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This is a documentation of best practices for creating and using key performance indicators (KPIs) for the Access Holdings family of companies. Companies to which this applies will be small to medium sized enterprises (SMEs) in the service and manufacturing sectors.

Definition

KPIs are performance measures used to manage progress towards specific business goals or strategies.

Benefits and Importance of KPIs

Central to the concept of KPIs is the necessity of linking them to business strategy. The effective use of KPIs allows management to make data-driven decisions to optimize performance towards achieving strategic goals. KPIs used by companies without a link to strategy are of limited value and can even be damaging. While throughout this paper strategic goals are referenced, KPIs are also used for sub-units in a business below the whole company level – business units, departments, functional groups, project teams – with the same approach and benefits.

Well-designed KPIs properly aligned with strategic goals KPIs are important because they:

- Keep strategic (or business unit/department/functional group/project team) goals top of mind for management.
- Cut down on information overload by providing complex, summarized results in a single metric.
- Convert abstract goals into manageable targets.
- Offer critical insights to help management to make informed decisions and improve outcomes.
- Help improve productivity, efficiency, and effectiveness of business processes.
- Provide clarity and focus on the strategic plan by measuring progress towards and aligning the company's teams' efforts to the company's strategic objectives.
- Provide a shared understanding of success in achieving long term vision.
- Create a shared language to express progress.
- Provide signals to help identify when to act on early warning signs of trouble.

Types of KPIs

It is useful to think of KPIs in several different ways.

1) Strategic/Operational/Functional
   - Strategic KPIs are high level measures focusing on the company's strategic goals. EBITDA can be a strategic KPI as can organic sales growth.
   - Operational KPIs are a layer down - business unit, department, functional group - but still focused on goals, those of the unit. Operational KPIs include net promoter score for sales, employee satisfaction for HC.

- Functional KPIs are the layer below that - individual projects, individual customers or suppliers, manufacturing processes - but also driven by specific goals. Functional KPIs include DSO for individual customers, project milestones met and missed.

2) Leading/Lagging
    - Leading KPIs are best thought of as predictive measures. They provide information that allows management to predict what is likely to happen. Number of visits per day to service locations during the month can be used to estimate monthly revenues before month end, website conversion rates can help predict likely sales from the company's ecommerce strategy. With leading KPIs management has the opportunity to act to influence future results before they occur.
    - Lagging KPIs provide information on something that has already happened and can be used by management to devise responses to prevent or encourage such events going forward. Production scrap rates and call center first call resolution rates are both lagging KPIs. With lagging KPIs management has the opportunity to change drivers of underperforming operations or sustain desirable outcomes based on analysing past performance and will have to implement operational changes over time to improve results.

3) Numbers/Progress/Change
    - Number KPIs count something – units sold for example.
    - Progress KPIs measure progress towards a desired outcome – project % completion for example.
    - Change KPIs measure change - % increase in sales year over year for example.

Characteristics of Great KPIs

What makes a great KPI?

A great KPI has six characteristics:

1) An important goal
2) A measure
3) A target
4) A data source
5) A reporting cadence
6) An owner

To reiterate, number one with a bullet, KPIs unconnected to a goal or strategy are often worse than useless. KPIs must be aligned with business strategies or goals. For a good example of why that is, see the discussion below under Developing KPIs.

By definition, KPIs have to be expressed by some measurement financial or statistical and there has to be a target that represents the desired value of the KPI. What's measured, matters. KPIs have to be based on data collected, analyzed and summarized to help management decision making.

It is necessary to understand the data source for KPIs and unless the source is soundly based and reliable the KPI itself is suspect. KPIs must provide clear information based on sound data.

A reporting cadence (daily, weekly monthly quarterly annually) is required to ensure that KPIs are providing useful information and management is acting on the information provided.

And as with most things, a named individual owner responsible for driving the KPI towards its target helps ensure that the KPI is serving its intended purpose.

What else should we look for in effective KPIs?

- There are way too many KPIs. Less is more. A few powerful actionable KPIs are better than a laundry list.
- SMART – specific, measurable, attainable, realistic, time bound
- Easily quantified
- Easily defined and understood
- Actionable

Developing Great KPIs

Benefits, types, characteristics - how does all this work together to create great KPIs?

Most companies already have KPIs, so this is the place to start to develop great KPIs. Look at the KPIs the company reports and ask the question - So what?

Days sales outstanding (DSO) for accounts receivable appear on just about every list of KPIs we ever see. Easily quantified, defined, understood and the lower the number the better right? Actually, no. Here's what happens when the company does not tie a KPI to company strategy or confuses leading and lagging or strategic/operational/functional KPIs and why when you look at an existing KPI at the company the question - So what? - is critically important.

Your company's terms are net 30. Your DSO is 50, your public company competitors are 42 (DSO is much loved because it is so easy to calculate from very little data). Management directs the company to get to 40 days. The AR group acts quickly and changes the terms to 2/10 net 30. DSO starts to drop as planned. But so does gross margin and EBITDA of course. Is the company driving towards free cash flow from operations to reduce the need for additional debt raising or is it flush with cash and debt and its strategy is to drive EBITDA to target levels that will allow it to go public? If the latter, the mandated DSO target disconnected from the company strategy is hurting the company. Lower DSO is not better here.

Your company's terms are net 30. Your DSO is 45, a lagging indicator and about where you want it having traded off your cash flow goal against your EBITDA growth goal. Is that it for DSO, just a strategic lagging KPI? It remains valuable because a significant deterioration will be a lagging indicator of performance issues. If it crawls up to 60 various operational issues could be occurring. Your customer credit approval processes could be failing to follow policy. Sales staff could be channel stuffing to meet sales or commission targets and giving extended terms without authorization. Receivables staff may be offering unauthorized discounts for payment and leaving unallocated debits in the accounts receivable subledger. Invoicing errors may be creating customer disputes and delayed payments. In this example using DSO as a strategic lagging indicator is working because it signals to management that analysis and action is needed.

But DSO should also be a functional lagging indicator so stopping at the corporate level is a mistake. Your company's terms are net 30. Customers are creatures of habit. They have established policies on how they handle accounts payable and almost never pay exactly on terms. Companies are also creatures of habit and generally tolerate some slowness in payment of their receivables. Using DSO by customer as a functional lagging indicator and believing that lower DSO is better and cash flow has to be managed, management mandates that all customers must pay by 40 days or credit will be cut off. When Joe's garage goes over 40 days this might work. But Walmart is notorious for taking discounts without authorization and delaying payments. Setting your receivables managers on Walmart may improve cash collections and DSO but at the cost of losing sales to Walmart and EBITDA. KPI goals matter.

DSO can be a very useful functional leading indicator. Your company terms are 30 days. Customer A pays in 40, B in 45, C in 35 and so on. Your receivables department's functional goal is to avoid bad debts. By tracking DSO at the individual customer level, using automation and exception reporting, your receivables staff will be warned as soon as customers' habitual patterns are breached and can immediately address what appears to be a developing pattern before it deteriorates into a bad debt.

As the DSO example illustrates, if developing great KPIs had a theme song it would be *Think* by Aretha Franklin.

So what are the steps for developing great KPIs?

First review every existing KPI and put them through the same development steps as you would proposed KPIs. Keep them or drop them as appropriate. A lot will get dropped. Those retained will likely be modified.

Second create KPIs that the company really needs.

Steps to develop great KPIs, for strategic, operational or functional purposes:

1) Define the 1 or 2 critical, most important goals for the business unit. There are too many KPIs. Fewer quality KPIs are better.
2) Choose a measure for each goal. If what will drive the goal is not known, choose a lagging KPI that will give you data over time to determine what works. If what will drive the goal is known, choose a leading KPI so you can proactively manage outcomes. Be sure to review proposed KPIs with stakeholders who will be using them before going too far in the process of creating them.
3) Establish the target measure, or the measure of progress towards the target, or the measure of change to be used as appropriate. A timeline for achieving the target is a must. Answer the question - What will success look like?
4) Envisage what steps can be taken to achieve the target KPI.
5) Identify the data source to be used and take steps to ensure its integrity and the tools and software needed to deliver the data are available. If accurate measures are not readily available defer the KPI and set up a project to find, capture, report data to allow

you to measure it. Don't use KPIs where data is unreliable or very hard to get with existing systems.

6) Establish the desired monitoring and reporting cadence.
7) Establish reporting content of actual KPI results compared to target using the 5 steps for good MD&A reporting - variance analysis, identification of proximate cause(s), root cause analysis, remediation/sustainability plan, forecast of future results.
8) Identify the individual responsible for achieving the target for the KPI.
9) Envisage how to iteratively improve the KPI over time. Often lagging KPIs can be turned into leading KPIs which results in faster management action to achieve goals. A regular review cadence will help keep KPIs relevant and effective.
10) Document all of this and compare the proposed KPI to the definition of a great KPI above.

Managing and Reporting KPIs

If the KPI has been created under the ten steps for developing a great KPI, management and reporting will be relatively straightforward.

Internal processes will include:

1) Agreeing on when and through what reporting mechanism the individual responsible for the KPI will report on progress towards target and on iterative improvements in the KPI itself.
2) Insisting on effective MD&A reporting so that the information the KPI provides is understood and actionable.
3) Establishing who will receive the reports and work with the responsible individual and others to identify and implement steps to assist in making progress towards the target result.
4) Ensuring that the reporting and iteration cadences are adhered to.

List of KPIs

Strategic KPIs, marketing KPIs, service KPIs, website/ecommerce KPIs, human capital KPIs, customer service KPIs, project management KPIs, manufacturing KPIs, financial KPIs, social media KPIs, information technology KPIs, business unit KPIs, departmental KPIs – if the issue is looking for examples - Google will provide endless links to "15 Client Service KPIs You Must Use", "Top 10 Human Capital KPIs to Manage Your Team", "Best KPIs for Manufacturing Efficiency" - endlessly.

Have I mentioned this?

- Great KPIs must be linked to business goals.
- There are too many KPIs. Fewer quality KPIs are better.

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