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Consulting

Key Performance Indicators:

Putting the Customer First

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Don't underestimate the power of measurement to motivate employees, departments, and even entire organizations. But the metrics must motivate in the right way. They need to encourage people to act in a manner that promotes positive change and supports corporate strategies and goals. Key Performance Indicators can help organizations make the most of measurement by focusing everyone's attention on what matters most—the customer.

Key Performance Indicators *(KPIs)* are the measures that businesses put into place to track their progress against both short-term goals and strategic plans. Much has been written already about individual measurement of key business processes and overall business performance. Successful KPIs, however, are not just internally focused metrics. They also are forward facing, or focused on the customer, and, ultimately, the end-consumer. This is why KPIs are so critical to a company's success.

Even intra-company or intra-department measurements must focus on improving execution to meet customer requirements. These measurements can provide businesses with the yardstick that indicates whether activities are meeting the needs of customers and consumers. They often provide an "early warning" long before the profit impact of not meeting customer requirements manifests itself in the company financial statements.

Companies need to select KPIs that address both functional responsibilities and their marketplace drivers. The KPIs need to be those few vital functional measures that complement not only your organizational goals but also your customer's goals.

What to Measure

Customer service should be a key measure of company and supply chain performance. Customers want what they ordered when they ordered it, and they want it delivered on a certain date and in a certain manner. From a customer perspective, the ultimate measure is always service level. As such, the customer establishes the criteria for success. Therefore, customer service will always be a key metric of any enterprise.

The final scorecard comes externally, from the customer, not from the internal customer-service department, sales, or the supply chain organization. Internal measurements, however, are necessary for tracking and improving service to the customer. With that said, measurements need to be top down, focused on the customer, and consistent with the areas identified for improvement. The internal organizations will have KPIs associated with improvements in their functional areas that will affect overall service levels.

Reasons to Measure

Establishment of key measures will influence behavior throughout the organization. To attain the desired results, management needs to understand the proper approach to establishing KPIs. In order to bring about the desired changes in behavior and improved service levels, we have identified three approaches to consider in the development of KPIs:

- Measures to Motivate
- Measures to Align
- Measures to Improve

Measures to Motivate

Do not underestimate the power of measurement to motivate employees, departments, and organizations to modify their behavior to be consistent with strategy and goals. The sole act of measurement will improve the performance of the process simply by calling the attention of management and employees to the process. In other words, your selected KPI will motivate individuals to examine their contributions, take corrective action, and drive improvement on the selected metric.

The functional organizations must be able to affect the measurement through their actions. Most importantly, they need to be able to undertake root cause analysis and subsequent corrective action. The impacts of improved methods and procedures must be fully considered both within the functional unit itself and across the enterprise.

For example, a consumer fulfillment company established a KPI for its packing department based on cases per man-hour. After several weeks, the facility manager noticed packers placing extra stickers in a box by their workstations after the completion of each pack. The packers explained that the company measurements were only at the department/shift level and they wanted to better understand their own cases per individual man-hour. This is an example of a measurement's generating the motivation to understand an individual contribution against a higher organizational goal.

If not selected carefully, the measurement can sometimes motivate behavior that is detrimental to the enterprise's objectives. This was the experience of a large consumer-products company that absorbed a branded import operation. The retained general manager of the import operation was measured only on top-line sales. After a year, sales had increased significantly. Unfortunately, product quality and margin were significantly lower than in previous years. There was a warehouse full of defective merchandise, and many sales had taken place at cost. The results were great for the top line, but the company never saw a return on its investment.

Measures to Align

The misalignment of measurements within an organization may be the single biggest reason why companies fail to achieve their overall goals. Many times, measurements are consistent with the functional objective but conflict with the enterprise's overall goals. To assure alignment, KPIs need to be based on customer requirements established at the company level first. They then must be filtered down through the organization to areas in which employees have a "line of sight" on the impact of their performance on the objective.

KPIs will motivate individuals and teams alike; their implementation will drive change in the organization.

Alignment must be done carefully so as not to appear to subvert past efforts or "blame" the previous team. Extensive communication on the need for measurement, improvement, and alignment with the overall organizational goals is a requirement for success. The enterprise will depend on the team to implement the new metric and take the necessary corrective action. Understanding the big picture and being part of the solution are keys to successfully selecting the right measures.

The following example illustrates this point: Customers of a consumer-products company indicated that service levels were poor, although internal measures by the operations group indicated customer-service levels in the mid 90-percent range. However, these internal measures forgave missed shipments based either on problems with order visibility from order entry or missed appointments by the scheduled trucker. The operations group was forgetting that ultimately, the customer defines service level. Based on that reality, on-time shipments actually were less than 60 percent at the time.

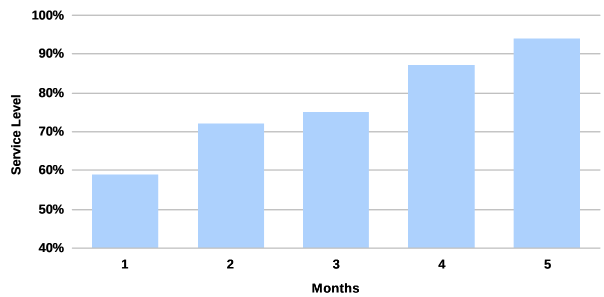
The company in this example ended up changing its service measures to match customer expectations. It then investigated root causes of under-performance and took corrective action. Customer service improved significantly, with service levels climbing to 95 percent within five months *(as illustrated in Exhibit 1)*. These measures are expected to reach the 98.5 percent on-time fill rate target once the company gains control of outbound logistics through a planned modification of freight terms.

All of the functional areas contributed to the alignment. For example, the root cause analysis found that pricing was so complex that delays to order visibility were the rule, not the exception. In response to this finding, the sales department reduced the complexity of pricing and established measurements supporting price simplification. Similarly, plant managers were originally measured against an inventory target that was unrealistic compared with service-level goals, lead times, and forecast accuracy. The plant managers now have migrated to a service-based measure and the forecasting department has adopted accuracy improvements to support inventory and service goals.

This case illustrates the importance of aligning measurements with customer expectations. For this particular organization, alignment against the service objective led to changes in measurements at the functional level. The resulting measurements reflected service as viewed by the customer. They therefore motivated the organization to take corrective actions to improve service to levels that met the customer's expectations rather than internal expectations.

EXHIBIT 1

How KPIs Improved One Company's Service Levels



Measures to Improve

Business processes, regardless of their simplicity or complexity, need constant refinement to reflect changing requirements, new technology, and emerging business needs. Thus, many measurements are established to improve the output of a particular business process. These measurements are normally pretty straightforward and easy to track via existing systems. Yet companies should not be deceived by their lack of complexity. Choosing the wrong KPIs can result in complacency about performance among employees or produce diminishing returns.

Complacency often is driven by unrealistic goals, canned measurements from legacy and enterprise resource planning *(ERP)* systems, or the inability to influence the measure. For example, an expectation to raise forecast accuracy from 45 percent to 85 percent on "A items" with no change in business processes, information quality, or tools will only generate frustration for those assigned responsibility for that metric. Diminishing returns is another phenomenon that can occur in efforts to improve performance. An organization's management may continue to raise the bar on a performance metric only to find that the resource allocation required is too great. There might also be a natural reduction in performance resulting from "forced changes" that end up reversing previous gains.

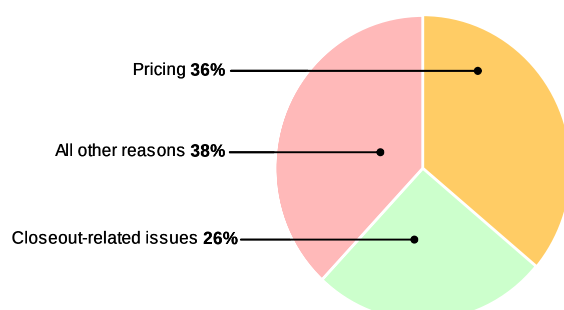
The following example clearly shows how to avoid these kinds of danger points and use measurements to improve a business process. A company's order-entry department had no metric for compliance to a service objective of "same-day order entry." The operations group complained of not seeing many orders until the requested ship date. Measurements showed that the percentage of orders entered into the system on the day they were received were as low as 50 percent and that most orders required some issue resolution before entry.

Corrective actions taken to improve operations' order visibility—and thus improve service to the customer—included tracking the reasons for any order not entered into the system the day it was received. Root cause analysis found that more than 60 percent of the order-entry delays were due to either pricing or closeout issues. *(See Exhibit 2)*

The company took action on several fronts. First, it charged the sales department with developing and implementing a pricing simplification methodology. This not only eased the order-entry complexity but also lowered deductions and became a field sales

EXHIBIT 2

Reasons for Order-Entry Delays



Closeout issues include items on the closeout list, invalid commission code flags, and discontinued products asset by removing pricing ambiguity. Next, the supply chain group was charged with developing and implementing improved procedures for closeout items. This made pricing decisions and product reservation clear and easy to execute.

Customer service then implemented several "decision trees" that empowered the order-entry associates to make the majority of the decisions related to pricing discrepancies and minimum order volumes. These previously had required higher-level approvals. Finally, a new KPI of "orders entered into the system the same day as receipt" was developed and measured by the customer-service department. This represented a major behavioral change on the part of customer-service personnel, as they took responsibility for order visibility *(although the department did not own all the individual components)*. The stated policy was that "any order received before 3 p.m. was to be [entered] into the system the same day." Performance against this measure improved to more than 95 percent within two months.

How Much to Measure

The highest-level enterprise measurements should be set with the full knowledge of the customers' requirements and, perhaps, their methodology for measuring your performance. Our experience indicates that three to five key measurements at other levels of the organization will provide the needed focus without overwhelming teams, functional areas, or operating departments. This "vital few" approach is consistent with many successful quality programs.

As with most goal-setting methodologies, a top-down approach provides the necessary prioritization and required organizational overlap for successful measurement. The organization's measurements for its functional units will align and may overlap with the stated enterprise-level KPI measure. In selecting their "vital few," the functional units need to consider both the enterprise goals and the performance shortfalls within their own operation.

For example, poor performance in a new-product execution might be a customer issue, a profitability issue, and/or a market share issue. In this case, the enterprise might select "percentage of sales from new products" as the new-product development KPI for the company. The sales team may choose a similar KPI for new products that overlaps with the enterprise goal. Operations, on the other hand, may track a different new-product KPI associated with "in-stock targets before launch date" that, while functional in nature, is fully aligned with the enterprise KPI.

We believe that there is a real fear of measurement within most organizations. Companies must deal with this fear, however, because being aware of how they are performing in the eyes of the marketplace is essential to success. The best way to accomplish this is through communication, realistic goal setting, and the elimination of competing goals.

Organizational Effectiveness

KPIs will motivate individuals and teams alike. It is the implementation of these KPIs that will drive change in the organization. *(For more on some of the key implementation considerations, see the accompanying sidebar on page 94.)* Because these changes may have a significant impact on the organization, the process must be structured and managed. When working with organizations to implement KPIs, we use several tools and techniques to accomplish this based on the level of change anticipated. For implementation of KPIs focused on the customer's evaluation of quality and performance, we would use the Model for Organizational Effectiveness *(shown in Exhibit 3)* in conjunction with our structured change model.

As with most goal-setting methodologies, a top-down approach provides the necessary prioritization and required organizational overlap for successful measurement.

The Model for Organizational Effectiveness is a simple yet highly effective tool for producing sustainable change in the organization. In fact, companies should consciously and actively apply it to all processes, systems, resource allocations, and organizational changes to ensure that:

- Expected gains are realized.

- Implementation plans consider a 360-degree view of the organization and the implementation's impact on it.
- Barriers and pitfalls and their implications to the organization are identified and addressed before they derail or curtail the effort.

EXHIBIT 3

Model for Organizational Effectiveness

Process ("How")	**Structure** How we are organized to work together	**Culture** What are the unwritten rules, values & beliefs of the organization	Process ("Why")
	Mechanics How we actually do our work–procedures, processes & systems	**Motivation** Why we act the way we do (What's in it for me?)	

Consider the four components of the Model for Organizational Effectiveness—structure, mechanics, culture, and motivation.

The process *(or "How do we do this?")* components of structure and mechanics address the "hard" side of change—the tangible, readily identifiable, and "diagrammable" elements of the enterprise. Making changes to these components has received significant attention over the past few decades, and numerous tools and methodologies have been developed to assist in successful change.

More difficult, but equally important, are the "soft" side *("Why do we do this?")* components of culture and motivation. Today's organizations realize that all four of these components must be considered and addressed for effective and sustainable change. Let's consider the application of the Model for Organizational Effectiveness to the implementation of KPIs.

Structure

Structure can be defined as an organization's reporting relationships, deployment, responsibility, and authority to drive a measurement system. We will consider two structural aspects of successfully implementing a KPI:

1. Identifying how people are aligned within the organization in order to develop KPIs that are appropriate to the way the enterprise works
2. Creating a structure that supports the development of KPIs and the ability to measure against them

KPIs must match the actual structure of the organization to be effective. For example, an organization that is structured in a traditional, hierarchical manner would most likely establish KPIs around the deliverables and outputs for each of its functional units, assuring that these are closely tied to the overall organization's goals. For companies organized around cross-functional teams, KPIs would most likely be established around the team outputs and deliverables rather than individual functional unit outputs. Team outputs would also be closely tied to the organization's overall goals.

Critical to the organization's ability to develop and measure against KPIs is having a person or a group assume overall responsibility for the effort. This responsibility should rest with senior management, while development & implementation of details, physical generation of measures, and systems and mechanics should be delegated to lower management levels. The actual structuring and makeup of the group will vary from company to company. All organizations, however, should ask themselves, is there someone/some group responsible for:

- Assuring that KPIs align with corporate goals?
- Setting up and implementing the measurement systems and processes?
- Taking action or following up if KPIs are not achieved?
- Determining customer expectations and incorporating them into KPIs?
- Communicating the organization's expectations, reasons, KPI alignments, and successes/failures to the organization?

Mechanics

Mechanics can be defined as systems, processes, and procedures to manage the measurement system. The organization must objectively determine if it has the appropriate systems, procedures, and processes in place to determine and use KPIs effectively. This must include defining and communicating the responsibilities and ownership of the processes. Systems, processes, and procedures, while certainly subject to change in a changing work environment, must be tested and in place before beginning the measurement process. Failure to do so will result in loss of confidence in the validity of the numbers and in management's commitment to measurement. Among the questions to be considered are:

- Do we have procedures and systems for producing the measures and then reporting them back to the organization in a timely manner?
- Do we have an ongoing process for communicating measurement results and measurement reasons to the appropriate people in the organization?
- Do we have processes for acting on measures once they are communicated?

Culture

Culture defines an environment that supports and encourages the measurement system. An organization's culture is the most difficult component to change but also arguably represents the most important component for ensuring success. The product of the organization's history and leadership, a company's culture defines the values and beliefs under which its employees operate and make decisions. If the organization cannot respond positively to the following questions, employees will not adhere to the measurement system. Although these questions at first may appear relatively straightforward, they have a significant impact on management decisions:

- Does the organization have a long-term commitment to a continuous, consistent, and ongoing focus on measurement?
- Is the organization willing to act on negative measures and non-compliance?
- Will the organization consistently allow and encourage action on measures?

Motivation

Motivation defines the rewards employees gain for supporting the measurement system. Reward and incentive systems must be aligned with the organization's overall goals. When designing these systems, the organization must consider not only positive rewards that encourage employees to participate fully in the measurement system but also the sometimes inadvertent negative results that may drive failure. The questions to consider are:

- Are our incentives and rewards aligned with the appropriate long- and short-term organizational goals?
- Are there incentives and rewards for full participation in the measurement process?
- Are there negative consequences for non-compliance with the measurement process?
- Are the rewards and incentives consistent with the importance of the measurement process to the organization?

To be most effective, an organization must consider all components of the Model for Organizational Effectiveness equally. Neglecting any of the components may not result in a total failure of the measurement system, but results will fall short of expectations or be unsustainable. An organization may consciously decide not to align one or more of the components of this model with the measurement system. It may, for example, determine that it does not wish to make changes to a well-functioning culture even if that culture does not support a measurement system. An organization that makes such a conscious decision, however, must understand the implications of that decision on the outcomes of the measurement systems—and be prepared to adjust its expectations accordingly.

Customer Focus as a Measure of Success

One last example sums up the power and potential of effective KPIs. It relates to a consumer-products manufacturer that experienced many of the problems cited in the other company examples presented here. For this particular business, it was found that line-fill *(the percentage of units ordered that shipped on time)* was a contributing factor in several significant issues. Poor line-fill led to empty retail shelves and share decline because consumers had branded alternatives available to them. Retailers were reluctant to take new-product listings because of missed promises on previous items. On-time shipment performance was reduced as orders were held pending receipt of product. Order-entry errors and delays led to higher deductions from customers with a resultant negative impact on profit.

Improving customer service was a critical imperative for this company because poor execution in meeting customer requirements had created a risk to the business. Shares were declining, sales of new products were weak, and profits were off. Each of these metrics was important to the business, but customer service became the key corporate measure. Developing and implementing customer-centric KPIs, guided by the principles of the Organizational Effectiveness Model, was the critical success factor in helping this company turn the situation around.

Customer service is the key corporate measure. It is the most robust indication that the enterprise's internal business processes are working to optimize both the needs of the customer and the goals of the enterprise. This is because the needs of the customer define the reason for the organization to exist.

Key Performance Indicators are powerful tools because they influence behavior. The establishment of the highest-level key performance measures for the business, when adequately supported by corresponding drill-down measurements, will motivate, align, and improve the processes that drive activities. Executives must assure that measures and rewards throughout the organization support not only the critical success factors of the business plan but also the expectations of customers and consumers.

Implementation Consideration

You have decided to review the key measurements within your organization. You've also confirmed that you understand the motivation, alignment, and improvement influences of the metrics you plan to introduce into the operation. As you prepare to implement the measures, here are some key considerations:

Data sources. Matching the appropriate data to your metric could be a challenge. Often the data required are available but not all of the information resides within the same system. The various data sources need to be identified, mixed, and matched for each metric.

Data extraction. If queries are required from multiple systems and databases, how the data are extracted and merged becomes a key concern. Database managers and functional leaders need to fully understand the data's source and composition.

Data elements. There may be issues with how transaction-processing systems capture data vs. the data elements required for the agreed-upon measurements. This could manifest itself, for example, as differences between your customer's method of measuring your success and your internal systems' standard available metrics *(for example, ship date vs. arrival date)*. Before you implement any measurement, validate what data are readily available.

Assigning responsibility. Will IT or a functional user be responsible for generating queries/reports to get the required information? Who will have responsibility for converting data to formats for analysis and display? These responsibilities need to be clearly assigned and understood throughout the organization.

Commitment. Both management and those directly responsible for delivery against the metric must follow up on the measurement's "message." By searching for root causes and then following up with appropriate corrective action to implement solutions, you achieve sustained metric improvement. If the program turns into a "just post the number" exercise, you won't obtain the desired results.

Presentation. The metrics must be displayed in a simple yet meaningful way. Reformatting data into a graphical display package can be very time consuming, but it is an important activity.

Hierarchical approach. Measurements should exist at the enterprise level and drill down to the other levels of the organization. Maintain a line-of-sight relationship between the metric and the organizational level's ability to improve the metric. To get the performance improvements you seek, the associates need to see how their actions actually affect the metric.

Appraisal and compensation. These related activities should be tied to the metrics. This assures that all associates understand the importance of organizational improvements and the evaluation of their own performance.