Key Performance Indicators

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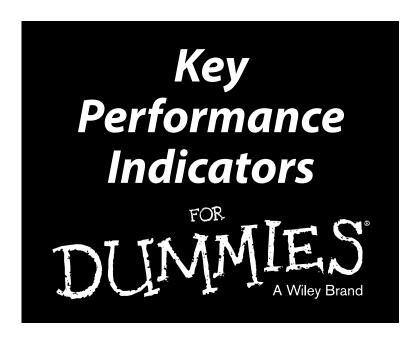- Videos
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Contents at a Glance

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Introduction

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*I*f you were to eavesdrop on just about any management or executive meeting, strategy session or performance review in any business you would hear the term 'KPI' mentioned many times in many different contexts. Most people in those discussions would know that the acronym stands for Key Performance Indicators but if you pressed each person to explain what a KPI actually is, it's likely that you would hear many different definitions.

Business is challenging, especially during difficult economic times. It is also extremely competitive and our customers are becoming increasingly discerning. As a result business leaders and senior executives are all looking to improve performance, minimise errors and seek out new and novel ways to gain the edge over their competition. KPIs – when properly understood and used effectively provide a powerful tool in achieving just that.

Key Performance Indicators for Dummies was written as the definitive guide to KPIs for anyone wishing to separate the rhetoric and flavour-of-the-month-management fad approach from the genuinely useful information. Whilst coving the relevant theory this book is focused squarely on practical solutions to persistent business problems that KPIs can and do solve.

KPIs are a ubiquitous in modern business. They are everywhere – common almost. And yet businesses that are using KPIs correctly and effectively are not common. Knowing about KPIs and understanding their relevance is of course important and we'll explore these essential topics in this book. But, when push comes to shove KPIs are only really useful if you identify the right ones to measure for *your* business and only measure those ones. They will only deliver mission critical data if you then use the KPIs and analyse what they tell you on a regular basis to inform and illuminate your decision making.

This book is therefore specifically designed to ensure that you design, implement and use KPIs correctly for the maximum impact with the minimum fuss. When used properly KPIs can become the compass that can guide you through even the choppiest of corporate waters leading your business to even greater success and prosperity.

About This Book

Key Performance Indicators for Dummies is your essential guide, or road map to effective KPIs and their successful implementation. It is jammed full of practical information, ideas, suggestions, tips, checklists, sample diagrams and figures designed to help anyone who wants to get the best out of KPIs. And that is true regardless of the type of business or industry you are in. KPIs are relevant to all businesses, in all industries as well as government departments and not for profit organisations.

The information contained in this book is deliberately accessible and covers everything you need to know about KPIs from the basics to more sophisticated insights that could further improve and fine tune existing KPI initiatives. As a result this book is essential reading whether you are new to business, in your first management role or a seasoned professional seeking some additional nuggets of wisdom to help squeeze just a little more value out of KPIs. If you are already familiar with KPIs this book will shine some light on the common problems or mistakes people make so you can rectify any errors that may be impairing your results. Re-inventing the wheel is time consuming and costly – learn from other people's mistakes instead and make your KPIs matter right now. Ensure that they are the useful, insight and powerful business tools they were designed to be right from the start.

Consider this book your KPI reference guide and come back to it often. Try out the ideas and band and shape the advice to suit your situation in your business. Make it your own and allow KPIs to revolutionise your performance, inform your decision making and drive your strategy.

In order to make reading this book as easy as possible certain things are treated consistently:

- ✔ All Web addresses appear in monofont
- ✔ New terms appear in italics and are closely followed by an easy-to-understand definition.
- ✔ Bold text indicates keywords in bulleted lists or highlights the action parts of numbered steps.

If you decide to visit a Website listed in the book then you just need to copy the Web addresses exactly as it appears in the book. This is true even if the address falls between two pages – we will not have inserted any extra characters (such as hyphens) into the text.

Foolish Assumptions

In order to write a book you need to think about the audience. Who is most likely to read this book and once you know that you need to speak to that audience. For this book I've assumed that you are a manger, senior executive or leader within a business, government department or not-for-profit organisation seeking to better understand and utilise KPIs and improve performance. And I've also assumed that you are in a position to make changes or at least table changes within your organisation so that you can actually action what you read.

Icons Used in This Book

No one likes huge blocks of daunting text! These little icons are used to break up the text so that it's easier and more enjoyable to read. They also flag important information and help you find that information again when you come back to the book.

These indicate expert advice or suggestions to fast track success. They are intended to help save time, effort, money or brain cells as you implement KPIs into your business.

This icon flags critical material that you should store away in your memory for later use. But don't worry – they are usually very short.

As the name would suggest this icon flags potential pitfalls that you need to avoid as you become more and more familiar with KPIs.

The quickest, easiest and often most enjoyable way to really 'get' something is to read a true story, case study or real world example of the theory in practice. This icon flags those stories so you can learn quickly – often from others who have already walked your path.

Beyond the Book

In addition to the material in the print or e-book you're reading right now, this product also comes with some access-anywhere goodies on the Web. Check out the free Cheat Sheet at www.dummies.com/cheatsheet/kpis for some helpful key checklists.

Furthermore, check out the website of the Advanced Performance Institute, which I founded and head up. There you will find many relevant case studies, white papers and reading material on KPIs and performance management: `www.ap-institute.com`.

Where to Go from Here

That's entirely up to you. You can read this book in order from Chapter 1 to Chapter 21, but you don't have to. So where you start reading will depend on how familiar and comfortable you are with KPIs already.

If you are new to KPIs, or are interested in or charged with designing a KPI agenda for your business, or changing the way KPIs are measured in your business then start at the beginning. Otherwise use the table of contents to find what you are most interested in and jump straight to that section. Whatever reading approach you take you will find a treasure trove of information that will allow you to unlock the power of KPIs for your business.

Part I

Getting Started with Key Performance Indicators

getting started

with

KPIs

In this part . . .

- ✔ Understand how everything in your business can be measured.

- ✔ Get to grips with what KPIs are and how you can benefit from using them.

- ✔ Become aware of the importance of evidence-based decision making.

- ✔ Learn to use KPIs to enact and enhance your business strategy.

Chapter 1

Introducing Key Performance Indicators (KPIs)

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*S*o what the heck are Key Performance Indicators (KPIs) anyway?

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

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

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

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

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

- ✔ **I**dentify everything that is easy to measure and count
- ✔ **C**ollect and report the data on everything that is easy to measure and count
- ✔ **E**nd up scratching your head thinking, 'What on earth does this all mean and what are we going to do with all this performance data?'

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

Why Every Company Needs KPIs

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

The Fishing Analogy

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

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

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

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

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

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

The Datafication of our World

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

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

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

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

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

KPIs as vital decision support tools

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

Using KPIs to answer your most critical business questions

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

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

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

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

Using KPIs to learn and improve performance

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

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

Using KPIs to report externally and demonstrate compliance

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

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

Using KPIs to focus effort and monitor output

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

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

Making KPIs Work in Your Business

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

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

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

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

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

Create a KPI culture

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

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

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

Decide on the right KPI framework

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

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

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

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

Develop the right KPIs

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

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

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

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

Analyse and report

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

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

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

Assessing Your Financial KPIs

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

Revenue and profit

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

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

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