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Ten Characteristics of a Good KPI

There's a lot of talk these days about key performance indicators (KPIs). They are the backbone of scorecards and dashboards, which have become an irresistible way for organizations to present performance information to executives and staff. Unfortunately, *Business Intelligence* developers seem to focus more on creating visual metaphors (dials, gauges, arrows, etc.) than understanding what constitutes a good KPI that delivers long-term value to the organization.

Part of the problem is that people use the terms "KPI" and "metric" interchangeably. This is wrong. A KPI is a metric, but a metric is not always a KPI. The key difference is that KPIs always reflect strategic value drivers whereas metrics may represent the measurement of any business activity.

When developing KPIs for scorecards or dashboards, you should keep in mind that KPIs possess 10 distinct characteristics. Although metrics may exhibit some of these characteristics, good KPIs possess all of them.

#1. KPIs Reflect Strategic Value Drivers

KPIs reflect and measure key drivers of business value. Value drivers represent activities that, when executed properly, guarantee future success. Value drivers move the organization in the right direction to achieve its stated financial and organizational goals. Examples of value drivers might be "high customer satisfaction" or "excellent product quality."

In most cases, KPIs are not financial metrics. Rather, KPIs reflect how well the organization is doing in areas that most impact financial measures valued by shareholders, such as profitability and revenues. As such KPIs are "leading" not "lagging" indicators of financial performance. In contrast, most financial metrics (especially those found in monthly or annual reports) are lagging indicators of performance.

#2. KPIs Are Defined by "Executives"

Executives define value drivers in planning sessions which determine the short- and long-term strategic direction of the organization. To get the most from these value drivers, executives need to define how they want to measure their organizations' performance against these drivers. Unfortunately, too many executives terminate strategic planning sessions before they define and validate these measurements, otherwise known as KPIs. The results are predictable, giving proof to the adage, "You can't manage what you don't measure."

#3. KPIs Cascade throughout an Organization

Every group at every level in every organization is managed by an "executive" whether or not the person carries that title. These executives may be known as "divisional presidents," "managers," "directors," or "supervisors," among other things. Like the CXOs, these "executives" also need to conduct strategic planning sessions that identify the key value drivers, goals, and plans for the group. At lower levels, these elements may be largely defined and handed down by a group higher in the hierarchy.

However, in every case, each group's value drivers and KPIs tie back to those at the level above them, and so on up to the level of the CXOs. In other words, all KPIs are based on and tied to the overarching corporate strategy and value drivers. In this way, top-level KPIs cascade throughout an organization, and the data captured by lower-level KPIs roll up to corporatewide KPIs. This linkage among all KPIs, which can be modeled using strategy mapping software, supports flexible analysis and reporting at any level of granularity at any level of the organization.

#4. KPIs Are Based on Corporate Standards

The only way cascading KPIs work is if an organization has established standard measurements. This is deceptively hard. It can take organizations months if not years to hash out the meaning of key measures or entities, such as "net profit" or "customer." Functional representatives at a major U.S. airline spent months trying to agree on the meaning of "flight" and "segment" and their entire analytical infrastructure was put on hold until they achieved consensus. In some cases, organizations can only agree to disagree and use metadata to highlight the differences in reports. Only with enough top executive support can organizations overcome the political obstacles associated with standardizing definitions for commonly used KPIs.

#5. KPIs Are Based on Valid Data

When pressed, most executives find it easy to create KPIs for key value drivers. In fact, most industries already have a common set of metrics for measuring future success. Unfortunately, knowing what to measure and actually measuring it are two different things. Before executives finalize a KPI, they need to ask a technical analyst if the data exists to calculate the metric and whether it's accurate enough to deliver valid results. Often, the answer is no! In that case, executives need either to allocate funds to capture new data or clean existing dirty data. Or they need to revise the KPI. Providing cost estimates for each approach will help executives decide the best course of action.

#6. KPIs Must Be Easy to Comprehend

One problem with most KPIs is that there are too many of them. As a result, they lose their power to grab the attention of employees and modify behavior. According to TDWI research, the median number of KPIs that organizations deploy per user is seven. More KPIs than this makes it difficult for employees to peruse them all and take requisite action.

In addition, KPIs must be understandable. Employees must know what's being measured, how it's being calculated, and, more importantly, what they should do (and shouldn't do) to positively affect the KPI. This means it is not enough to simply publish a scorecard; you must train individuals whose performance is being tracked and follow up with regular reviews to ensure they understand and are acting accordingly. As one IT manager said, "Measurements without meetings is useless."

#7 KPIs Are Always Relevant

To ensure that KPIs continually boost performance, you need to periodically audit the KPIs to determine usage and relevance. If a KPI isn't being looked at, it should probably be discarded or rewritten. In most cases, KPIs have a natural lifecycle. When first introduced, the KPI energizes the workforce and performance improves. Over time, KPIs lose their impact and should probably be revised. Most organizations review and revise KPIs quarterly.

#8. KPIs Provide Context

Metrics always show a number that reflects performance. But a KPI puts that performance in context. It evaluates the performance according to expectations. The context is provided using 1) thresholds (i.e. upper and lower ranges of acceptable performance), or 2) targets (i.e. predefined gains, such as 10% new customers per quarter), or 3) benchmarks, which can be based on industrywide measures or various methodologies, such as Six Sigma. In addition, most KPIs indicate the direction of the performance, either "up," "down," or "static."

#9. KPIs Empower Users

As stated above, you can't manage what you don't measure. But a corollary is that you can't manage what you don't reward. To be effective, KPIs must be reinforced with incentives. Almost 40 percent of organizations surveyed by TDWI say they restructured incentives systems when implementing KPIs. However, it's important not to link incentives to KPIs until the KPIs have been fully vetted. Often, KPIs must be tweaked or modified before they have the desired effect.

It's also critical to revamp business processes when implementing KPIs. The business process needs to empower users to take the appropriate action in response to KPIs. The last thing you want is informed but powerless users. That's a recipe for disillusionment and poor morale. Forty percent of organizations said they modified business processes when implementing KPIs, according to TDWI research.

#10. KPIs Lead to Positive Action

Finally, KPIs should generate the intended action—improved performance. Unfortunately, many organizations allow groups to create KPIs in isolation. This leads to KPIs that undermine each other. For example, a KPI for a retail store might track stock outs (when it lacks enough merchandise on hand to meet demand) but the regional warehouse has an incentive to carry minimal inventory. If the regional warehouse does too good a job, it may not have enough inventory to keep the retail shelves stocked when there is a surge in demand for certain merchandise.

Another problem is human nature. People will always try to circumvent KPIs and find loopholes to minimize their effort and maximize their performance and rewards. Good KPIs are vetted before deployed and closely monitored to ensure they engender the intended consequences.

Conclusion

I hope you are convinced that KPIs are a breed apart from your run-of-the-mill metric. While an organization may have hundreds or thousands of metrics, it should only have a few dozen KPIs that focus employees on the key activities that deliver the most value to the organization. In essence, KPIs are communications vehicles. They enable top executives to communicate the mission and focus of the organization and grab the attention of employees. When KPIs cascade throughout an organization, they ensure everyone at every level is marching together in the right direction to deliver the most value to the organization as a whole.

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