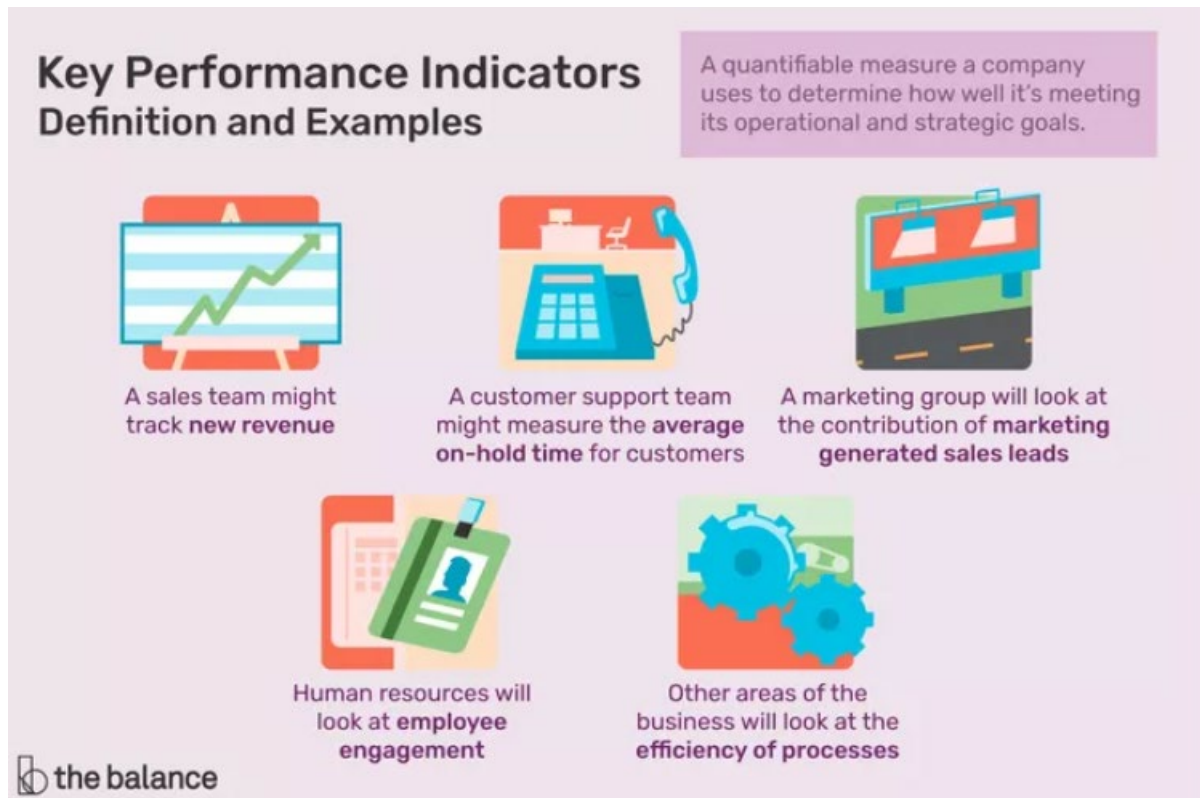


The Basics of Key Performance Indicators



A Key Performance Indicator (KPI) is a value used to monitor and **measure effectiveness**. Although some, like net profit margin, are nearly universal in business, most industries have their own key performance indicators as well.

Some Examples of KPIs

KPIs are intrinsically linked to a firm's strategic goals. Managers use the indicators to assess whether they're on target as they work toward those goals.

- A sales team might track new revenue, total revenue, new customer capture, average deal size, and deal pipeline size to assess progress toward corporate revenue targets.
- A **customer support team might** measure the average on-hold time for customers and the percentage of calls that result in a positive post-call survey rating.

- A marketing group looks at the contribution of marketing-generated sales leads to total revenue over time.
- Production areas of the business measure the efficiency of processes and various quality metrics.
- **Human resources departments** measure employee turnover **among other related metrics**.
- Managers and key stakeholders monitor these indicators over time and adjust plans and programs to improve the KPIs in support of the firm's strategic goals.

Leading and Lagging Indicators

Developing performance indicators is both art and science. The objective is to identify measures that can meaningfully communicate the accomplishment of key goals.

Lagging Indicators

- Measure performance in a period that is past. Financial metrics are classic examples. As the standard disclaimer warns, past performance does not guarantee future returns.

Leading Indicators

- Contain guidance about future results. For example, an increase in orders for auto parts suggests a rise in new auto production and sales in the near future.

In most businesses, the goal is to have the right balance of leading and lagging KPIs.

Four Challenges in Developing KPIs

It's not easy to develop a high-quality set of performance indicators. Managers and functional experts work together to debate and consider the right set of measures and their relative importance—and there are pitfalls.

1. If the **firm's strategy and key objectives** are not clear, its indicators tend to focus exclusively on financial outcomes. Overreliance on financial indicators leads to an unbalanced and incomplete view of a business's health.
2. Measures deemed important by one area of the business may not be viewed as important by others.

3. If compensation is tied to key targets of performance indicators, conflicts of interest and considerable bias are built into the process.
4. Accurately measuring and reporting indicators may be difficult or impossible if the internal reporting system to support them isn't in place.

A healthy process for identifying and implementing key performance indicators includes a requirement that the managers and other contributors regularly revisit and revise the measures. This fine-tuning process requires the time and diligence of all parties.

Designing KPIs

When choosing which KPIs will offer the most valuable business insights, ask a few questions to keep focused:

- Are these KPIs derived from a valid strategy?
- Are they simple to understand?
- Are they relevant, not just now, but over time as well?
- Are they clearly defined?
- Do they accurately reflect the business process?
- Do they involve factors or quantities that the business can fully control or influence?
- Do they focus on improvement?
- Do they offer quick feedback?

KPIs are more useful when they reveal trends over time, rather than taking one KPI in isolation. Keeping them precise, simple, and relevant can reward a business with useful insights and guidance.

Proper Use of KPIs

A properly developed and implemented KPI program incorporates regular review processes during which managers and other stakeholders assess the meaning of the results. No matter how positive an indicator is, it needs to be analyzed and assessed in order to repeat or even strengthen the performance.

No single KPI number standing alone explains how a situation happened or how to improve. However, a well-defined set of KPIs can include numbers that point to where conditions deteriorated and how they can be improved. Armed with these insights, team members can take action to strengthen the leading indicators and drive improved future results.

A simple way to check whether a KPI can be used properly or offers meaningful data is to put it through the SMART filter. Each KPI should have:

- A Specific objective
- A way to Measure goal progress
- Attainable, realistic goals
- Relevance to the business
- A Timeframe that makes sense for the company