Improving management reporting using non-financial KPIs

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Knowledge ▪ Experience ▪ Insight

Agenda

1. Performance metrics

2. Issues with Metrics

3. Improving Non-Financial Reporting

4. Developing a Framework

5. Linking Non-Financial KPI reporting to financial outcomes (Case Study)

6. Concluding comments

Different views

"If you can't measure it, you can't control it, and if you can't control it, you can't manage it."

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

(Albert Einstein)

"What you measure is what you get."

"When you can measure what you are speaking about and express it in numbers, you know something about it"

(Lord Kelvin)

1. Performance Metrics

The KPI dilemma

- 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 'measurement swamp'

- The issue is that not all KPIs are equal in importance or critical in nature to an organisation. However the excessive use of the term KPI often implies the converse

- There is deep misunderstanding about their role and how they should be used

- They often drive behaviour that does not achieve the desired outcomes

KPIs – what do we mean?

A set of metrics that focus on those aspects of organisational performance that are most critical to the current and future success of the organisation

- Performance measures or an organisation's <u>Critical Success Factors</u> (CSFs)
- Measure the processes that support the achievement or realisation of CSFs of the organisation
- Whilst CSFs are spelled out in the organisations business plan and they do not change frequently
- The processes and strategies supporting the CSFs can change frequency
- KPIs must satisfy management's need

KPIs should

- Make strategic objectives clear

- Focus on core processes

- Focus on critical variables

- Signal where the performance is headed

- Identify which critical factors warrant attention

- Be used as a basis for reward

Differentiating PIs and KPIs

Performance Indicators

Measures that focus on a certain aspect of performance
- Lower level
- Operational
- Many measures

Key Performance Indicators

Measures that are critical to identifying success
- Higher level
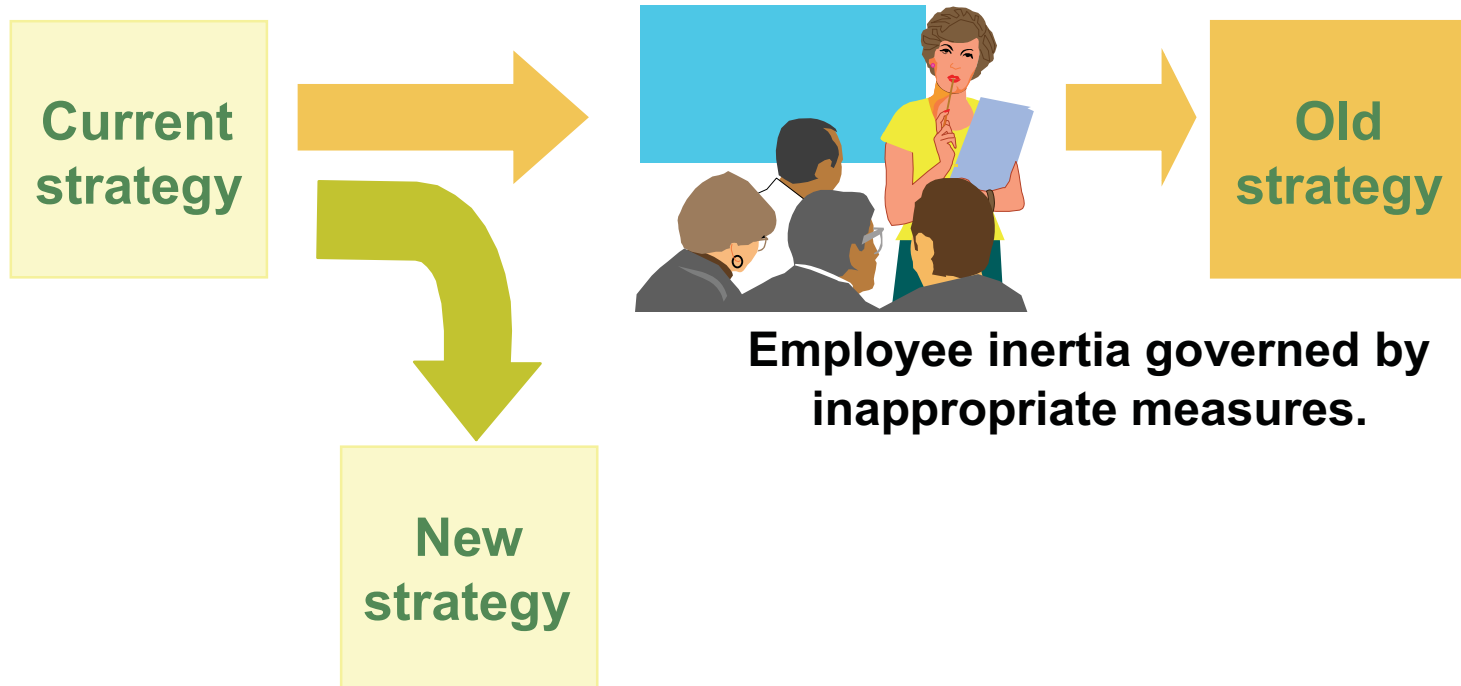- Strategic
- Fewer Measures

Behavioral impact

> **As soon as measures are used as means of control, the people being measured begin to manage the measures rather than the performance**

What and how you measure determine people's behaviour

- **Change measures – change behaviour** (good or bad)

Performance Gap

When executives are surveyed about their frustrations, it's common that they can not get their organisation to execute to shifts in their strategy.

Current strategy

New strategy

Old strategy

Employee inertia governed by inappropriate measures.

Beware!

FALSE ALARMS

- Focusing on areas that do little to improve or have good consequences for the organisation
  - (Typically associated with cost-based measurements)

GAPS

- Failing to use the right measures, resulting in something important being neglected
  - (Often associated with non-financial measures)

Effective KPIs

✓ Non-financial

✓ Measured frequently

✓ Actioned by Senior Management

✓ Linkage of metric understanding to corrective action required

✓ Aligns responsibility to individual/team

✓ Impacts on the critical success factors

✓ Impacts on other performance measures

Effective KPIs - 2

- ✓ Supportive and consistent with an organisations:
  - ✓ Goals/ actions/ people& culture / key success factors

- ✓ Strategically relevant

- ✓ Ease of implementation – not to complex

- ✓ Driven by the customer/user

- ✓ Appropriate to the organisation level and promotes co-operation both horizontally and vertically throughout the organisation

- ✓ Appropriate to the external environment

Effective KPIs - 3

✓ Realistic

✓ Directed to factors that matter & make a difference

✓ Linked to activity so a clear relationship exists between cause and effect

✓ Focussed more on managing resources and inputs, not simply costs

✓ Committed to providing action oriented feedback

✓ Supportive of individual and organisational learning

✓ Promotes continuous and perpetual improvement

2. Issues with Metrics

Problems

- Too much data

- Measures are short-term focused

- Lack of detail

- Poor or no alignment

- Drive the wrong performance

- Behaviour vs. accomplishment

- Encourage competition – discourages team work

- Isolating KPIs leads to a lack of focus and direction

Identifying appropriate KPIs

- When you put a **$** sign on a measure, you have already converted it into a result indicator

  - e.g. sales are the result of upstream activities to generate the sale

- Non-financial indicators should be monitored 24/7 or weekly at the minimum

- Lead vs. Lag indicators – clouds the issue

Dumb KPIs

- Not improvement / actioned oriented

- Non-aligned with strategy

- Focus on the past performance

- Functional focus

- Static – does not change in alignment with business dynamics

Dumb KPIs - 2

- Quantitative in nature

- Isolated / silo based

- Control focus

- Poor communicators

Case study – 'chicken efficiency'

Background

- Fast food chicken franchise chain

- Waste % factor key to store profitability

Objective

- KPI that promotes and rewards minimal waste % to improve profitability

Results

- Wastage %

- Sales

Profitability reduced

Smart KPIs

- Integrate financial & non-financial measures

- Shifts from measuring the what to explaining why simultaneously

- Links measures to a key action driver

- Are powerful behavioral tools

- Qualitative measure more than quantitative

- Becomes indices rather than strict measures

Smart KPIs - 2

- Focus is on improvement of a given area / function etc.

- Monitors progress toward achieving business objectives

- Corrects weaknesses in work or processes

- Recognises early warning signals

- Responds to changing environments

- Has clearly defined accountabilities

Developing relationships

In key to developing SMART KPIs is to develop a relationship between the cause (key action driver) and the effect (result / measure)

$$\frac{\textbf{Effect}}{\textbf{Cause}} \longrightarrow \frac{\textbf{What}}{\textbf{Why}}$$
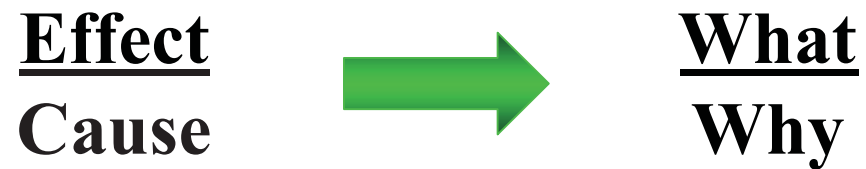
The process is not precise …but gives an explanation into the behaviour as to the cause of the what (result). It links qualitative with quantitative measures (financials & non-financials)

Application

We develop a relationship that the more phone calls we make chasing up debtors the more positive impact it will have on our DSO measure

- Cause = No. of calls made
- Measure = DSO

So our relationship can now be expressed as:

$$\frac{\underline{DSO}}{No.\ of\ calls} = \quad Index\ measure$$

Month 1 – 60 days

Month 2 – 65 days

Month 3 – 70 days

Month 4 – 75 days

Result

Month 1 – .10

Month 2 – .13

Month 3 – .155

Month 4 – .187

Explanation

The measure now tells us that the deteriorating DSO is the result of not making as many calls in the 4th month (approx. 400) as in the 1st month (approx. 600 calls).

The key now is to investigate why this is occurred and do something about it

3. Improving Non-Financial Reporting

What non-financial KPIs to use?

The types of non-financial measures available are only limited by your thinking

- Can be used for any application
- Allows for greater use of qualitative factors
- The critical issue is to use those that are most appropriate to your organisation in ensuring it achieves its strategic objectives
- Fewer is better than more
- Should tell you what action needs to take place
- Develop a KPI data base to control their use
- Measure to learn and improve
- Choose the right measures
- See measurement as patterns, trends and abnormalities
- Provide external reality checks

The right KPIs

- Objective and measurable

- Agreed upon by all parties

- Focused on the most important things

- Related to strategic goals

- Well communicated through out the organisation

- Foster improvement

- Provide comparative and competitive data

- Reward and recognise good performance

- Focus on the long-term viability of the organistaion

Hierarchy of services

Example - Hotel

Service functions

- Guest services
- Sales /Reservations
- Banquets/food/beverages
- Facilities

Service Groupings

- Concierge
- Operator
- Housekeeping
- Guest relations

Individual Services

- Wake-up calls
- Calling assistance
- Messages

Quality Measures

- Guest called on time
- Use of guest name when taking requests

Sales Competition (Retail Race)

4. Developing a Framework

Emerging performance measurement system

Focus / Area	Traditional	Emerging
Scale	Departmental	Enterprise wide
Focus	Historical	Timely
Decisions	Strategic & Tactical	Strategic, Tactical & Operational
Users	Analysts	Everyone
Orientation	Reactive	Proactive
Output	Strategic Analysis	Strategic Action
Process	Open-ended	Closed Loop
Measures	KPIs	Metrics
Views	Generic	Personalised
Visuals	Tables / Charts	Dashboards / Scorecards
Collaboration	Informal	Built-in
Interaction	Pull (ad hoc query)	Push (alerts)
Analysis	Trends	Exceptions
Data	Numeric only	Numeric, Text etc.

BPMS framework

Moorestone.

Strategy

Strategy Plans Strategy Maps	→	Plans, Budgets & Scenarios Projects / Initiatives

| Forecasts & Models Actions | ← | Scorecards Reports / Analysis Alerts |

Execution

Characteristics of an effective measurement system

- Fewer is better – focus on key variables

- Linked to factors needed for success- key business drivers

- Mix of past, present and future

- Focus around the needs of customers, shareholders and other key stakeholders

- Should start at the top and flow down

Characteristics of an effective measurement system - 2

- Multiple indices

- Be flexible – change to reflect organisational environmental shifts

- Targets/goals based on research rather than arbitrary numbers

Key Steps

1. Guiding Documents
   - Mission
   - Vision
   - Values

2. Situational analysis

3. Definition of key success factors and business fundamentals

4. Macro performance measures
   - Measurement categories

5. Measurement plan

6. Data collection instruments and procedures

KPI Linkage

Business Idea → Strategy ← Actions and KPIs

Strategy
↓
Balanced Scorecard ← Main actions & KPIs
↓
Objectives/Measures/Milestones → Target Data
↓
Strategic Program/Actions (cost, benefits, KPI, milestones)
↓
Management Process

Gap Analysis

Rolling Forecasts

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38
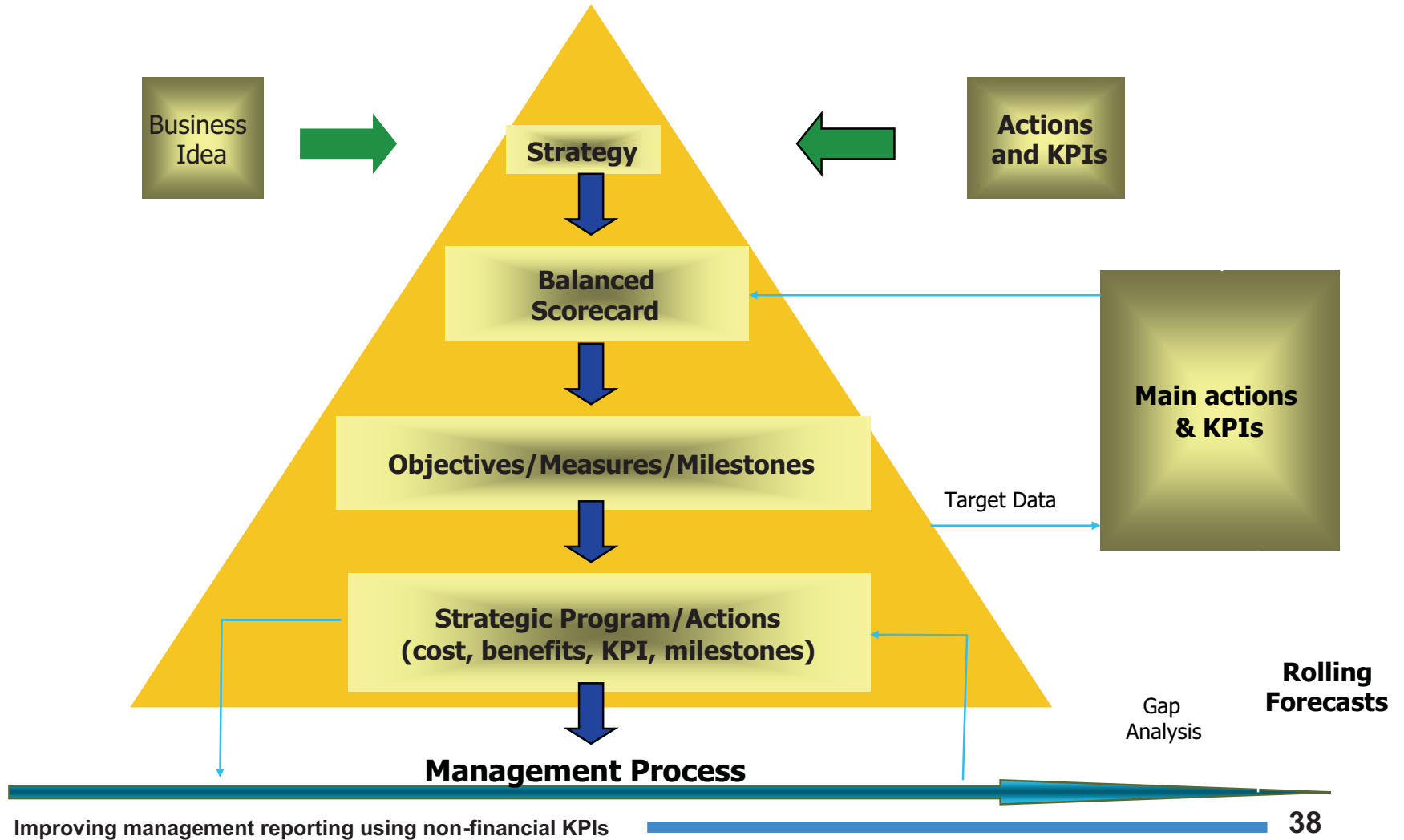
The metrics pyramid

KRIs

KPIs

PIs
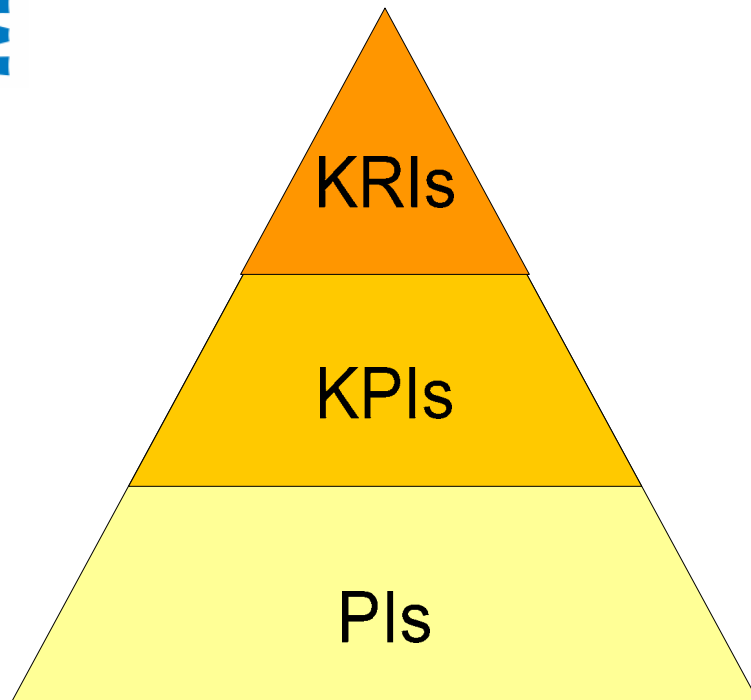
1. ***Key Result Indicators (KRIs)*** – are the key outcomes of performance used by senior management to determine the success of their strategies in achieving organisational goals

2. ***Key Performance Indicators (KPIs)*** – are the measures that focus on those aspects of organisational performance that are most critical for the current and future success. They are commonly used through out an organisation at varying levels (e.g. individual, functional, divisional etc.)

3. ***Performance Indicators (PIs)*** – are detailed operational / housekeeping measures that support and underpin KPIs. Extensively used throughout an organisation in different forms at different levels and linked more to individual and functional activities

How many is enough?

- KRIs – 5 or less

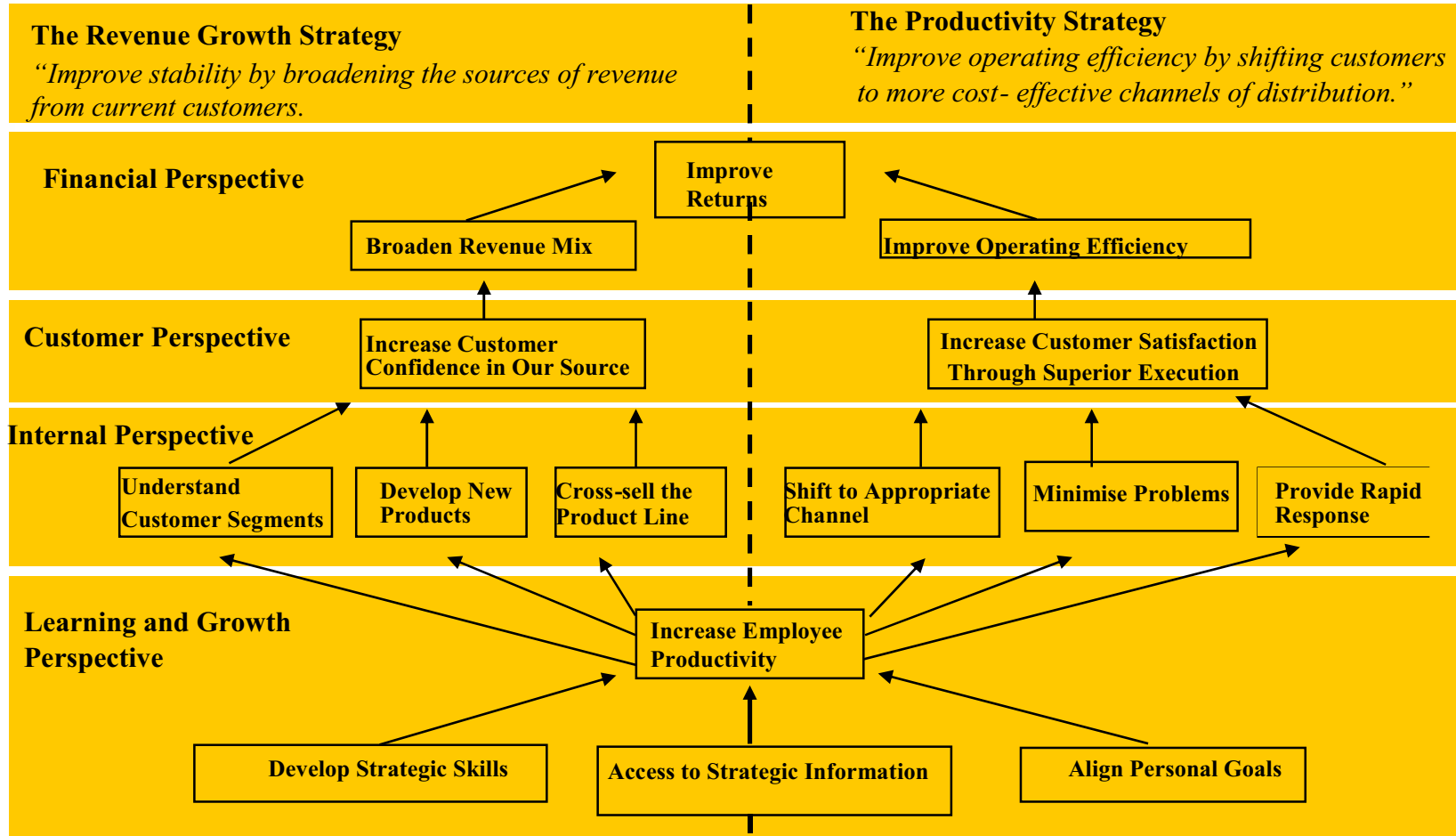- KPIs – 10 or less

- PIs – Range of 50 to 70

How many is enough – 2?

In determining how many measures to use, remember less is more as too many measures will tend to:

- Dilute focus

- Promote undesirable organisational behaviour

- Blur alignment of strategic objectives

- Create unnecessary reporting and administrative overhead

5. Linking Non-Financial KPI Reporting to Financial Outcomes

The financial & non-financial relationship

The Revenue Growth Strategy
"Improve stability by broadening the sources of revenue from current customers.

The Productivity Strategy
"Improve operating efficiency by shifting customers to more cost- effective channels of distribution."

Financial Perspective

Improve Returns

Broaden Revenue Mix

Improve Operating Efficiency

Customer Perspective

Increase Customer Confidence in Our Source

Increase Customer Satisfaction Through Superior Execution

Internal Perspective

Understand Customer Segments

Develop New Products

Cross-sell the Product Line

Shift to Appropriate Channel

Minimise Problems

Provide Rapid Response

Learning and Growth Perspective

Increase Employee Productivity

Develop Strategic Skills

Access to Strategic Information

Align Personal Goals

(Source: Kaplan & Norton : "The Balanced Scorecard")

Case Study

- Details provided on the screen

- Focus: Links KPI reporting to an improvement plan that is quantifiable in $

6. Concluding Comments

Concluding comments

- There is no magical non-financial KPIs – its what's appropriate to organisations in delivering on their strategic objectives

- The key is to have fewer KPIs with greater alignment and linkage to strategic objectives and outcomes

- Effective non-financial KPIs will:
    - Focus on the now and the future
    - Enable people to understand
    - Encourage the right behavior

- KPIs allow people to assess where they are and how their performance might be improved, the real value comes from the action that follows from them

Moorestone.

THANK YOU

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Knowledge ▪ Experience ▪ Insight