

## The Key Performance Indicators (KPI)

*(An effective tool to manage growth and navigate your business to the next level)*

Periods of change and transition in our personal lives tend to be filled with tension, uncertainty and doubt. The same applies to our work and professional lives. As a business grows, managers find themselves overwhelmed with the day-to-day activities and tasks. They are constantly pushed towards new territories and forced to sail into deeper waters. They are required to step out of their comfort zones and test new ways, processes, formulas, etc.

***Management is required to make more decisions, quicker, on more important things, with greater consequences and often with limited information at hand.***

This is where things can get “sticky” or fall apart. Making the wrong decisions or procrastinating about making them is equally damaging. Being distracted by the day-to-day on account of the overall direction of the business is another common error. Concentrating on tactical decisions and neglecting the strategic ones is a frequent sin. All these are practical examples of the many pitfalls of managing growing businesses. I meet these important issues on a regular basis during my consulting assignments.

Handling growth and managing it effectively is indeed challenging. Not knowing how to manage growth and adjust your business to the next level can be fatal. In this issue of ***Marketing Instincts***, I shall explain one tool I have found to be excellent to manage your business more effectively and in particular to better manage growth.

*What is the KPI?*

***The Key Performance Indicators or KPI*** is a process consisting of a monthly report that shows the key drivers of the business. The information is discussed by the senior management team in a monthly meeting timed around the 7<sup>th</sup>, 8<sup>th</sup> or the 9<sup>th</sup> of the month. The KPI may not be original in as far as it is a tool used to monitor the performance of the business. In one way or another, most companies use a process to monitor their business.

The KPI though puts everything into a one-page document available before the 6<sup>th</sup> working day of the following month and highlighting all the key areas that affect the business performance. It is, in a way, a set of business gauges similar to a car dashboard that tells you at what speed you are traveling, how much gas you have in the tank, if the oil pressure OK, if all the doors are properly closed and so on.

The KPI contains the key indicators of your business. It contains both financial and non-financial figures. It is an X-ray of your business for a given month and a given period. Many business operators rely on the financial numbers to monitor their business performance. They concentrate primarily on the Profit and Loss monthly statement (P&L). This is good but is not sufficient. There are three important shortcomings to relying solely on the financial numbers:

First, they do not provide all the needed business tools to manage the business. They cover only the financial aspect. They do not tell you about your customers, your product line, your productivity, your quality, etc. In short, they tell you part of the story. Secondly, they are made - by design - by the financial people primarily for financial reasons while what we need is a business monitoring tool and not only a financial monitoring tool. Third, the financial numbers may only be available by the middle of the following month or in many organizations even towards the end of the following month. This makes the information too historical or too old for managers to use in a practical way. If you are heading in the wrong direction, the sooner you know the quicker you can change course! If you are heading in the right way, you may want to accelerate your speed, if this is feasible.

### *Contents of the KPI*

**Financial information** on revenues, gross profit, gross margin, selected key costs such as manufacturing, distribution, sales, administration and overhead, operating profit, etc. in addition to selected information on inventory levels and accounts receivable. **Commercial information** on sales, product/service performance, sales mix, repeat business, new orders and other selective data. **Production, operations and overhead information** as appropriate to the business i.e. manufacturing costs, distribution costs, productivity levels, quality data, back-orders, fill-rate, work in progress, number of employees, etc. **Forecast information** regarding future performance will include the revenue/sales forecast for the next 90 to 120 days and other information as appropriate such as projects underway, work in progress, etc. This part predicts future performance. The forecast will usually guide short-term decisions that influence employment levels, purchasing decisions, pricing issues, etc. Lastly, an "other section" may group particular information which is important as an indicator to a particular company or activity.

The KPI will highlight revenues and sales for the month and year to date (YTD) and compare them to the same month last year, YTD last year and to your monthly target and YTD target. The revenues would also include the sales mix, meaning the main product/service lines or categories up to a maximum of 5 different categories. Remember we do not want all the details but only the key ones. In some business, the geographical mix of the business would also be shown or the channel by which sales were generated and so on.

Every time I install the KPI in a client company, I go with management through a process of customization to arrive at the right data to show. This is a common sense judgment of what to include and what to discard. There is no right or wrong information to show. Usually, I find managers wanting to show more details and I resist the temptation by convincing them not to "clutter" the overall report with too much information.

Let me give you an example because this is very important. Let's assume you have 4 product lines, which in turn are divided into 14 categories and then 24 sub-categories. The KPI should tell you how the month's sales performed vs. your target and vs. the same month last year. Are we up, flat or down? Then you want to know how the four main product lines are behaving. Where do we stand vs. our yearly target and how are we doing thus far this year vs. last year? Some top line analysis by volume and price can also tell you how are your prices and volumes are performing. This is the KPI. If you want to go beyond this into more details, then you need to have a specific sales meeting analyzing in greater detail the sales performance. The KPI allows you to

quickly and once a month, appraise the key indicators of all the business and not only one or two areas or the financials.

#### *What you need to know*

An example of a KPI is attached to this edition of **Marketing Instincts** for illustrative purposes only. In the many KPI I have designed and implemented with clients, no two were similar. Over 70% of the contents was the same, but the 30% variable part was very important and often determined if the KPI was valid or not.

The KPI needs customization and its sections need to be adapted to your particular business situation. It also needs some expertise to be able to handle objections and various forms of resistance by the managers involved. I must also report to you, in honesty, that while I was successful in implementing the process in the vast majority of the companies (probably well over 80% of the cases), I was unsuccessful with certain companies.

Where the KPI failed was more due to the lack of desire to implement or due to a style of management rather than for the technical aspects of implementing the KPI process. For instance, some Presidents/General Managers did not want to share confidential information with their team, or preferred not to give clear areas of accountability to their managers. Others simply could not adjust to the discipline needed to implement the KPI.

#### *Watch for potential resistance*

Here in a nutshell are some common areas of resistance to implementing the KPI process. The **Financial Manager** by definition wants to have financial numbers with high integrity and accuracy. This is honorable and good. But, he/she can achieve this around mid month, when he/she closes all the books and reconciles all entries. My KPI cannot wait until the 15<sup>th</sup>, 20<sup>th</sup> or month-end to be ready! I will settle for 95% accuracy - favoring speed - over 100% accuracy but with slow availability. In other words, I am trading the 5% exactitude for 10-15 or more calendar days. Financial managers resist this trade-off. Once they understand the benefits though, most will cooperate eagerly.

The **Sales Manager** also usually resists making forecasts at first. Forecasts push them outside their comfort zone. It requires them to involve all their team members and to forecast the future. Nobody wants to forecast the future because they do not want to look foolish when they are wrong.

Is it easy to forecast? Absolutely not. It is very hard to forecast. The difficulty though must be addressed as a challenge rather than an insurmountable obstacle. In brief, it is difficult but doable. You also get better at it as you practice. I always suggest, aiming for 90% accuracy for the forecast of the current month, 85% for one month out, 80% for two months out and 75% for three months out. These margins of deviations (10 to 25%) are significant. The bottom line is simply this: a well-run business can reasonably forecast its revenues. This has nothing to do with the size of the business or the activity, but has to do with the quality of the management in place and the forecasting process.

Finally, the **President or General Manager** can also have resistance if he/she does not want to share info with his/her team. The KPI is an open book with sensitive data. While there are ways to conceal some financial details, the KPI is indeed an X-ray of the business and a good one. Of equal importance, the KPI also involves chairing a meeting once a month with all the senior managers. The meeting will usually be a

minimum of two hours and may go to four hours. Some CEO's are not comfortable with this role. In such a case, the CEO needs coaching.

### *Benefits of the KPI*

Once implemented successfully, the KPI provides numerous benefits: It promotes **greater accountability**, as every manager will see his/her area exposed with factual data. No blah.. blah.. blah.. anymore! Hard, comparable and indicative numbers gathered and reported in a systematic and consistent manner are indeed powerful. More importantly, not only will a manager know the numbers of his/her area but he/she will also know the numbers of other areas and the company as a whole as well as who is and is not performing. This is a very strong motivator and when used correctly, a great tool for **team building**.

The KPI forces the management team to look at **the big picture** without sacrificing the details if you need to go to the details. All managers are working from the same set of numbers and working with focus on the key issues, areas and drivers of the business. Peripheral and secondary issues fall by the wayside. They will get handled no doubt, but the team is now working with focus and in order of priority.

The KPI also forces management to evaluate and discuss **strategies and not only tactical issues**. It obliges the Managers to look at results rather than just engage in activities. They can see the consequences of their decisions and how these decisions influence the business. Pricing actions, hiring decisions, quality measures, new product launches, margin improvement initiatives, cost management actions, etc. stand out in the numbers and are now made available to all team members.

Finally, the improved ability of the business to forecast its performance allows it to **better plan** and to "cultivate" the areas of opportunities while urgently addressing the weak areas. The management team becomes more **proactive rather than reactive**. The KPI also addresses balance sheet issues and capital requirements needed to finance expansion.

While it is true that businesses face difficulties if they lack growth, it is also very true that businesses run into trouble because they simply do not know how to manage growth. Making a U-turn with a regular sedan – on a busy street - is somewhat difficult. Making a U-turn with a school bus starts to be a little bit more complicated. Making a U-turn with a freight truck is next to impossible.

The KPI is an excellent tool to monitor the business performance and rally the management team to focus on the key drivers of the business. Growing the top and bottom line in a healthy manner while simultaneously strengthening the strategic position of the business is what it's all about. The usefulness and validity of the KPI have been proven in many of the more than 120 consulting assignments I have completed successfully during the last six years.

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