DEVELOPING
KEY PERFORMANCE INDICATORS

- The Balanced Scorecard Framework -

The purpose of this presentation is to identify and address the key questions necessary to design an effective framework for performance measurement in both public as well as private sector organisations.

AGENDA

A Strategic Approach to Performance Measurement

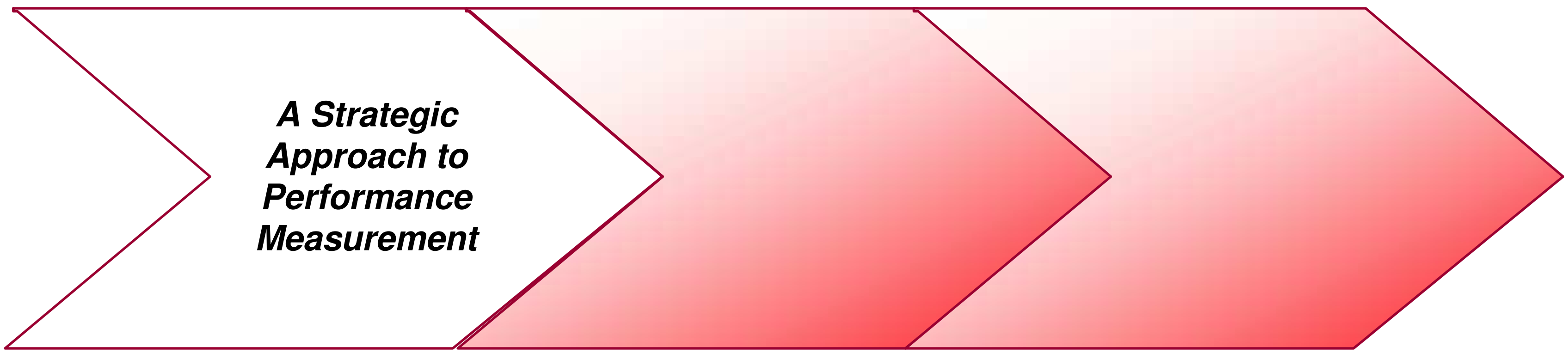
- What should organisations measure?
- What is the link between Strategic Planning and Performance Measurement?
- What are some of the common traps in designing performance measurement frameworks?

The Balanced Scorecard Framework

- What is the "Balanced Scorecard"?
- Why has it proven to be successful?
- How can it be used to enhance performance?

Constructing a Balanced Scorecard

- How can we link performance measures throughout the organisation?
- What value can this add?
- How has it been done in practice?


A Strategic Approach to Performance Measurement

The first step in identifying what matters in an organisation is to ask the right questions. Defining what constitutes effective performance is the initial task confronting management.

MEASURING THE THINGS THAT MATTER

WHAT FACTORS ARE CRITICAL TO THE SUCCESS OF YOUR ORGANISATION AND HOW ARE THESE FACTORS MEASURED?

A study recently undertaken by the Institute for Management Development in Switzerland (IMD) involved questioning a group of 92 senior executives in Europe, North America, South America and Asia. They were asked to consider areas in which performance improvements are commonly sought. A major implication of the study findings is that organisations need to seriously consider changing their systems of performance measurement to more accurately reflect their organisational objectives.

IMPROVING PERFORMANCE MEASUREMENT

- Employee Involvement - the degree to which workers participate in decision making that affects their particular jobs and areas of responsibility
- Quality - the extent to which services reflect the things that customers value
- New-Product Introduction - the degree to which new products and services can be quickly and easily developed
- Integration with Customers - the extent to which an organisation communicates and interacts with its customers
- Cost Reduction - the degree to which costs should be reduced (eg: direct costs,overhead costs, labour costs, computer system costs).

In spite of considerable efforts devoted to planning, strategy implementation often fails to deliver the outcomes originally envisaged. What is often regarded as a failure of strategic planning is in reality, a failure of an adequate system of identifying, measuring, monitoring, evaluating and modifying performance.

COMMON DEFICIENCIES IN PERFORMANCE MEASUREMENT

Common Deficiencies

- Conflict between functional areas and priorities
- Precision at all costs
- Behavioural effects
- Selecting the wrong target
- Reliance on the rear vision mirror
- Too many measures

Key Performance Indicators (KPI's), are tools which can be used by managers to enable particular aspects of organisational performance to be progressively evaluated and corrective or preventative action to be taken before minor variances become major problems.

THE ROLE OF KEY PERFORMANCE INDICATORS

KEY PERFORMANCE INDICATORS..........

ARE	***ARE NOT***
Indicators	Measures
Indicative	Definitive
Flexible	Rigid
Output Orientated	Input Orientated
Means to an End	Ends in Themselves

The Balanced Scorecard Framework

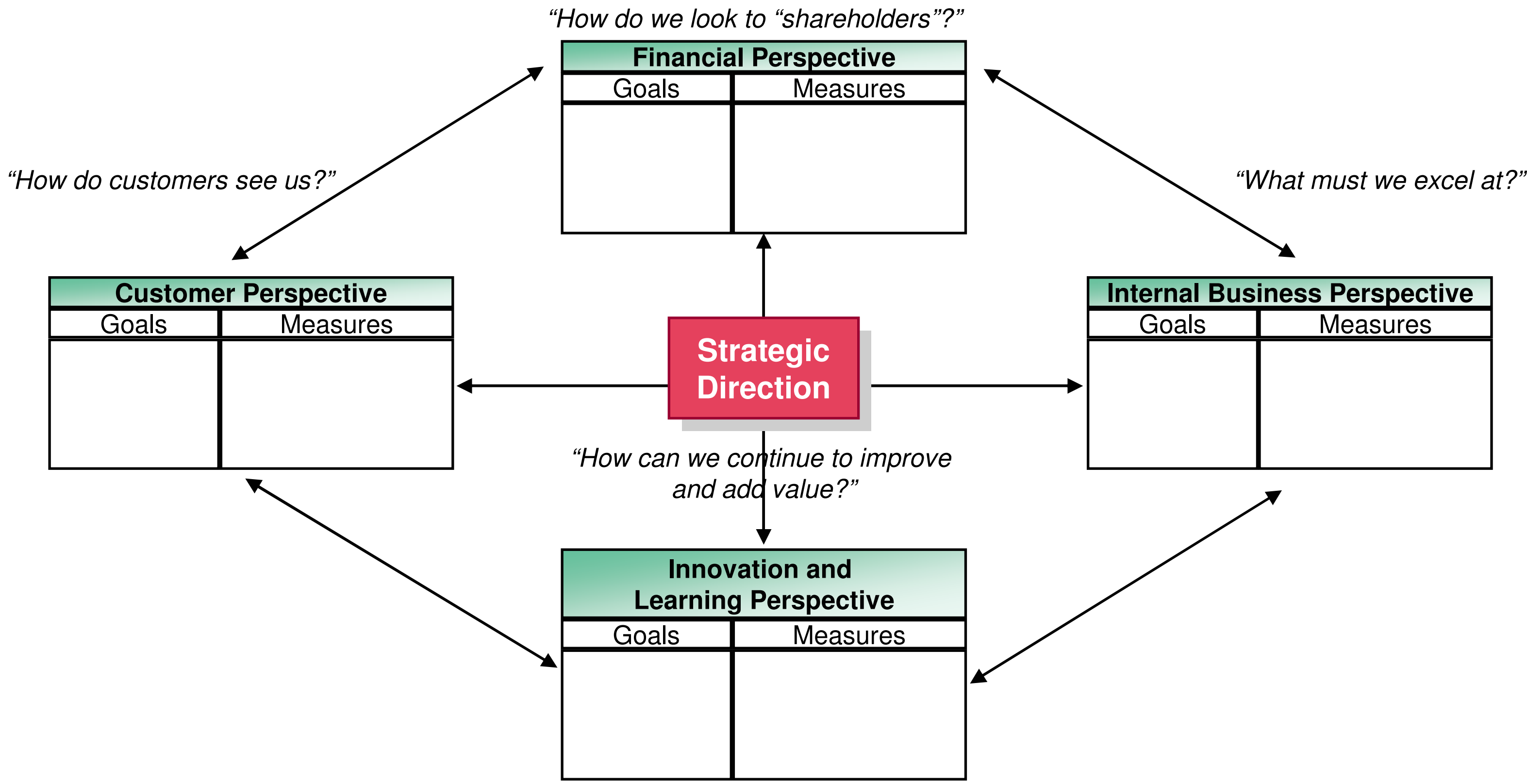
The Balanced Scorecard is an approach to designing KPI's that arose from research undertaken by US management academics, Robert Kaplan and David Norton. It argues that traditional measurement of organisational performance which focuses on financial management account only for some of the factors fundamental to business success. Although financial performance is important, KPI's which ***support*** *the financial success of an organisation need to be incorporated within the performance measurement framework.*

THE BALANCED SCORECARD - AN INTEGRATED FRAMEWORK

- Gaining increasing attention in Australia
- Used by McDonalds Restaurants, RAAF, Smiths Snack Foods, some South Australian organisations
- Financial performance only one of four critical perspectives
- Performance also needs to be evaluated from perspective of Customers, Internal Business and Learning/Innovation.

The Balanced Scorecard recognises that no single measure can provide a clear performance target or focus attention on the critical areas of the organisation. Managers need a ***balanced*** *presentation of both financial and operational measures that will provide a comprehensive view of the business. Moreover, while providing information from four different perspectives, the Balanced Scorecard minimises information overload by limiting the number of measures used and forces managers to focus on the handful of measures that are most critical.*

EMPHASIS ON BALANCE



Most organisations today have a corporate mission that focuses on the customer. How an organisation is performing from its customers perspective has therefore become a priority for management. The Balanced Scorecard demands that managers translate their general mission statement on customer service into specific measures that reflect the factors that really matter to customers. This can be done by organisations articulating customer service goals and then translating these goals into specific measures.

CUSTOMER PERSPECTIVE

- Customer evaluation to define performance
- Experience and industry knowledge is no substitute for the voice of the customer
- Undertake independent customer surveys
- Define customer needs
- Benchmark performance against competitors' best practice
- Consider "best of breed" comparison programs and form a composite of those best practices
- Set performance objectives
- Develop meaningful indicators.

The overall objective of obtaining customer perceptions is to determine the Value added by the organisation in the provision of products and services. Measures which reflect customer-perceived benefits and costs can then be developed and strategies designed to improve performance can be formulated.

CUSTOMER PERFORMANCE

TIME	QUALITY	PERFORMANCE AND SERVICE	COST
• Lead time • Response time • Downtime	• Standard of product or service as against: - expectations - competitors - other organisations	• Reliability/accuracy • Interaction with staff - What is done? - How it is done?	• Value for money • Cost components
VALUE = BENEFITS - COST			

Excellent customer performance derives from processes, decisions and actions occurring throughout the organisation. Although customer-based measures are important, they must be translated into measures of what the organisation must do internally to meet customer expectations. Managers need to focus on those internal operations that enable them to satisfy customer needs and then specify measures for each.

INTERNAL BUSINESS PERSPECTIVE

- ☐ Identify and measure core competencies
- ☐ Decide what processes you must excel at
- ☐ “Re-engineer” business processes as necessary
- ☐ Specify measures for each critical process.

To achieve internal business goals, measures which are capable of being influenced by employees' actions need to be devised. This ensures that employees at lower levels have clear targets for actions, decisions and improvement activities that will contribute to the organisations' overall customer service objectives.

INTERNAL BUSINESS PERFORMANCE

TIME	QUALITY	PERFORMANCE AND SERVICE	COST
• Expense recovery • Outstanding receivables • Customer order processing • Order and receive supplies • Delivery to customers	• Defect rate • Rework rate • Proposal development • Accident rate • Conformance with specifications • Customer complaints	• Staff survey assessing - customer service - behaviour change - outcomes - improvements - extent of participation	• Relative rather than absolute measure • Ratio of output to input
PROCEDURES TO IDENTIFY AND SATISFY CUSTOMER NEEDS			

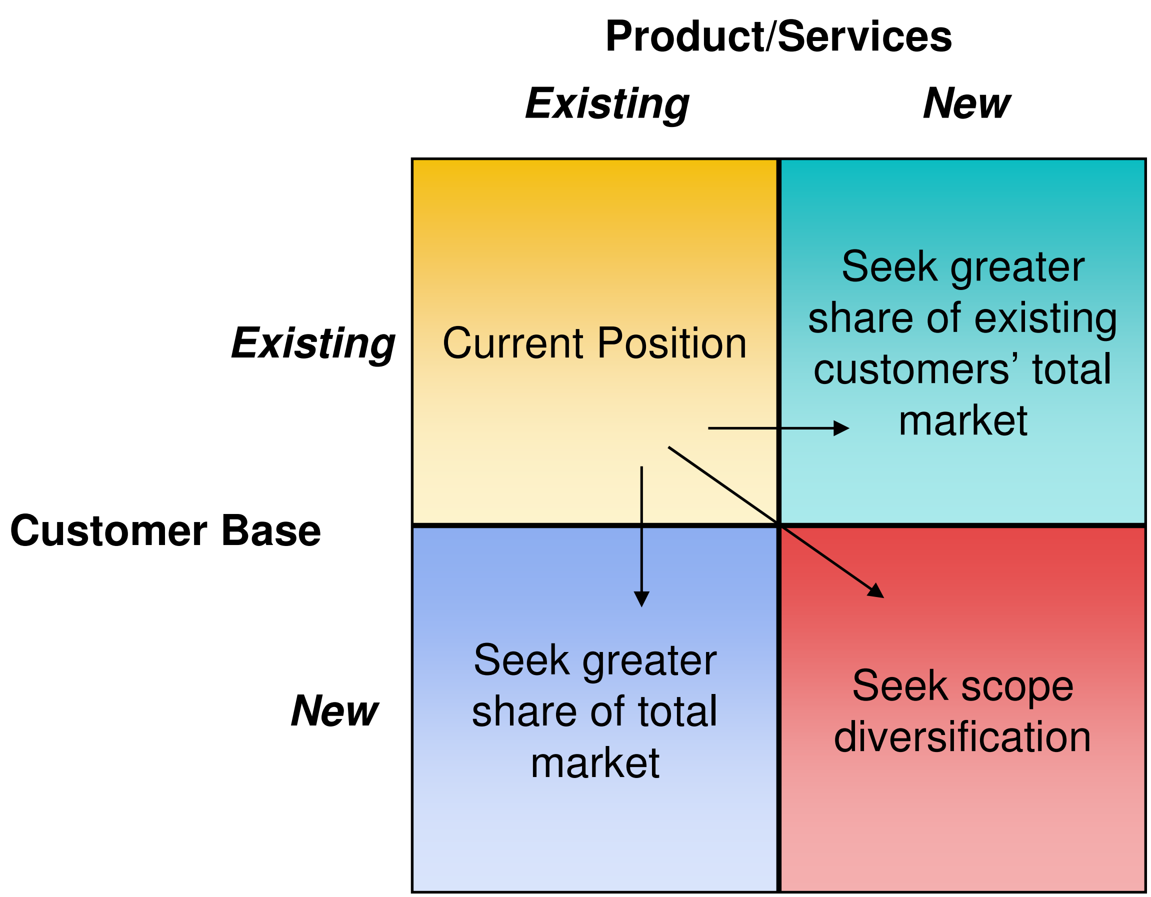
The customer-based and internal business process measures on the Balance Scorecard identify the parameters most important for current success. The targets for success however invariably keep changing. Changing policies, legislation, and competitor strategies are but some of the factors that require organisations to make continual improvements to their existing products and services. These changes demand that organisations develop the ability to introduce entirely new products and services with expanded capabilities. Only through the ability to innovate, improve and learn continually can an organisation continue to maintain successful performance over time.

INNOVATION AND LEARNING PERSPECTIVE

- Analyse service usage/“sales” patterns
- Review socio-demographic profiles
- Form initial forecasts
- Test the market through surveys, market research, focus groups, etc
- Identify likely service priorities
- Develop indicators
- Introduce low-risk pilot programs
- Develop monitoring mechanism, accountability, responsibility and authority
- Modify and augment over time.

Innovation and Learning measures focus on the ability of the organisation to develop and introduce standard products and services rapidly. These products and services are those that the organisation expects will comprise the majority of its future business. The focus of the future direction of the organisation can be in seeking to expand its customer base, seeking to expand its product/service range or a combination of both. Innovation and Learning measures need to reflect this strategic direction.

INNOVATION AND LEARNING PERFORMANCE



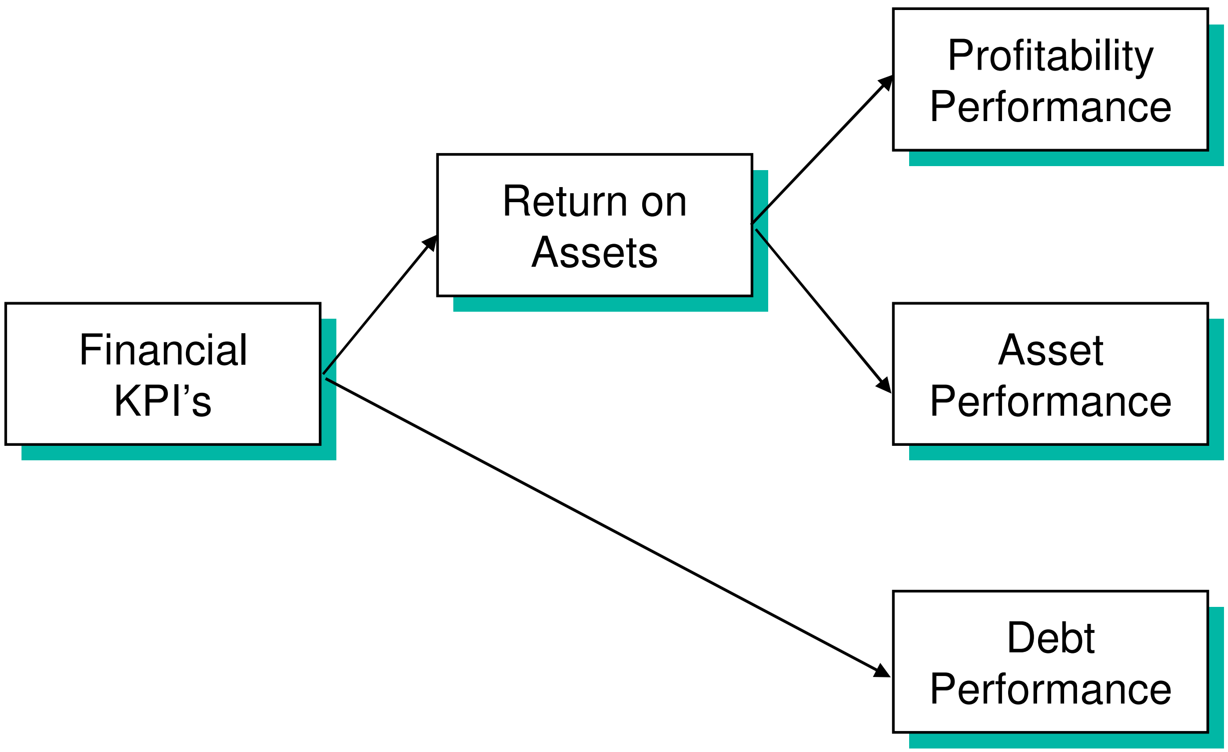
Financial performance measures indicate the extent to which strategy, implementation and evaluation are contributing to bottom-line improvement. Not all strategies however prove to be profitable. If improved performance fails to be reflected in the bottom line, management may need to re-examine the basic assumptions of its strategy and mission or rethink its strategy or its implementation.

FINANCIAL PERSPECTIVE

- Use conventional measures (Return on Assets, Profitability, Asset, Debt and Liquidity performance)
- Look at timing problems, information system capability, accuracy of data
- Revisit customer, internal business, innovation and learning assumptions
- Look at method of implementation and execution of strategies
- Conduct simulation, sensitivity analyses and cost modelling
- Understand the reasons why.

Financial KPI's are a useful reflection of organisational performance. However, they should be considered to be ball-park estimates and cannot consistently provide complete, detailed and accurate information. The three main areas which can yield valuable information about the financial performance of an organisation are profitability, asset utilisation and debt management. KPI's in these areas can be compared with similar organisations and over time.

FINANCIAL PERFORMANCE



- EBIT Margin
- Gross Margin
- Operating Expense Margin

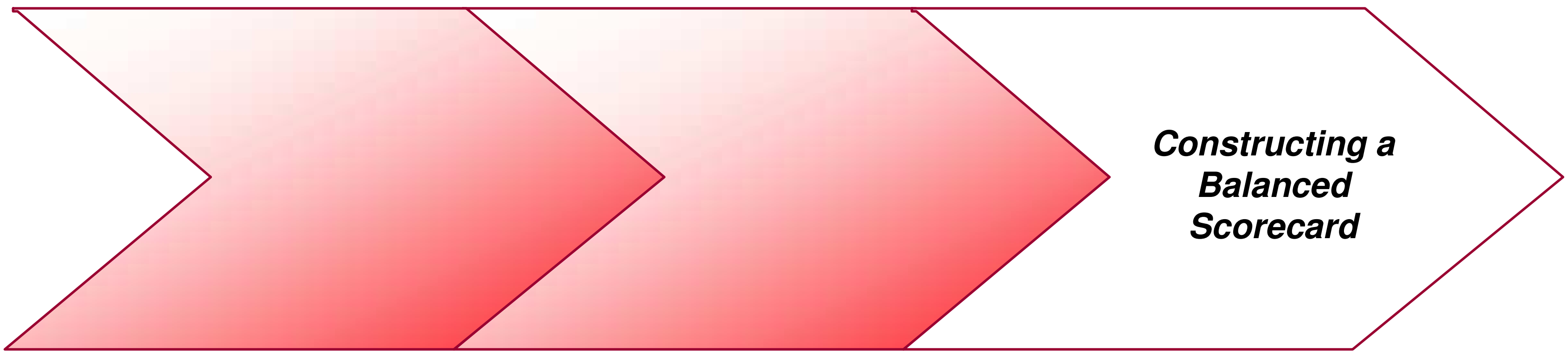
- Asset Turnover
- Inventory Turnover
- Debtors Turnover

- Total Liabilities to Total Assets
- Interest Cover

The KPI's incorporated within the Balanced Scorecard will vary between Industries, Organisations and even Organisational Units. Examples of some of the KPI's developed by organisations adopting the Balanced Scorecard reflect those particular factors critical to their success.

THE BALANCED SCORECARD IN PRACTICE

Financial Indicators	Customer Indicators
• Return on Assets • Cash flow • Project Profitability • Sales Forecasts • Sales Backlogs • Gross Margin • Sales Growth	• Customer Survey • Customer Ranking • Market Share • On-time delivery
Internal Business Indicators	**Innovation and Learning Indicators**
• Time spent with prospective customers • Tender success rate • Safety/Accident rate • Length of project lifecycle • Employee productivity • Actual introduction schedule vs plan	• % revenue from new products/services • Staff attitude survey • Number of employee suggestions • Cycle time • Yields by process • New product/service introduction vs competition • % of products/services that equal 80% of sales


Constructing a Balanced Scorecard

The Balanced Scorecard does not comprise a set of KPI's that can be applied to organisations in general or even industry wide. Different market situations, competitive environments and commercial factors require different scorecards. Organisations need to devise customised scorecards to fit their mission, strategy, technology and culture. A process by which organisations can arrive at a Balanced Scorecard comprises four phases which can be completed in a relatively short time frame.

BUILDING A BALANCED SCORECARD

PHASE 1	PHASE 2	PHASE 3	PHASE 4
Introduce Balanced Scorecard	Evaluate Current Strategy	Identify Performance Targets	Construct Balanced Scorecard
1 Day	***2 Days***	***4 Days***	***3 Days***

The initial phase involves communicating the use of the Balanced Scorecard and the value it can provide in measuring organisational performance. This is achieved through introductory workshops for management and staff. An important outcome of Phase 1 is the development and agreement to a plan of action to design and implement the Balanced Scorecard in the organisation.

PHASE 1 - INTRODUCE BALANCED SCORECARD

KEY QUESTIONS

- What is the Balanced Scorecard?
- How can using the Balanced Scorecard add value to our organisation?
- Why should we adopt this framework?

KEY OUTCOMES

- Understanding of the Balanced Scorecard framework.
- Agreement as to its application in our organisation.
- Confirmed workplan and timetable.

The objectives of Phase 2 are to analyse the previous, current and future strategic direction of the organisation, evaluate our performance and identify what we need to focus upon in order to improve our performance in the future. Phase 2 involves reviewing past and current strategic plans, existing performance measures and achievements, and meeting with management and staff at all levels with the organisation.

PHASE 2 - EVALUATE CURRENT STRATEGY

KEY QUESTIONS

- In what direction is the organisation heading?
- What are the critical issues that need to be addressed in the business if we are to achieve our objectives?
- How well have we performed and what have been the reasons attributable to this performance?

KEY OUTCOMES

- Understanding of the historical, current and future strategic direction of the organisation.
- Identification of the factors most likely to contribute to success and failure of the business.
- Consensus on the areas of critical importance.

Phase 3 of the process is designed to identify the key organisational priorities and to translate these priorities into targets and objectives. This phase requires a survey of customers, a review of current business operations and an analysis of financial projections and forecasts. A high-level benchmarking analysis is often included in Phase 3 in order to provide an indication of how realistic objectives are. At the conclusion of Phase 3 is a workshop designed to analyse and evaluate the information obtained and to design a prototype Balanced Scorecard.

PHASE 3 - IDENTIFY PERFORMANCE TARGETS`

KEY QUESTIONS

- How well do our customers believe we are performing?
- What do we need to excel at as an organisation?
- How will we continue to improve and add value to our customers?
- How has our operational performance been reflected in our financial performance?

KEY OUTCOMES

- Identification/confirmation of customer needs, critical business operations, anticipated programs and initiatives, and financial targets
- Agreement of targets, standards, objectives and priorities of the organisation
- Development of prototype Balanced Scorecard

*In the final phase of the process an Implementation Plan is developed which details **what** measures will by used, **how** these measures will be used and **how** the necessary information will be collected. The Implementation Plan will be developed in conjunction with both management and staff and will specify what action needs to be taken, by who and by when in order to implement the Balanced Scorecard framework within the organisation. The completed Balanced Scorecard and Implementation Plan is formally presented to management and staff at the conclusion of this phase.*

PHASE 4 - CONSTRUCT BALANCED SCORECARD

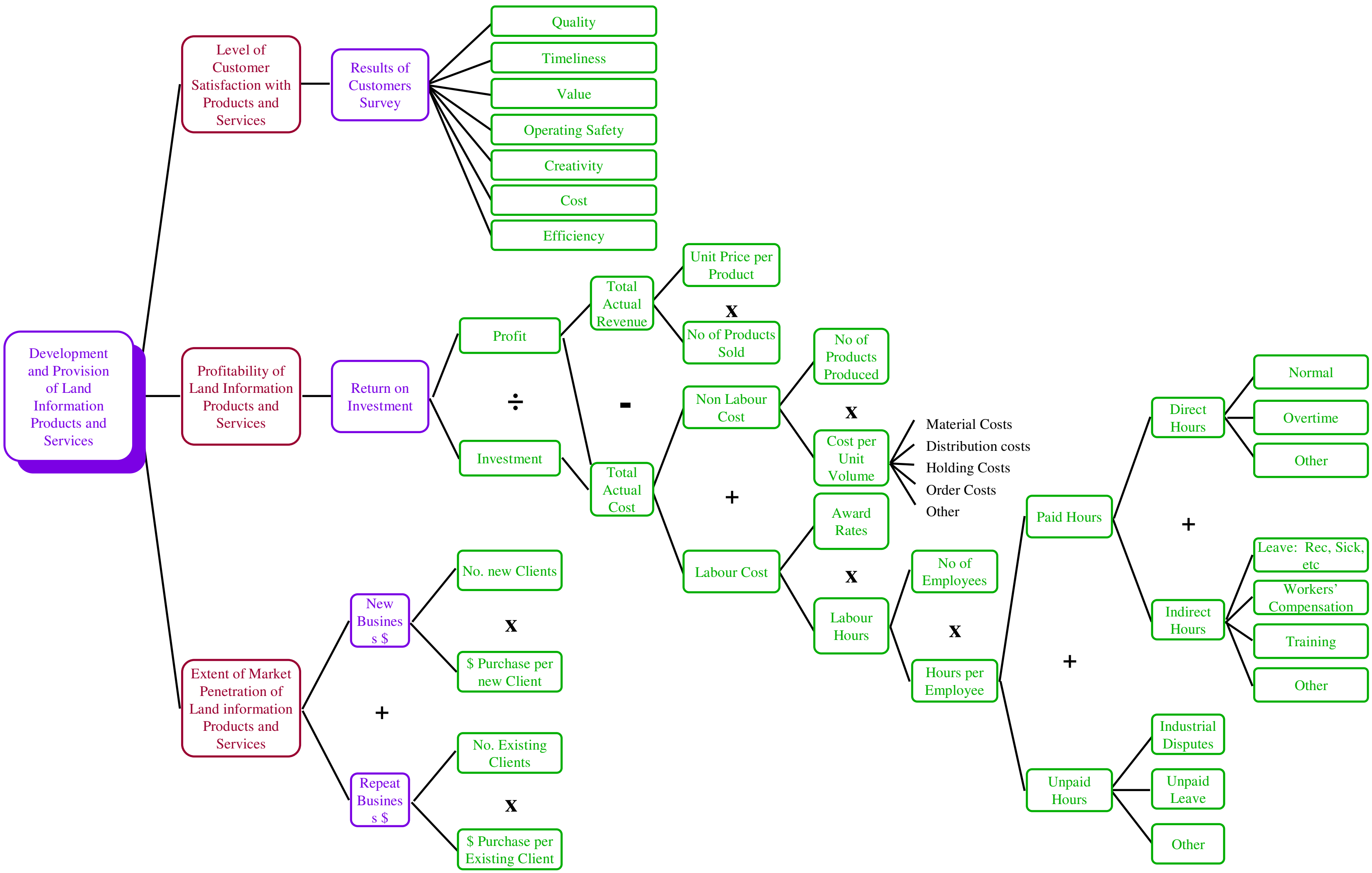
KEY QUESTIONS

- What will we measure and how will we measure it?
- How will the information be used, by whom and how frequently?
- How will the Balanced Scorecard framework be introduced within our organisation?

KEY OUTCOMES

- Development and agreement on a set of organsiation-wide performance indicators.
- Development of a mechanism for collecting information and monitoring over time.
- Development of an Implementation Plan for the introduction of the Balanced Scorecard within the organisation.

A PRACTICAL EXAMPLE



The objective of establishing and using Key Performance Indicators is to stimulate employees -both as individuals and as groups - to successfully implement strategies. Without appropriate measures of performance, strategy implementation is likely to fail.

KEY PERFORMANCE INDICATORS

KPI's should be:

- focusing on action
- leading not lagging
- qualitative or quantitative
- accurate
- controllable and reasonable
- permanent or temporary
- at different levels
- reflect the core business of the Organisation
- likely to extend over more than one year.

BUT REMEMBER →

- Do you intend to use the data you are collecting?
- Does the KPI support a Strategy?
- Have we distinguished what is essential from what is desirable?
- What is the cost of collection?
- Is the data measurable and credible?
- Is the data timely?

The Balanced Scorecard presents four different perspectives from which to measure performance. It complements traditional financial measures with measures of performance for customers, internal processes and innovation and improvement activities. This approach has real benefits for organisations...

BENEFITS OF THE BALANCED SCORECARD

- Translates strategic objectives into performance measures
- Identifies *the real* priorities of the organisation
- Focuses on those priorities
- Forward looking
- Provides evidence of performance.