors. Present these to all staff.
3.1 Run the two-day performance measures workshops to train all the remaining relevant staff to develop meaningful measures. (See Chapters 8 and 9.)	Select representatives across the organization to attend a two-day workshop to be trained in the methodology, as well as how and why the organization has chosen its CSFs. Attendees will be shown how to design appropriate measures from the CSFs and how to get a mix of past, current, and future measures.
3.2 Refine the measures after the performance measures workshops. (See Chapter 9.)	KPI team will delete duplicated and inferior indicators, remove those measures where the cost of data extraction is greater than the derived benefit, and reword all indicators to improve their understanding.
3.3 Hold a performance measures gallery to weed out dysfunctional and poor measures. (See Chapter 9.)	Hold a "measures gallery" where staff are invited to share their views on the measures that have been displayed on the walls of the project team's room.
3.4 Ask all teams to select their team performance measures from the finalized database of measures. (See Chapter 9.)	Teams select the relevant measures and indicate their selection in the database.

(*continued*)

Exhibit I.5 (*Continued*)

Task	Description
3.5 Find the key result indicators (KRIs) and the key performance indicators (KPIs). (See Chapter 9.)	Ascertain the eight to twelve KRIs that will be reported to the Board to show how the organization is performing. Ascertain the winning KPIs, ensuring they have the seven characteristics discussed in Chapter 1. Commence the testing of the KPIs in three designated areas.
3.6 Design the reporting framework. (See Chapter 10.)	The intraday, daily, weekly, monthly, and quarterly progress reports are designed utilizing best practice visualization techniques. Utilize existing technology so that the CEO can receive intraday updates on a smart phone and laptop.
3.7 Help facilitate the appropriate use of the selected performance measures by all the teams in the organization. (See Chapter 11.)	For several months, the KPI team will be required to ensure the reporting of measures is prepared on time and correctly and that corrective actions are undertaken where necessary. There will need to be a program to roll out KPI training to existing and new staff.
3.8 Refine CSFs and associated measures after one year of use. (See Chapter 11.)	A review should be undertaken to assess what modifications, if any, are needed to the existing CSFs and measures.

PDF Toolkit

With all my books there is a heavy focus on implementation. The purpose of this book is to prepare the route forward for the KPI team, to second-guess the barriers the finance team will need to cross and set out the major tasks they will need to undertake. Naturally, each implementation will reflect the organization's culture, future-ready status, and the level of commitment from the CEO, the in-house KPI team, and the organization's staff.

The PDF toolkit is to be read and used in conjunction with *Key Performance Indicators: Developing, Implementing, and Using Winning*

KPIs (fourth edition). The location of the templates is indicated in the relevant chapters with this icon:

PDF DOWNLOAD

To support your implementing the strategies and best practices in this book, the following electronic media are available:

- Webcasts and recorded presentations (see www.davidparmenter.com/webcasts). Some of these are free to everyone, and some are accessed via a third party for a fee.
- A PDF download of the checklists, draft agendas, questionnaires, and worksheets referred to in the chapters are available from kpi.davidparmenter.com/fourthedition. The website will refer to a word from a specific page in this book that you need to use as a password to access these for free.
- The electronic versions of all the forms, instructions, templates, and most of the report formats featured in the book can be purchased from www.davidparmenter.com.
- For small to medium-sized enterprises (SMEs) I have developed two special toolkits consisting of electronic versions of all the forms, instructions, templates, and most of the report formats. One tailored to suit SMEs with 100–250 full-time employees (FTEs) and one for SMEs with less than 100 FTEs. These toolkits are available from kpi.davidparmenter.com/fourthedition.

For example, the PDF includes the following to support this introduction:

- Overview of Toyota's 14 management principles
- Overview of the advice from paradigm shifters such as Peter Drucker, Jim Collins, Jack Welch, Tom Peters, Gary Hamel, Jeremy Hope relevant to a KPI project
- "Getting the Right Consultants on the Bus" by David Parmenter, Finance Management Faculty, ICAEW, December 2013

Notes

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