KPIs and the Logic of Decision Making

About this white paper

This paper explores how to establish proper (KPIs) Key Performance Indicators and the relationship those numbers must have with corporate goals. Implement these ideas for better business insights and performance measurement.

White Paper

THE TROUBLE WITH KPIS

The problem isn't with using KPIs (Key Performance Indicators) for business performance measurement. The problem is with KPIs themselves. Often KPIs are poorly chosen and misused, producing numbers that no one understands or that aren't very useful. They mostly tell you *what* happened but, rarely *why*.

For KPIs to be valuable they should be actionable metrics that immediately inform how things are progressing and what activities should be taken to improve performance measurement. KPIs should require little or no interpretation. When properly set up, KPIs deliver exceptional insight into how business is performing and what to do to affect change.

We will explore why KPIs so rarely produce the results users expect. But we'll also detail a proven methodology for identifying and using KPIs which improves user acceptance. The process will show the logic of selecting KPIs that align with corporate goals and the benefit that delivers.

As part of this discussion, we'll look at KRIs (Key Results Indicators) and how they differ from KPIs, and why the confusion between the two always creates complications.

KPI ISSUES

Tracking business success is difficult. It's complex to figure out what to measure, so most companies monitor items that seem to be important but actually are not. That may sound ridiculous, but it's true.

According to Dean R. Spitzer, 93% of organizational leaders believe that measurement is important in influencing business outcomes, but only 51% are satisfied with their current systems, and only 15% are very satisfied. That's a terrible gap in expectation to reality.

KPIs are overused but underutilized. Companies often spend months trying to establish effective KPIs to improve business performance measurement, but they are often abandoned shortly after implementation because the numbers being tracked are ill conceived and not suitable, so users quickly lose interest. That's mostly because what's often called a KPI isn't a KPI at all.

KPIs are a great way to help identify how your business is performing, but if they aren't well conceived, you may be relying on faulty values which may cause more harm than good.

KPI DEFINITION

A KPI is a *metric* that informs how your business is doing. Many people confuse measures and metrics, so let's define them:

Measure is a number that is derived from taking a measurement. A measure is the observed value of a number at a point in time. Measures are raw numbers and data points found in data or reports; often in corporate databases, call centers and other data silos. On their own, measures deliver little value.

Metric is a calculated number derived or calculated from measures. Ideally, it should be expressed as a ratio, average, percentage or rate.

For example, 'in-store visitors' is a *measure*, while the 'percentage increase of in-store visitors' is a *metric*. Simply knowing how many visitors we had at a point in time delivers no real insight unless we know how many we had before. The calculation to arrive at the metric does that for us. So by monitoring the metric we better understand how store traffic is changing. That may be very important to know when evaluating how promotional programs are driving customers to stores.

Since there are hundreds or even thousands of measures and metrics produced in our daily corporate lives, KPIs should only focus on the ones that are essential or impactful to business performance measurement. A KPI, as the name implies, measures critical items that are necessary for success. They should monitor actions and events that tell you about performance.

KRI (KEY RESULTS INDICATORS) DEFINITION

KRIs measure the results from your *many* business actions, whereas KPIs track *specific* actions or activities. Don't confuse the two. KPIs don't measure goals; KRIs do.

Unlike KPIs, which measure the precise actions we take to obtain certain results, KRIs report on results of many activities, are backward looking and inform what has happened.

KRIs measure the *effect* of business activities but ignore the *cause*. Product sales, new customers, and even revenue are KRIs and only inform how you did but not why. For that we need to establish KPIs.

The reason we make the distinction is that many people incorrectly track the results of many actions or activities and call them KPIs. It's certainly important to track goals, but you don't know what caused the goal to be reached or not if you don't track the actions or activities that align with those goals. For that you need to establish KPIs.

POOR KPIS

Total number of customers is not a KPI. Neither is company revenue. Instead, they are KRIs.

What action would you take if revenue dropped? Or more precisely, what *specific* action would you take? Total Revenue is the *result* of many factors so by definition is a KRI. It's important to track, but you can't look at that single value and know what to do since it's influenced by many factors. To identify what you need to do, you will have to drill down further into the activities and processes that cause the revenue to change.

In his book, Key Performance Indicators, David Parmenter states that KPIs have a significant impact on the organization and that they must clearly indicate what action is required by staff. And that's the part that most KPIs don't do. Yes, in some cases they may be important KRIs because they tell you how you did. But unfortunately, many KPIs are really KRIs and so don't measure the precise actions and activities we do to drive performance.

Just measuring high level results such as revenue or number of customers is a mistake because it doesn't answer how you got there and what should be done next. Instead, we need to evaluate the *events* that *caused* those results. Certainly, we can conclude that if Revenue increased to meet our goal, we succeeded, but we don't know what we did that caused it. It could have been due to improved customer retention, higher conversion rates, better margins, more affiliate partners, more sales people, opening of new markets, new product launches and so on.

KPI CONSIDERATIONS

Calculating KPIs

KPIs are not typically found in reports. That's because reports usually just contain measures which on their own aren't very insightful. Instead, KPIs should be calculated values which are described as *ratios*, *percentages, rates,* or *averages*. And they should all be measured over time.

So, we don't use number of customers or web site inquiries as KPIs, but rather percentage increase in customers and the ratio of visitor inquiries to total visitors, and compare them over time, such as month over month. Knowing we had a 3.5% increase in customers over the previous month is much more valuable than knowing we had 1,500 customers. Understanding how many customers we had is of course important, but it needs to be put in perspective and compared to the previous time period.

Track granular actions and activities rather than aggregate values

Setting personal, departmental or corporate goals is fundamental to most people, but measuring how we perform against those values is not enough. Make sure you identify the actions or activities that align to the overall goal. It’s certainly useful to know if Revenue or Profit is changing. But it’s better to figure out why and what’s influencing it. So drill down to determine what actions or activities are needed to reach your goal. And visualize that.

Select KPIs based on your goals, not what others are doing

Don’t fall into the trap of picking your KPIs because those are the ones used by others or on someone’s top 10 KPI list. KPIs need to be consistent with your particular needs and always driven by your unique business goals. What works for one organization may not work for yours. The factors impacting their performance may or may not apply in your situation. Again, figure out what your activities should be by starting with your organization’s goals and drill down from there.

Reconsider your KPIs if they look like this:

- Number of web or store visitors
- Number of customers
- Top profitable customers
- Sales revenue
- Client sign-ups
- Number of registrations
- Product failures in a production line
- Top 10 lists; campaigns, products, customers, etc.

THE LOGIC OF DECISION MAKING

Make KPIs more effective by mapping them out. There is, or at least should be, a logical thought process for how those numbers were conceived that creates a hierarchical, decision structure. By showing the logical structure of how KPIs are conceived, team members understand how they are determined, what activities people are working on, and how their work affects business performance measurement and the overall goals for the company. It’s valuable to see how work aligns with corporate goals and that work assignments make a difference. Although the following example is about marketing, the logical flow is the same for any business discipline.

Saying that gaining greater blog interactivity will increase Revenue is a flawed approach and not well thought-out. That's just guess work and people don't buy into targets if they are not supported by logic.

Instead, figure it out systematically.

1. You might say that one of the things you can do is to increase Revenue;
2. a critical item to accomplish that might be to improve your overall presence in a certain market;
3. to do that, you need to market to a new audience who is unfamiliar to you;
4. and the area of focus is decided to be engineers in North America;
5. for that you may decide it's a good idea to show thought leadership; and
6. one way to accomplish that may be to blog regularly;
7. you establish a KPI to monitor Percentage increases in blog interactivity; and
8. you set a target of 5 interactions per month and a 20% increase in blog interactions for each quarter. Or you might add a KPI to monitor how engaged your blog posts are by tracking comments people leave and how that improves over time.

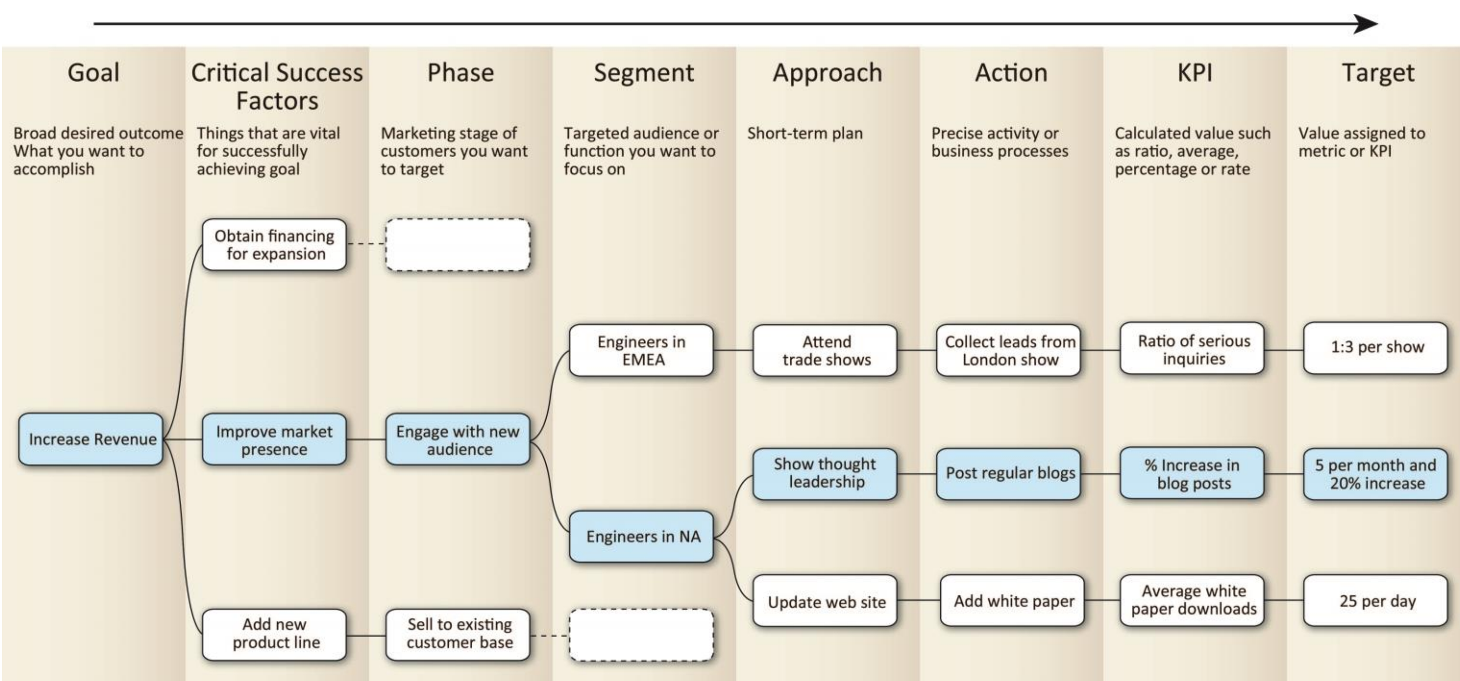
As the example illustrates, there is a logical flow to decision making and in the evaluation of what is important to do. It shows an increasingly detailed dissection of the work or processes needed to accomplish the stated goal. What we have done is to make increasingly more refined decisions to arrive at effective KPIs and the targets we will assign to them. Here are the building blocks we used:

Function	Definition
Goal	Broad desired outcome. It states "what" we want to accomplish but not "how." It states where you are going rather than how you will get there.
Critical Success Factor	Things that are vital for successfully achieving the Goal.
Phase	Stage or state we are addressing. For Marketing, it's one of four (Engage, Acquisition, Conversion, Retention).
Segment	Targeted audience or function being focused on. For Marketing, it can be based on existing customers or new, age, gender, location, etc.
Approach	Short-term plan taken to achieve a critical success factor. It's what you do, and for every critical success factor, there are a number of approaches.
Action	Precise activity or business process required to be performed to attain

	stated goal.
KPI (Key Performance Indicator)	Calculated value that is critical to the business and to attaining stated goal. Should be expressed as Ratio, Average, Percentage or Rate.
Target	Value assigned to Metric or KPI.

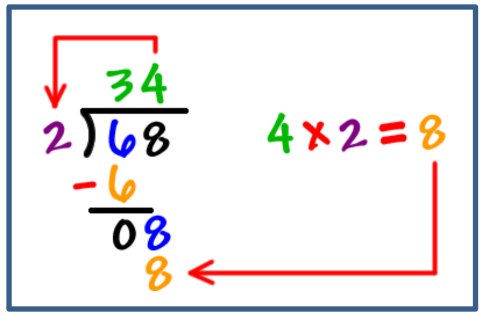
To start, state your goal and then isolate the work you need to do to accomplish it by recording the phases as shown in this example. You can use Word, Excel, Visio, or [KPI Karta]() to do that and then track your actuals against set targets.

Moving from left to right, the logical flow looks like this (the boxes in our example are highlighted in blue):



This provides an organized flow of how the decision of increasing blog interactions was determined. “Increase Revenue” is the goal and the measurement of that is a KRI. But by using this approach we can determine what the actions are to accomplish that result and which KPIs we should monitor.

Show your work – just like in grade school



"A mere 7% of employees today fully understand their company's business strategies and what's expected of them in order to help achieve company goals," according to Harvard professors and co-authors Robert Kaplan and David Norton. By establishing KPIs that align with corporate goals, all team members feel more engaged because they can see how their work affects the bottom line.

Creating KPIs in a logical structured way helps identify what to measure, and it also shows others the roadmap of how you got there. That provides several advantages because it shows:

- progress of critical work
- who is responsible for each activity
- everyone that what they do is important and how their work directly drives corporate goals and objectives
- how much has been accomplished

Be open about your KPIs. Tell the whole company about them. Make results visible for all.

Great KPIs

As we discussed, all too often KRIs are used instead of KPIs. But only KPIs provide enough granularity to inform what actions are needed, whether the actions succeed or not, and report on current progress. Combine that with the requirement to report on metrics that are values calculated from measures, and you can produce very effective KPIs that look like this:

- Rate Increase in Customers
- Rates of forms filled in
- Average Rating per article change
- Percentage of visitors who Submitted a Question
- Ratio of Registrations to Visitors

CONCLUSION

KPIs are a great way to drive business decisions and monitor performance. When set up correctly, they identify the actions and activities to correct or to improve corporate results. Derive the logic of how the KPIs were arrived at. By defining them in a logical hierarchical structure, better KPIs will be created and individuals tasked with those activities will have stronger buy-in because they will see how their work impacts larger goals.

THE KPI KARTA ADVANTAGE

KPI Karta offers a cloud based performance management service to help companies identify, measure and manage metrics and KPIs (Key Performance Indicators) and to track them against actual performance.

The founders have spent decades in the business performance measurement industry where they have assisted hundreds of companies establish actionable KPIs using the KPI Karta methodology. KPI Karta optimizes organizational success by aligning KPIs with corporate goals and objectives and provides a rigorous environment for collaboration, verification and adherence to the right metrics.

KPI Karta allows you to create hierarchical maps of corporate decision making. You can identify what actions need to be done and chart them along with who is responsible for each task and what progress is being made.