Delos

Looking at your business
another way

Conundrum: How many Key Performance Indicators are really key?

Performance measurement and KPIs have been the subject of much writing and analysis; we authored one of the first specific Performance Measures courses back in the early 90's, and still deliver an evolved version of this today.

Leadership of a business requires that we set out our strategy, and then review our ability to achieve this strategy through the measurement of our performance. Obvious!

But since then, the fever and efforts around performance measurement has created so much confusion over the very reasons to identify and track indications of success, to the point that some organisations are spending an inordinate amount of resources generating hundreds of data points and piles of reports that simply are not driving the results they desire. They achieve paralysis through analysis.

They find themselves faced by a conundrum. They know that performance measurement is worthwhile, but struggle to find the most effective and efficient framework within which to measure.

That is why the Delos Partnership have developed a core set of measures which will provide a leader with the means to ensure you measure and control the fundamentals of your business, and hence solve the conundrum of what should be Key Performance Indicators.

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Why measure performance?

The conventional wisdom, which I certainly agree with, claims “what isn’t measured, can’t be controlled and what can’t be controlled, can’t be improved”. This certainly speaks to a fundamental goal of measurement, which is to drive continuous improvement. The other simple part of this idea is that “what gets measured always improves”. Human beings respond to being told whether they are doing well or badly.

This article was written during the Christmas period. Many people come out the other side of the festive period recognising they are overweight. There is a rash, now, of devices relating to keeping you fit – from devices that sit on your wrist, monitoring your sleep, your calorie intake, the number of steps you take and so on. You can pay £250 or more, or get a free app on your mobile phone. But even these are showing the symptoms of the problem businesses face – there are dozens of different measurements that are being made all the time. They are complex electronic devices. There is also serious doubt whether they really accurately measure what they purport to measure!

But losing weight ultimately happens if you consume fewer calories, and take more exercise. So the two measures which tell you if you are doing this are key. But the number of stairs you climb or the number of hours you sleep are not key measures (although they might contribute).

In the final analysis, performance measurement is only successful if it actually changes behaviour so that the person or persons who are measured operate in a different way to the way that they would otherwise behave. So you can measure how much exercise you take, but unless you go for a twenty minute walk each day, or go for a one mile run, you will not achieve the objective of losing weight.

This is the challenge of business. Clearly, the way somebody’s performance is measured will drive their behaviour, and that behaviour drives improvement. It is well documented that if somebody is measured irrationally, they will behave irrationally. Actually, it is a general truth, however, that human beings actually work out rationally what is good for themselves, and even if this is bad for the organisation, will pursue what is best for them.

For example, if you pay sales people or sales directors in a business a bonus on the basis of setting them a target, and rewarding them if they exceed that target in terms of sales, then do not be surprised when they ‘sandbag’ the forecast by consciously setting a low target and then heroically overshooting it. This is not good for the organisation when the supply side of the business – having planned on the basis of the forecast – have to react through firefighting, getting extra raw materials in at horrendous cost to the business etc.

Equally, if we set a target for the manufacturing side based on ‘Operating Equipment Effectiveness’ which implies making the same product every day, do not be surprised if the operational side of the business wants to make the same product every day rather than respond to the customer with what they want and when they want it.

Thus in business we require clarity on our overall goals, and then set performance measures which will drive the right behaviour to achieve those goals. If customers want flexibility – which they do – do not measure something which drives against this.

It is psychologically damaging and leads to 'displacement activity'! People do something odd, when confused by having to achieve two apparently contradictory activities. The result is sometimes no activity. That is why some people have said "If you measure me differently, and do not explain to me what I am supposed to do, then no-one will know how I will behave – not even me!"

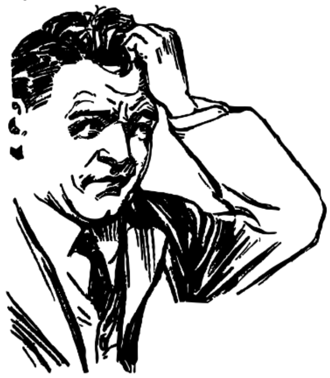


Figure 1 Displacement head scratching occurs when humans do not know which of two options to choose!

We measure performance to drive improvement towards achieving our corporate goals – and correctly collectively drive all of the people towards the same common goal, and set of objectives.

Where do measures fit with the vision?

A key part of the leadership activity of any business is to establish the long-term vision, mission and strategy for the organisation. Simply put, the vision is the place that the business will be in in 10, 20 and 50 years' time. The mission relates to the fundamental problems the business will solve in its quest to survive. The strategy is a set of 'hows' that are built around strengths, weaknesses, opportunities and threats to the business from the political and economic landscape, which determines the operating framework for the business. This means creating a marketing strategy, sales strategy, manufacturing strategy, IT strategy, financial strategy and talent development strategy to deliver the vision.

This should lead to the creation and agreement of a set of strategic objectives and supporting actions to achieve the vision.

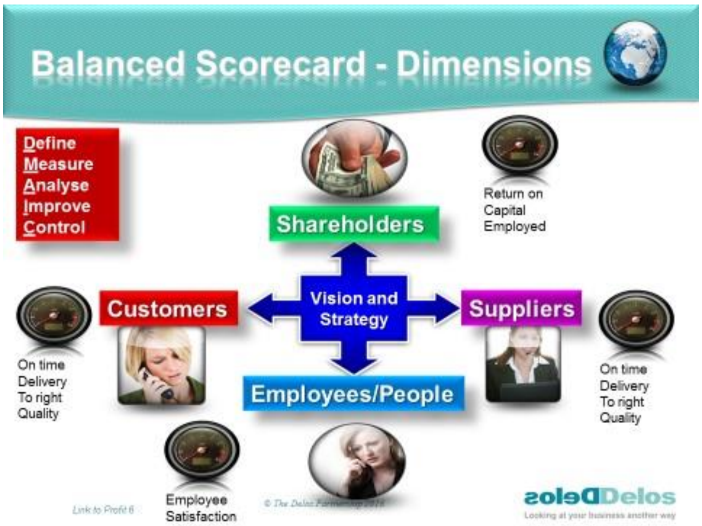
The business should determine the critical success factors that support the achievement of the vision, and then the Key Performance Indicators that will ensure that the various functions are driven towards achievement of the objectives. We summarise all of this in the following diagram which illustrates the clear 'line of sight' between the Performance Measures and the vision.

The flow implied by this pyramid requires significant clarity and focus from leaders in the strategic planning process. Often, leadership teams get very excited about the top four levels of the pyramid (the vision, mission, strategy and critical success factors), leaving little energy or time for the part that actually drives delivery - the identification, cascade and production of meaningful measures, each of which take significant resources and require capability in communication and information technology.

Figure 2 : The model for Strategy Execution

What should be measured?

Another key principle behind performance measurement is that the measures that are developed will form a 'balanced scorecard' of financial and non-financial metrics. This concept came from Kaplan and Norton in their works on this area. This work in principle illustrated that any business has four dimensions on which it operates – and those four dimensions require measures to demonstrate that the business is satisfying those four areas. The following chart graphically illustrates:



Often people see these measures and dimensions as conflicting. Thus a shareholder wants a high return on capital. This in turn means higher prices. This is not what customers want. It also means lower costs, which suppliers do not want. Employee satisfaction could be driven by fewer hours and higher wages, which conflicts with costs and profits. Delivery on time in full to customer requirement can lead to higher costs. The truth is they do need to be balanced.

Figure 3 : The Balanced Scorecard approach to measures

However, we see that there is in this a key distinction to be made between output and input or operational measures. Output measures, including financial measures, tell us how well we have **done** (our results), while operational or input measures tell us how well we are **doing** with respect to the actions that we know will deliver our desired results.

Given that the purpose of measurement is to truly drive improvement, then clearly more improvement can be achieved through increased focus upon 'how we are doing' rather than 'how we have done'. This is why a balance of financial and non-financial measures is so critical to continuous improvement.

To use the post-Christmas losing weight analogy, getting on the scales and seeing that our weight leads us to appearing to be obese according to a Body Mass Index chart is a measure of the result of all of our activities (or lack of them!). The measure of how many calories we have eaten or the amount of exercise we have taken are input or operational measures which are key areas of focus if we are going to change our results.

Making the measures relevant

While all of that makes sense, a balanced scorecard often becomes an overwhelming laundry list of dozens and dozens of unorganised and seemingly unrelated measures that challenge the K in KPI (<u>Key</u> Performance Indicators).

Any individual, team or function can only focus upon a limited number of measures. Conventional wisdom sets the limit somewhere between eight and twelve - the so-called 'measures on a page'.

While this adage has some truth to it, people can handle more when they see how the measures for which they are accountable relate to business performance. In fact, they *need* more measures in order to link their operational work to the big picture of strategy and company-wide results. It's not unreasonable to expect that everybody who works in business relates to performance being financially driven.

Where many companies fall down is neglecting to illustrate the link between their work and overall results in an understandable way flowing from a matrix like Figure 4 overleaf. Thus in this list of measures, we have illustrated the conceptual link between the key performance measures (down the left hand side) and the results (along the top). So, if your company wants to reduce inventory, go down the inventory column, and you will see all the measures which will help you reduce inventory.

Overall the improvement in results will improve the Return on Capital Employed, which is what the shareholders basically require from the leadership of the business.

We have selected seven measures which together will support improved customer service, and will drive continuous improvement activity.

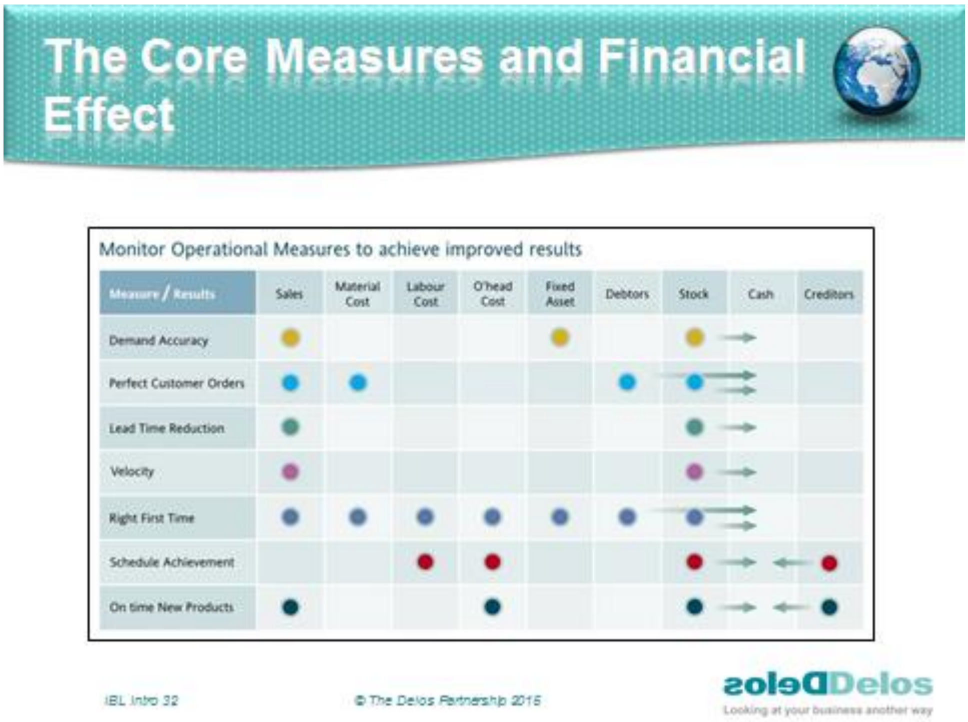


Figure 3 – The core few performance measures

The form of association and visibility illustrated in Figure 4 should also be widely communicated to all employees throughout the business. Performance measures that are not visible will not change anybody's behaviour.

Visibility should be simple, graphic in nature and omnipresent through a variety of media such as intranet pages, noticeboards, video screens, briefing notes, screensavers and, most importantly, verbal communication. Leaders should talk openly and often about the measures, how they add up to overall results, and how teams and individuals are doing.

Mechanisms and practices like these ensure that these KPIs are not considered in isolation. They should form the base of a 'line of sight' to the business vision and strategy, as captured in Figure 2.

How many measures are too many?

Finally to resolve the conundrum: how many is too many?

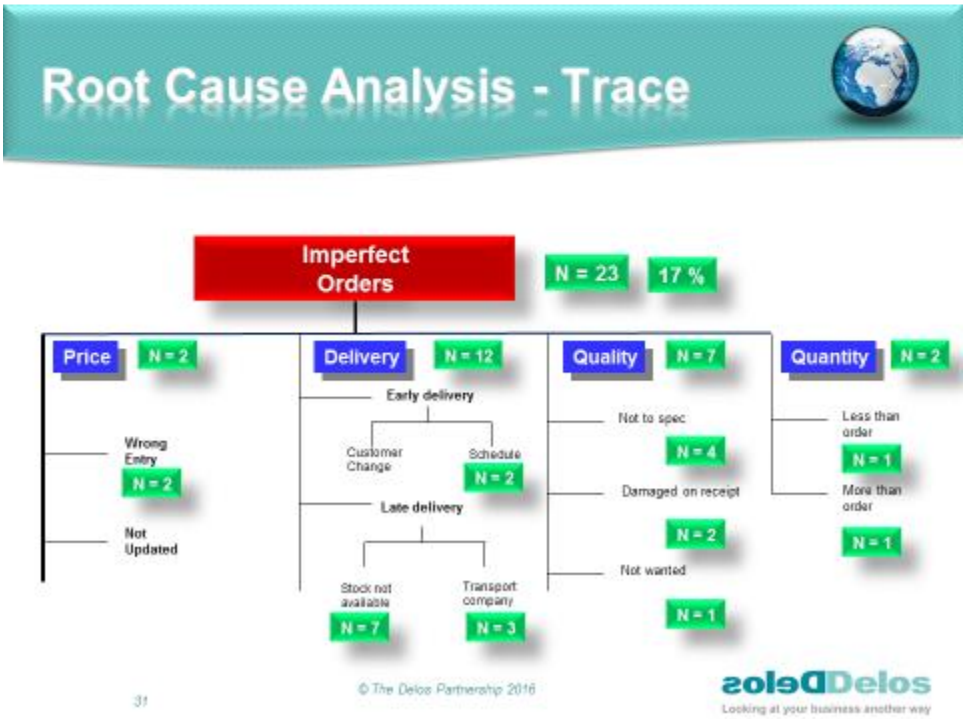
On the face of it the principles described above of having a few measures could be in conflict with the principle of marginal gains which we have previously written about.

Marginal gains is the principle that we should take hundreds or thousands or even tens of thousands of data point measurements, in order to look for fractional improvements which will contribute to significant overall performance improvement.

The theory of marginal gains was pioneered by Sir Dave Brailsford in order to help the British cycling teams achieve unprecedented success over the past few years. The approach deconstructs performance into all of its component parts and isolates the specific impact on performance of each of those individual parts.

Other sports such as Formula 1 racing have also adopted very sophisticated approaches to performance measurement. Paddy Lowe, the technical leader of the Mercedes team, said that they used to record data from eight channels, and today it is 16,000. From these they drive another 50,000 channels from that data. Obviously, they are using some sophisticated software. The marginal gains theory has also been adopted by economists trying to solve third world poverty.

In fact, marginal gains theory fits perfectly with the root cause analysis element of the overall performance measure structure. You can take anyone of the measures illustrated above and delayer it as the following diagram shows, by way of an example, for failures on 'Perfect Orders' by analysis of the root causes of failure to deliver each order:



This 'hierarchy of measures' allows us to dig deep into the data.

But this does not negate the principle that for the Senior Team to know if the business is improving, it should focus on the **seven** key measures which the Delos Partnership have identified as being the 'vital few'.

So at the end of the day there is no 'performance measurement conundrum' of how many measures are the right number, and should you use lots of measures to give you the right picture.

You should and will get a lot out of focussing on the key few we have derived through our experience. You should then create a structure below that which enables further detailed analysis.

If done in an integrated way, with the right focus, systems, process and, importantly, a measurement culture reinforced by communication and leadership, a multitude of measures can fit together to drive any business forward to achieve remarkable performance.

It is key that the Leadership Team sets the vision and strategy, and creates the framework through the 'line of sight' to the detailed measures. In this way employees will contribute to achieving the goals. The measures must be consistent – and bonus/reward structure must be changed to bring this about.

But your company must create its own performance measurement structure, and to do that it must have a clear understanding of the linkages of all parts of the business planning and execution process to the overall goals of the business to understand how to bring about the required leap in improvement in performance. The details of this article are contained in our book "The CEO's guide to Performance Measurement" which is available from our website http://www.delospartnership.com/books-articles/books.html.

Finally, if you are looking at your fitness watch, then work out which are the key measures which relate to your overall goal, and you will see the answer to the Christmas conundrum!