

Why KPIs are Key to Your Success

Keeping track of the "bigger picture".



THE ALTERNATIVE BOARD®

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What are KPIs?

Key Performance Indicators (KPIs) are metrics that provide a quantitative measurement of your company's performance over time. They should act as a "flash" report, giving you a quick understanding of how your business is progressing, or can be expected to perform in the near future.

The main idea is to have a few key measurements that help you track critical components of your business. Financial statements just aren't enough. KPIs should be more "big picture," taking into consideration your Personal vision and the company's goals. A secondary benefit is to help educate your Board members about critical processes and results in your company. The more they know about your business, the better advisors they can be to you.

For this reason, KPIs should be "normalised," which means expressing them in a way that is easily understood. For instance, if your finance company allows you a credit line based on 80% the number and age of units in inventory, you would want to express this as "My credit line is 94.8% of the allowable limit," as opposed to "My line is at \$347,000 on a current inventory value of \$458,000" which is difficult to interpret in terms of performance.

There are no "standard" KPIs. Every company has a different driving force, so KPIs will vary from one to another. Sales and profits are numbers every business tracks, but they only tell you the results of your efforts. Because dollars are a universal method of measurement, it's tempting to use them for KPIs. However, a KPI should be measured against something (e.g., sales against same month last year and against budget). A number is just data, but ratios provide information about how your business is performing in reality compared to expectations.

You may also track industry-related data, such as oil prices, but remember that industry indicators don't measure your performance. Your metrics should illustrate how you are doing, not how your industry is doing.

By way of example, here is some "KPI Logic" from members of our Board:

- I want to bring on "x" partners in the next three years. Each partner must be supported by "\$y" revenue, and my average new account is "\$z" annually. My KPI is the number of new accounts opened in the last month and for the year to date.
- If we have more than an "x" week backlog, we begin to miss deadlines due to over commitment, but less than "y" weeks results in under utilised personnel. My KPI is the number of weeks of backlog against the over/under optimum range.
- We are growing rapidly, and it is difficult to track the productivity of new hires. My KPI is dollars of revenue per field technician.

Once you start using KPIs, you'll be able to track your company's performance over time in a way that can be easily understood by your management team, as well as employees, Board members, potential partners, etc. Just remember, nothing is forever - if you find that a KPI is not giving you actionable information or is no longer relevant, get rid of it.

5 Elements to Determine Your Business's KPIs

Industry and Economic trends

What industries are above us in the food chain? Where does our work come from? Who measures the statistics we need?

Example: A civil engineering firm tracks upcoming government bond issues, land platting applications for development, and the Architects' statistics on new planning activity.

Example: A food manufacturing firm tracks a "market basket" of key commodity prices now and in the futures market.

Prospects

What do we have coming up? Who are we talking to? What is the likelihood of a purchase being made?

Example: A technology service company records all discussions with customers about equipment and service upgrades in their CRM system. Those who request written proposals are weighted by percentage of probability.

Pipeline

What is our workload in the immediate or near future?

Example: A services firm divides all budgeted hours for signed contracts by the number of employee hour per week to maintain a backlog measurement in weeks of work.

Efficiency

How are we operating?

Examples: Many. Production per labor hour. Profit per unit of production. Gross margin ROI. Inventory turns. Labour to expense ratios. Break even multiples.

Quality

How well do we do what we do?

Examples: Complaint ratios, errors per units delivered, jobs over budget, returns.

Setting and Using KPIs

A Key Performance Indicator (KPI) is a quantifiable measurement that reflects the critical success factors for your organisation. You can break it down this way:

- **Key:** Of fundamental importance in gaining a competitive advantage or a make or break component to success or failure (CSF)
- **Performance:** Measurable, quantified and easily influenced by individual behaviours
- **Indicator:** Leading information on future performance

The best KPIs provide a high-level snapshot of success for the business, and are rooted in the vision of the organisation. They are well defined and measurable, and are tied to key business processes and operational activity that supports the company's overall goals.

A good example of a KPI for increasing revenue might look like this:

- Annual Sales Goal: \$2,000,000
- Average sale/number of sales: \$4000/500sales per week/day:
10/22
- Close rate: 50%
- Appointments per day: 4
- Cold calls per appointment: 5
- KPI: 20 cold calls per day

The important thing is to be as specific as possible and to make realistic goals. For instance, you may not want to set a goal to be "popular among affluent customers" because this would be very difficult to measure. You wouldn't want to design a KPI for increasing customer satisfaction unless you had a way to measure and track customer satisfaction, such as a validated survey system.

Once you determine your KPIs, it's important to communicate them consistently and continually. One way to do this is to visibly chart their progress in break rooms or in periodic updates to your employees.

KPIs should also be incorporated into your performance management system, and/or tied to incentives, raises or profit distributions. In addition to providing a snapshot of how the business is doing, KPIs also help you improve your business processes. It's true - we manage what we measure

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