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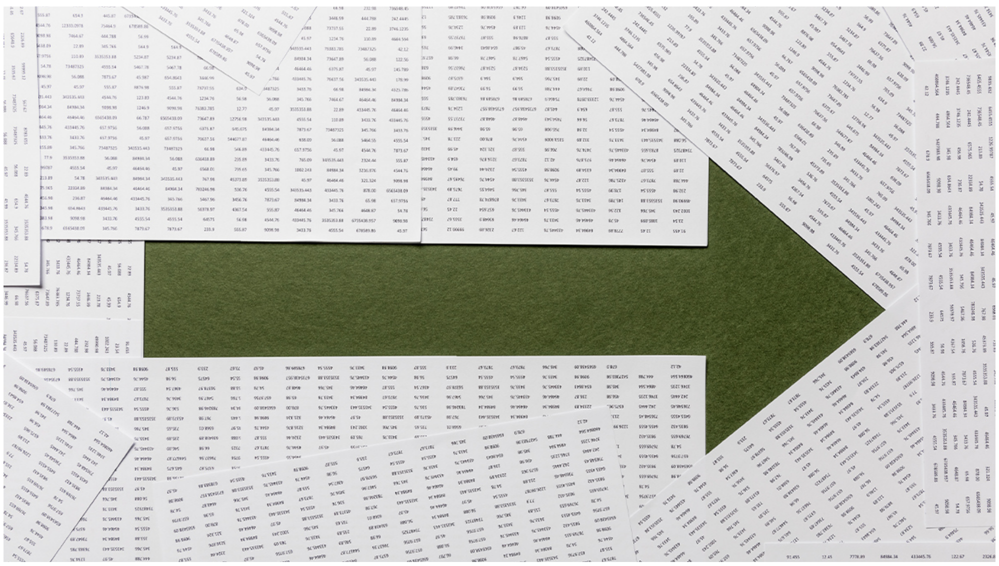

KPIs Aren't Just About Assessing Past Performance

by Graham Kenny

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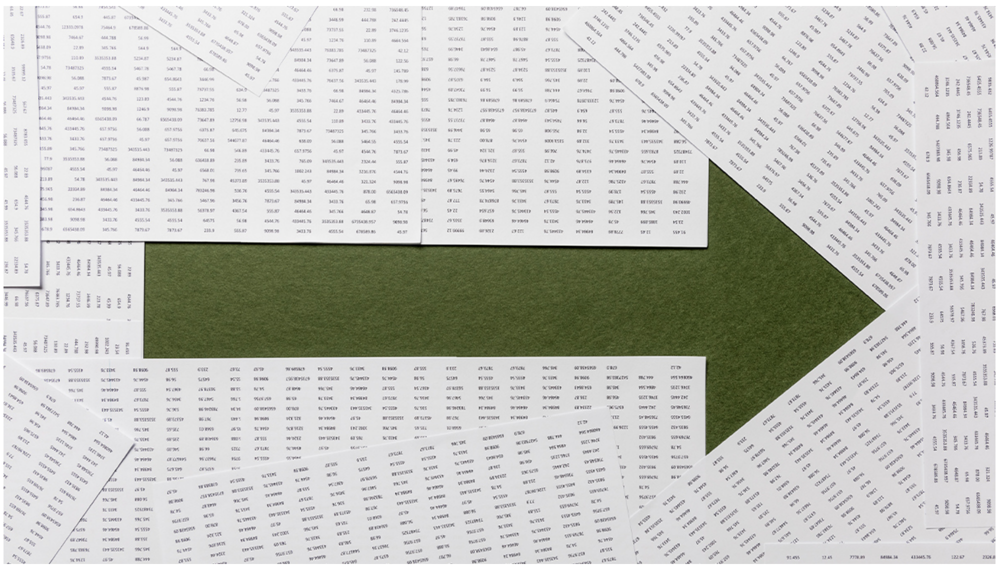

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Executive teams are very familiar with using KPIs (key performance indicators) to track recent corporate success. These measures are used like school reports, providing feedback on how things went over the past year. Employed this way, KPIs are backward looking and, as one executive described them to me, “just a bunch of numbers.”

But a properly constructed bunch of numbers provides much more than a rear view of performance. These indicators can become a powerful and nuanced tool to predict changes around the corner for your business.

The secret? It's all in mapping and measurement intervals. Let me explain.

Start with Success

The end goal for any business is survival and growth. This requires the support of many stakeholders with those at the end of the queue being the business owners or investors. I say "end of the queue" because all the effects taking place inside and outside a business determine whether the business shows a return on investment.

What you get is a chain of predictive numbers. If a business keeps its employees happy, you can predict that this will flow on to an effective relationship with suppliers. And then, effective employee and supplier relationships together drive great outcomes for customers. Happy employees produce happy customers. And effective relationships with these three stakeholders drives results for, you guessed it, investors – at the end of the queue, as I say.

Tracking Relationships

The full predictive ability of KPIs is unleashed by first tracking relationships.

One of my clients is a business owned by a holding company. It makes "grinding media" – large metal balls and rollers used in the mining industry. The grinding media are placed into barrels which rotate, thus crushing rock into smaller pieces. As the company's strategy consultant, I helped the executive team to build a predictive set of KPIs.

We started by identifying the company's key stakeholders. There were four – employees, suppliers, customers, and the holding company.

The next step involved reviewing the relationship that each key stakeholder group had with the company. It's two-sided, of course – the company wanted something from its stakeholders in exchange for providing something they wanted. In the case of employees, for example, the company wanted staff to stay with the organization, so KPIs were developed around employee turnover. For their part, employees wanted to be paid well, so a map was developed which benchmarked the company's reward system against industry standards.

In all, seven KPIs were developed for the employee relationship, including safety measures and employment conditions. Eight KPIs were designed for the customer relationship. Five of these concerned what the company wanted from customers – measured as revenue, gross margin, and market share – and three were concerned with what customers wanted from the company. These included KPIs around product quality and customer service.

You can see how this would continue in the case of suppliers and the holding company. In all the scorecard contained 21 KPIs.

Mapping KPIs

To fully appreciate how one KPI affects another it's necessary to map the relationship between KPIs themselves.

This requires nothing more than a whiteboard or flipchart and a pen. We started by nominating the end goal on the right-hand side. The goal was for the holding company to invest funds in its grinding subsidiary. Working from right to left, we looked at what would create this outcome. It was driven by three KPIs – profit, return on capital employed and net cashflow.

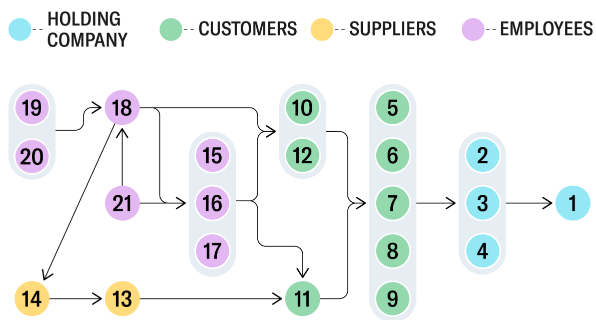
These in turn were driven by the previously mentioned metrics outlining what the company wanted from its customers – revenue, gross margin, and market share. These were driven by the KPIs for what customers wanted from the company (product quality and customer service), which in turn were driven by KPIs for suppliers and employees.

On completion this cause-and-effect diagram, shown in the graphic below, clearly demonstrated how causes to the left of the diagram produced effects to the right. It also clearly demonstrated how poor employee relations fed through the model to finally affect, up or down, investment from the holding company.

KPI Map and Scorecard

To fully appreciate how one key performance indicator affects another it's necessary to map the relationship between KPIs themselves. On completion this cause-and-effect map clearly demonstrates how causes on the left of the diagram produce effects on the right. It also clearly shows how poor employee relations feed through the model to ultimately affect investment from the holding company. The example shown below is for a company that manufactures grinding media.

Key stakeholders and performance indicators



1	Funds, annual capital expenditure
2	Profit
3	Return on capital employed
4	Net cash flow to profit
5	Revenue, grinding media customers
6	Revenue, forge customers
7	Gross margin, grinding media customers
8	Gross margin, forge customers
9	Market share, tonnes of grinding media
10	Customer complaints regarding product quality
11	On-time deliveries
12	Rating on customer satisfaction index
13	Deliveries made in full, on time, and within specification
14	Volume variation forecast compared to actual
15	Lost time injury frequency rate
16	Incident/accident reports raised
17	Hazard reports raised
18	Employee turnover
19	Employee remuneration packages at or above external benchmark
20	Overtime hours per employee
21	Noncompliance incidents on health and safety issues

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Setting Measurement Intervals

The process demonstrates how a scorecard of KPIs when viewed in two dimensions as a map, rather than in one dimension as a table, provides a predictive model for performance. The final step is making sure that you have the KPI measurement intervals you need.

A measurement interval is the time between readings on a KPI. If, for example, I only assess employee satisfaction via an annual survey, it's not going to be useful as a predictor of monthly employee turnover results. The information is gathered far too late to act as a predictor. You would need at least monthly employee satisfaction results to be of any use in predicting if employees were planning to quit.

So, the next step for me and the company's executive team was to work our way from right to left assigning measurement intervals. The holding company decided how much to invest annually. But this was driven by monthly readings on profit, return on capital employed and net cashflow.

Now this is an important point. Once the team and I set these KPIs at monthly, we realized that *all* readings to the left in the cause-and-effect diagram that fed into these had to be at least monthly to be useful. They could be shorter, as in weekly, but not longer.

Predicting Your Corporate Future

Many executive teams see producing a scorecard of KPIs as a dry, dull exercise. Viewed as generating a "bunch of numbers" it most surely is. What they don't appreciate are the dynamics which exist within any set of KPIs.

You expose this by firstly identifying your business's key stakeholders and then by tracking how one group impacts another. By going deeper and combining the cause-and-effect between KPIs with measurement intervals, you have a golden opportunity to put your finger on the pulse of your organization's performance.

Your scorecard thus becomes a dynamic representation of how your business will prosper.

Graham Kenny, CEO of KMS Education and Strategic Factors, is a recognized expert in strategy and performance measurement who helps managers, executives, and boards create successful organizations in the private, public, and not-for-profit sectors. He has been a professor of management in universities in the U.S., and Canada. You can connect to or follow him on LinkedIn.