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Establishing a management performance measurement system; Defining and selecting KPIs

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ABSTRACT: Managers and constituents of industries are increasingly concerned about measuring and managing organizational performance. However, launching a new measurement system goes beyond defining new metrics or developing new displays of existing data. However, as Bourne and Neely (2003) point out, there is some evidence that many of these implementations are not successful. This paper initially examines the most difficult elements in establishing and launching a management performance measurement system. The next step after the establishing of a performance measurement system, is to specify the essential elements in defining and selecting KPIs. Unfortunately, different people have very clear and different definitions for what constitutes the "measure" part and thus there is no "exactly" in such a process (Lichiello and Turnock, 1997). As such, this paper attempts to approach the essential elements involved in defining and selecting KPIs for effective performance management.

KEYWORDS: Performance Measurement System, Key Performance Indicators (KPI), Performance Metric.

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What to discern as the most difficult element of establishing and launching a management performance measurement system?

Management concepts such as the balanced scorecard, process management, key performance indicators and strategy deployment have prompted many executives whether to start thinking about establishing a management performance measurement system or, if they already launch one, to revisit their existing one (Bertels, 2010). Initially, the balanced scorecard was the creature of Norton & Kaplan (1992) when they were looking for ways to measure performance in the organization of the future. However, balance scorecards failed to provide a complete system for proper measurement and the two sources of failure, mostly in large companies, were at the design and process stage (Rompho, 2011). In particular, the unworkable complexity, the requirement for a cause-effect relationship that cannot possibly exist, as well as the high IT infrastructure costs led to many failures.

Consequently, the interest in adopting and developing a balanced and multi-dimensional system to measure process and business performance has become increasingly popular. But this time, firms left in the past the old measurement framework, paying attention mostly on providing a focus that lets each employee know how they contribute to the success of the company and its stakeholders' measurable expectations (Artley and Stroh, 2001). By doing that, they gave life to the mission, vision, and strategy of the firm.

Specifically, business performance measurement systems are the formal, information-based routines and procedures managers use to maintain or alter patterns in organizational activities (Simmons, 2000). As part of their overall management strategy, managers can use them to evaluate, control, budget, motivate, promote, celebrate, learn, and improve (Behn, 2003). However, performance measurement is not an end in itself and as such, establishing performance measurement systems comes with its difficulties. According to the existing literature, which is based on practitioner reflections, and few research studies of performance measurement implementation, the most difficult elements of establishing and launching a management performance measurement system are currently believed to be:

Contextual difficulties:

Time and expense needed to implement the system (Bierbusse and Siesfeld 1997; McCunn, 1998).

Lack of senior management commitment (Kaplan and Norton, 1996).

When the organization adopts too many indicators (Molleman, 2010).

Processual difficulties:

When strategy is not linked to resource allocation (Kaplan and Norton, 1996; Meekings, 1995).

When performance measurement system does not reflect the organization's strategy (Kaplan and Norton, 1996).

When the dynamics of the system are not fully understandable from the users (Osei, 2013).

Content difficulties:

The need to make a quantitative link between qualitative leading indicators and expected financial results (Norreklit, 2000).

When the performance measurement systems are not linked to departmental and individual goals.

The organization adopts too many indicators which dilute the overall impact (Kaplan and Norton, 2001).

Undoubtedly, the process of establishing a measurement system is intellectually challenging, fulfilling and immensely valuable to those managers who participate fully in it. However, as Neely et al. (2000) refer, the real challenges for managers come once they have developed their robust measurement system, for then they must implement the measures.

What are the essential elements in defining and selecting KPIs? Why?

The recent decades have witnessed a maturing of concern and interest in measuring and monitoring performance that is increasingly evidenced in the strategic agenda of many organizations (Alwaer and

Croome, 2010). KPIs can be defined as providing the most important performance information which can help organizations to understand whether the firm is on track or not. However, defining and selecting the right KPIs is a very critical process within organization, whereas wrong selection of them can result in significant deviation of business strategy, employee non-satisfaction, or may completely submarine a performance management initiative (Iveta, 2012).

There are two different kinds of KPIs: leading and lagging indicators. Leading indicators measure activities that have a significant effect on future performance (Eckerson, 2005), such as a high level of customer satisfaction during the last year or a low number of help desk calls for a single month. On the other hand, lagging indicators measure the output of past activity significant effect on future performance, such as product quality or number of sales calls placed. This means that since indicators are usually following industry-wide standards, different businesses should have different KPIs depending on their respective performance criteria or priorities (Lake, 2013). For example, the services industry may evaluate itself on the basis of KPIs such as annual revenues or year-to-year trends, while each of the services organizations that comprise the industry may look more to KPIs that measure specific areas of performance such as Mean Time to Repair (MTTR) or First-Time Fix Rates (Pollock, 2007). Generally, there are some essential pointers to consider when assessing the use of KPIs for a firm. According to Eckerson (2009) and Byatt et al. (2010), the KPIs:

Should be aligned with corporate strategy and objectives.

Need to be meaningful to the audience they are intended for.

Need to be regularly measured and progress-reported.

Should be owned by an individual preferably a manager who must be accountable for its outcome.

Should be balanced enough to inculcate all processes with the same level of importance attached.

Need to align with program and/or portfolio level objectives.

KPIs need to drive towards the benefits that your project is expected to deliver once its output is being used.

Further, IBIS Associates (2013) suggests some critical steps for the managers to follow when they are to define and select KPIs:

1. Define the successful areas of your business. It begins by identifying the areas of business that are successful, and continues by directly focusing on the measurements that are relevant and achievable
2. Brainstorm the criteria. The KPI is central to a number of other elements in the planning platform which provides the basis for answering the three crucial planning questions: Where are we? Where do we want to be (and when)? How are we going to get there cost effectively?
3. Define specific measurements. Having areas and criteria defined, the next step is to find the best way to measure them. If for example it is apparent that marketing is a strategic priority, then it might be considered measuring the number of unique visitors, the number of visitors to sales and the cost per lead.

Unlike the existence of a large literature suggesting ways to define and select KPIs, such decisions and processes throughout the business world are not a simple matter. As Jacobson (2011) successfully notes, regardless public-profit-nonprofit sector, metrics must be chosen carefully, monitored and adjusted diligently to ensure that they are in line with the organization’s true goals. However, KPIs cannot stand alone neither can ensure success when organizations refuse to revisit customer value in the down turn and recalibrate all those models that built upon that basis. If that happened, then the KPIs might actually mean something (Ping, 2008).

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