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Understanding and using KPIs

KPI is an acronym of Key Performance Indicator. They are designed in such a way as to give you a snapshot of your business in relation to the goals you have set for it. From it you should be able to see exactly how you are doing against pre-defined criteria be that historical data, goals or competitors.

The first you need to do is the most difficult - decide what it is you want to measure i.e. define your KPIs. They can be virtually anything, but ensure that they are relevant and avoid having too many. When setting out the KPIs for your business, consider what it is you are trying to achieve.

KEY

Identify what tasks or processes are actually KEY to your business success, and the issues that will make a real difference to the success of your business. Start by looking at your financial and management information reporting.

If you have a benchmark you can use for comparison, either industry research or previous personal experience, find the items that are out of step from your expectations and mark them out. Pin point which of these is pushing your business forwards and which is holding it back.

PERFORMANCE

Define a measure that actually affects or is affected by your business PERFORMANCE. Then consider if you change this measure by, say10%, will it actually alter the success of your business? Is it something that you can control or something that is specifically impacting your business, or is it something environmental that affects everyone in your market equally? Can you respond to this or are you better focussing attention elsewhere?

INDICATOR

Ensure it is conveying information to you, and is really an INDICATOR. Are you actually measuring something in a realistic manner? Can you put a numeric value on the measure so you can track progress and change? If you can understand that something is changing, can you understand how that change has come about?

Once you have a list of potential KPIs, you need to step back and make some strategic decisions.

- Which are the candidates that have the biggest impact on your business?
- Which of these can you actually do the most to change?
- How much capacity for change is there within your business?

A heavily regulated, process driven organisation with a workload driven externally, such as an accountancy practice, may have a narrower scope for change than say a wholesale distribution business.

The problem with management by KPI at a strategic level is that if you want to make big changes, you need to put a big percentage of your effort and focus into changing each selected KPI. The bigger the change you want to make, the harder it is likely to be to make that change, the greater the focus you need to place on the KPI selected to measure the effects. And that means selecting just a few.

Here is an example to show the process in action.

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Example

When the new Finance Director (FD) joined the company, engaged in short and long term contracts, it was heading for serious financial trouble. Dwindling cash reserves made the company vulnerable to its bank removing facilities. Rising debtor days was draining cash flow and no matter how hard the sales and marketing teams worked, no matter how fast they grew revenue, profits were falling as was customer satisfaction.

The FD reviewed the company's reporting and decided that it was extensive and comprehensive. He had access to data on just about everything the company did, and the monthly reporting pack for the owners ran to many pages. However, connecting the data to create genuine information was an enormous task, so extracting the knowledge needed to direct the changes the business obviously required was often just educated guesswork, despite the considerable volume of reported items made available to him.

His answer was to select just FOUR KPIs that the entire company would work towards and everything else could be ignored, at least at a strategic level:

- Sales revenue
- Debtor days
- Customer satisfaction
- Cash reserves

Debtor days were high because the company didn't receive payment until its projects actually went live. So a high debtor day figure probably meant there were project over-runs in the system, and possible disconnects between sales, consultancy, product management, support and accounts. There were undeniable disputes between the consultancy approach of one part of the business and the product-focused part stretching back into history.

By recognising that debtor days was the big financial stumbling stone, and that it was high due to a number of factors entirely within the businesses control, the business had a unified focus on what to improve. Provided they kept sales up, reducing debtor days would free-up cash, and probably reduce costs as a bonus, since so much time was being wasted on trying to fix related issues without ever getting to the heart of the problem.

The company therefore swung into action to identify exactly why the over-runs were occurring, and put into place plans and activities to deal with its findings. The result required investment to improve software testing, and changes to the implementation consultancy business and distribution channel. It also meant employing extra resource for the credit control teams.

Debtor days fell as predicted, and by also retaining a focus on sales revenue, cash reserves also rose. Maintaining a fourth focus on customer satisfaction ensured that changes made to fix the problem reflected the issues as customers saw them, meaning that the results would be sustainable because sales, consultancy, product management and support were all working together to ensure the customers were getting what they paid for.

As they started to see a quicker turn-around of their projects, customer satisfaction rapidly started rising, payments started arriving quicker and the company could move on to face the next issue, which meant re-evaluating the KPIs to which the FD would work.

Less is more

The example above shows that it's not how many KPIs that dictate how your business performs, but rather what KPIs you choose. By choosing the right KPIs and committing the whole company to fix one problem, the FD was able to improve the performance of the entire business.

If there had been 10 or 15 KPIs it is quite possible that the issues pushing up debtor days could have remained lost in the mix. Maybe the business might have been turned around by focusing on other things, but it is also possible that the company could have been split into groups dealing with many different aspects of business, some of which conflicted.

Selecting the right KPIs

In your business, ask yourself:

- What are the four things you need to change?
- How will you measure them?
- Is four too many, and if you need more KPIs, is your business structured to be able to act on them without creating conflict?
- What are you going to do to affect change to your KPIs?

Consider using the example again and ask the following questions:

- How do you measure the difference between time sold to clients and money received in your bank account?
- Can you measure how long it takes to get there?
- Can you identify the things that are slowing it down?

In this example, you should think about the journey and transformation taken by the hours of your fee-earners into invoiced hours and invoice value, and then into cash in the bank.

- Is your timesheet system turning records of time into billable hours quickly enough, and if not, why?
- Is your invoice process turning billable hours accurately and quickly into invoice value or is there a time consuming manual element to your billing process?
- How long do your invoices sit around waiting to be sent?
- How long does it take to get those invoices paid?
- Do you need a better credit control and chasing regime?
- What happens when you receive payment?
- Is your cheque handling process up to scratch?
- Can you offer your clients automated electronic payment?

If you were able to take a day out of each of these tasks you would reduce your DSO by several days.

Resource required

When you have selected the issues most critical to improving your business and identified the KPIs that will help monitor and deliver change, you need to identify all the business processes involved in processing the activities you wish to measure. From there you can identify the IT and manual systems that manage those processes and report on their throughput and results.

Once you know all the elements that create or report on the performance measured in your KPIs you can start to work out what you need to do to make improvements:

- Do you have IT deployed to manage the right systems?
- Do you have the right IT systems implemented in the most appropriate way?
- Do you have over or under capacity in any resource and can you redeploy more appropriately or do you need to invest?

REMEMBER

Being able to identify processes and reporting structures like this means that you can plan a series of small, incremental changes that could bring about a significant cumulative improvement, or identify an opportunity for a major step change - maybe a new IT system to integrate several processes, speed throughput, share information across your business and help improve client service responsiveness.

In many instances you will be able to identify these issues and the steps needed to resolve them for yourself. However, sometimes it helps to discuss options with a consultant able to take an objective view without the emotional attachment to the business, and the ability to see the wood from the trees.