KPI s – Not All Are Equal

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"Not everything that counts can be counted and not everything that can be counted counts"

(Albert Einstein)

The proliferation of Key Performance Indicators (KPIs) as common currency in organisational language is often an indication of management's obsession with 'metrics mania'. Organisations are drowning in a measurement swamp.

The issue is that not all KPIs are equal in importance or critical in nature, yet excessive use of the term often implies the converse. As a result, there is deep misunderstanding about their role and how they should be used.

What are KPIs?

KPIs are measures that identify the current and future state of an entity's internal capability and the results it achieves. They are defined within the context of organisational objectives. The process of developing and implementing performance measures should come from the business strategy and cascade through the organisation, ensuring alignment with key business objectives.

Too often however, KPIs are developed in an ad-hoc manner from an operational perspective. They are typically pushed up, thus creating poor alignment with an organisation's strategic objectives.

KPI hierarchy

Some KPIs have a greater impact on the organisation than others. Therefore it is imperative that they are structured to generate greater focus and alignment to achieving organisational objectives.

There are three distinct types of measures that an organisation should use in developing a performance measurement framework:

Key Result Indicators (KRIs)

KRIs are the key outcomes of performance used by senior management to determine the success of their strategies in achieving organisational goals.

KRIs should be the monitored and managed by the CEO and senior management in order to drive business strategies and ultimately achieve organisational objectives. It is important that these measures are reported continuously (e.g. daily) and be a primary focus of everyone within the organisation.

They play a governance role in reporting by communicating the:

- Direction the organisation is heading
- Level of progress on achieving stated outcomes and strategies

They are an outcome (lag) measure that is the result of many actions.

Key Performance Indicators (KPIs)

KPIs are the measures that focus on those aspects of organisational performance that are most critical for the current and future success. KPIs are commonly used through out an organisation at varying levels (e.g. individual, functional, divisional etc.). They are measures that report either a current or future performance state.

They play a key management reporting role by telling:

- The impact on the organisation’s critical success factors
- What action needs to be addressed

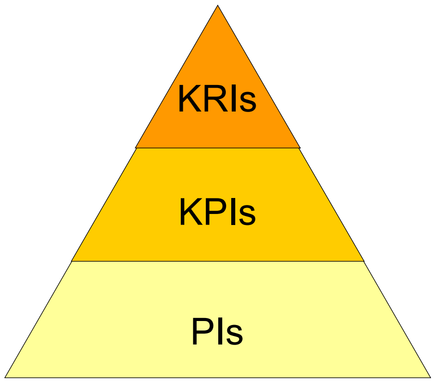
Performance Indicators (PIs)

PIs are detailed operational / housekeeping measures that support and underpin KPIs. PIs are used extensively throughout an organisation in different forms at different levels and linked more to individual and functional activities.

PIs are normally used in large numbers and have a low level of focus.

The Metrics Pyramid

The relationship between the three levels of performance measures are illustrated below:



To put into context how each of the level interrelates, consider the following example:

> *When you catch a train, the foremost issue in your mind is whether it will arrive on time. This is a key measure that rail organisations use to assess their performance against strategic objectives. In such a case the specific measure would be "on time arrival" (e.g. +/- 2 minutes of scheduled time). This is a KRI (and not a KPI as most would believe) because it is the outcome of a number of actions that defines whether a key objective is being achieved. This should be the ongoing focus of senior management.*
>
> *In understanding whether it is or will achieve this key objective, making trains available and having enough qualified staff to operate them are critical strategies that impact on the outcome. Measures for such strategies are classified as KPIs. The degree to which maintenance is done, and the turnaround of cleaning them impacts on the availability of trains. Measures used to assess this level of performance are of an operational / housekeeping nature, called PIs.*

How many is enough?

The challenge for an organisation when developing performance measures is to ensure focus on achieving organisational objectives.

Too often an organisation tries to measure everything (remember the adage if you cannot measure it you cannot manage it) resulting in a possible loss of focus and direction. Conversely, too few measures and organisational alignment can be lost.

The issue comes down to how many measures an organisation should use. The answer lays in right sizing the organisation with a balance of measures both quantity (the number) and quality (the mix) that enhances performance reporting. Various management writers (e.g. Kaplan and Norton, Niven et al) advocate differing numbers. A composite guideline to consider is:

- KRIs – 5 or less
- KPIs – 10 or less
- PIs – Range of 50 to 70

In determining how many measures to use, remember less is more. Too many measures will tend to:

- Dilute focus
- Promote undesirable organisational behaviour
- Blur alignment of strategic objectives
- Create unnecessary reporting and administrative overhead

Need for balance

As a result of the success of the balanced scorecard methodology there has been a marked shift in the focus of KPI reporting with the trend to qualitative (non financial) over traditional quantitative (primarily financial) measures.

To provide a balanced view of the business, it is imperative that measures represent a basket that balances financial with non-financial, internal with external, forwarding looking with lagging indicators to provide a balanced view of the business. The static financial measures that have so long dominated performance measurement are now being seen for what they are: lag indicators recanting history.

The focus on classifying measures as lead or lag indicators is a somewhat simplistic and prescriptive approach to measurement design. KRIs by their design will always be a lag indicator. Such classification is more about characteristics than fundamental purpose. KPIs and PI will always comprise of a mix of past, current and future measures.

The key to promoting better understanding and effective use of performance measures is ensure that measures are developed in a structured process that instils clarity of purpose and articulates the relationships to each other. Reporting and focus should be on quality and not the quantity of measures - less will be more. The structured layering of KRIs, KPIs and PIs is critical to ensure alignment through out the organisation in achieving the desired performance outcome.

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