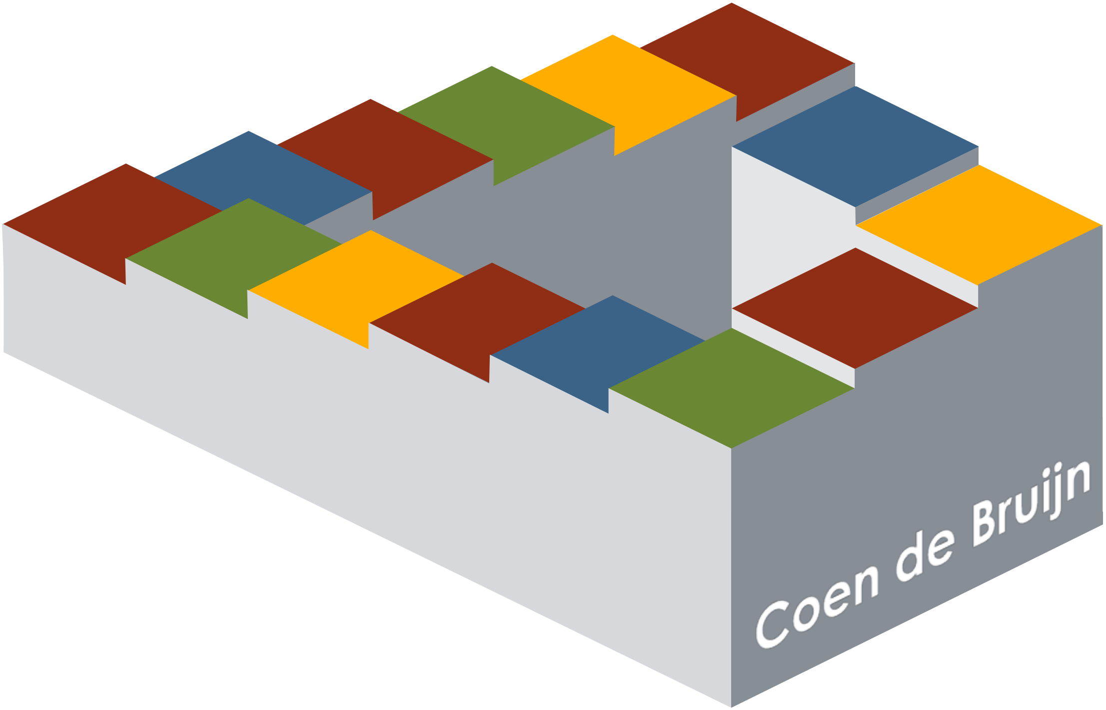
Key Performance Illusions

pitfalls and loopholes in performance measurement



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For general information about this book, please contact the author via keyperformanceillusions@gmail.com

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Chapter One

Key Performance Indicators

No other management tool is so widespread as the Key Performance Indicator. It is fair to say that it is by far the most common mechanism via which organizations try to measure how well they are doing in terms of strategy, people, processes, technology and finance. At some point in history, consultancy firms, management gurus, experts, accountants, etc. started evangelizing that the more you measure the better. This led to the availability of an increasing amount of measures, which in turn caused a rise in the demand of transparency by investors, regulators, policymakers and the like.

What started as a mechanism to measure financial performance ended up being the “holy grail” in the world of management. Over the past decades, a complete new industry has emerged around KPIs, called *Performance Measurement*. This should however not be confused with Performance *Management*. While Performance Measurement asks, “How do we *track* the progress of the strategy we’ve put in place?”, Performance Management was set out to answer the question, “How do we *manage* the strategy we’ve put in place?”. In recent years, things have become more confusing as in today’s business practice *Performance Management* usually means the appraisal approach in which employees, together with their managers, evaluate their individual performance.

Key Performance Indicators (KPIs) are the underlying mechanism for both Performance Measurement as well as Performance Management and will be the focus of this book. Take a look at some KPIs from a random organization and you'll notice that it is extremely hard to find common ground for one single definition. Of course, there are many books and websites available on KPIs that provide you with a nice academic definition for KPI. But most of them say little to nothing. These fancy definitions make the mistake by describing the KPI in terms what it *should* be, rather than what it actually does in practice.

In real life everything can be called a Key Performance Indicator, making it impossible to find one clear definition. I'll go easy on myself and first start with the three separate words in KPI (key, performance and indicator). The "K" for Key refers to the relative ranking of importance for a particular criticality for current and future success of the organization. The "P" of Performance is a task or operation seen in terms of how successfully it is executed. Performance is supposed to be measured in some sort of unit representing the activity or behavior. In a car this unit could be Miles Per Hour, Revolutions Per Minute, Car Temperature, or Tank volume. The "I" for Indicator is an index or statistical value that represents a certain state in the outside world. See it as the "needle“ indicating a given condition or direction. For example, the speed dial on the dashboard of your car. As stated before, people will call everything a Key Performance Indicator, even when it is questionable whether it is actually *key* or doubtful if it is really measuring performance. That's why I prefer to use a definition that might not be as fancy, but at least it can be understood and can be translated to actual KPIs.

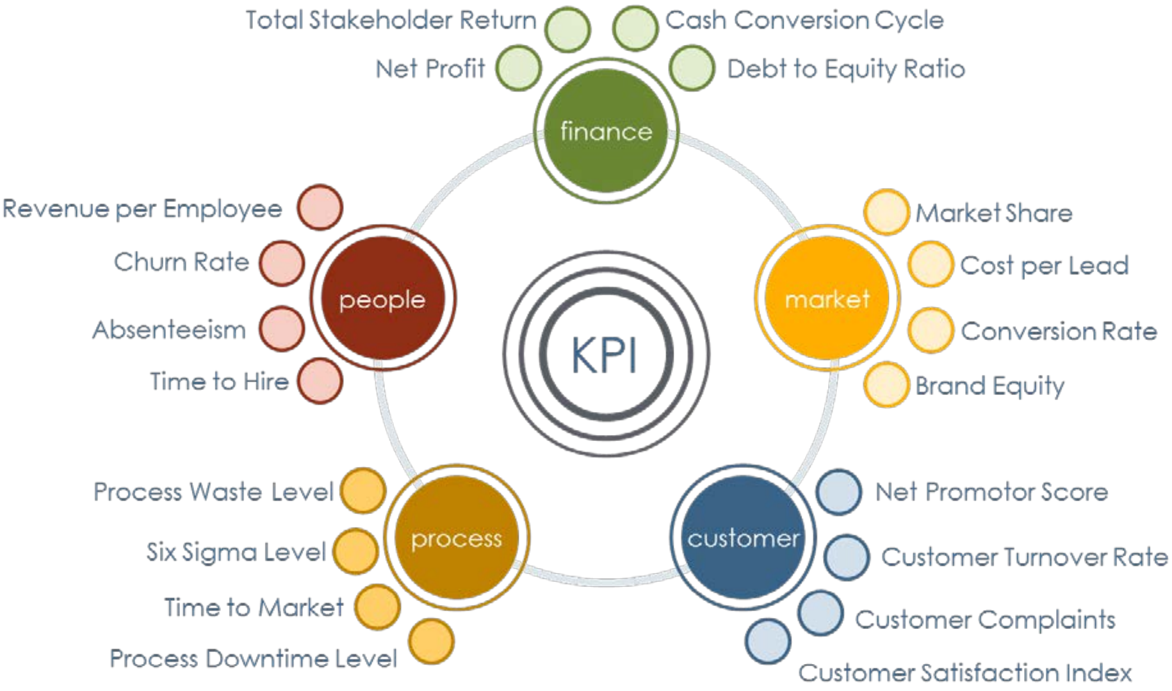
All academic terminology aside, a KPI can be seen as a way to measure how someone or something is doing. Nothing more and nothing less. In the next chapters this what I mean when using KPI. The

“Losing an illusion makes you wiser than finding a truth.”

Ludwig Borne (1786-1837)

German political writer and satirist

Trying to categorize KPIs would be like trying to categorize all animal species in the world. Whilst for the latter this is a useful task, for KPIs it isn't. There are just too many. Only in general terms can one make a distinction between different KPIs. There will be KPIs that are mostly for external communication and those that normally will be used internally. Another useful distinction is already captured in the definition posted on the previous page, where it states that a KPI indicates how *someone* or *something* is doing. I'll call the first category the behavioural-KPI. It measures how an individual is doing, focusing on the psychological aspects behind the performance (e.g. *Customer Satisfaction* or *Employee Engagement*). Non-behavioral KPIs, on the other hand, are those indicators that take a more objective *thing* to measure like money or systems (e.g. *Net Profit* or *System Uptime*). In this book I'll mainly focus on KPIs as they are used in the corporate world. Not that nothing can be said about other kinds of performance indicators. On the contrary. Much of what is explained in this book also applies to measurements in general. That's why in the examples, that can be found between the chapters, I will dive into some of these non-corporate stories as well. The diagram on the next page shows some common KPI examples across different management areas. In the next paragraph we will discuss the rise of the KPI by looking at the recent history of Performance Measurement and Control.



Some examples of KPIs across different areas

The rise of the KPI

It cannot be denied that in recent decades there was an increase in bureaucracy and, both in the private as well as in the corporate world, a wave of control and regulation resulted in a culture of “check the box”. This trend is well- documented in previous years. A good overview is provided by Michael Power in his book “The Audit Society” (1999). Even 20 years ago, Power already states that the culture of control and performance measurement has grown rapidly. For years, performance measurement was restricted to the financial side of things, but the past 40 years it extended to other domains as well. New management areas, like operational management, process management, competence management, knowledge management, or project management, were introduced for which progress measurement was needed (examples extracted from the book “In Control” by T. Homan).

In addition to this expansion, the types of measurement moved from macro to micro level. Rather than comparing different companies, the goal became to develop requirements and criteria for individuals. Nowadays, we are so used to this level of micro management, that we even frown upon those who refuse to be monitored via these kinds of systems. Another development that Power addresses is the development of a Risk Management culture that developed a complete new system to identify, predict and monitor risks. Key Risk Indicators were introduced to monitor individuals and if these indicators turned red, mitigating actions

were implemented (that in turn needed monitoring via KPIs). When all these monitoring systems proved unable to predict fraud scandals (e.g. Enron) or financial crises (like the one in the 1980’s) the corporate world responded with even more controls. For most companies, this was the time to have their internal audit department explode with employees. These departments would then check whether the implemented Risk Management systems were any good and if individual employees were living up to the implemented measures. Of course, these departments also introduced a whole set of new KPIs to measure the expected progress. To make things worse, there was another trend that boosted the performance measurement industry. Companies were monitored more and more from a distance. Not only by commercial parties like accounts or external audit bureaus, but also by countless governmental bodies that sprung to life to monitor, control and measure the performance of other governmental organizations or commercial companies.

All these trends led to a self inflicted *Control of a Control of a Control*. We thought that with the introduction of KPIs at the micro level, things would become more transparent and therefore more manageable. But with every crisis or bad press, it seems that we tightened this control system and threw another bunch of KPIs on top of the already existing ones. Leading to more KPIs that check whether the right new KPIs were implemented, resulting in an endless process of new KPIs and measurements. Of course, there are many who benefited from this never-ending circle, especially the knowledge industry (like consultants and business schools) who introduced and advised on many of these new management concepts and hypes. These companies are an important and influential conserving force that have a direct interest in keeping the 'tick the box society' alive. After advising governmental bodies on new possible control mechanisms, they then go to companies to explain how they should implement them. And of course, this consult comes with a price. And don't fool yourself into thinking that this is limited to the corporate world. The KPI has also become an established tool in the public and non-profit sector. Encouraged by senior management, consultancy firms, controllers, accountants, regulators and management gurus, we engulf ourselves in KPIs. Managers (forced or willingly) use numbers, statistics dashboards and *balanced scorecards* to supervise and tighten their grip on the organization and employees. KPIs, once implemented, tend to stay in place even when they are proven to be absurd. In the end, KPIs became the solution to an invented problem, that was never there in the first place.

Before, in the next chapter, we dive into the question why we then keep using KPIs, despite their obvious shortcomings, this chapter ends with a brief overview of the rise of the KPI. In order to make sense of the world around us, from the very small atomic scale to the very large cosmic scale, human kind introduced all sorts for measures like numbers, time, weight, length, volume, money, and so forth. For centuries we have been using these numbers to measure performance, but only when the corporate world got hold of these measures we saw the KPI transform from a tool to goal in itself.

3000 BCE

Banking

Banking was first developed (3000-2000 BC), and laws were first used to regulate banking operations (1792 – 1750 BC, The Code of Hammurabi).

1400 CE

Venice

The Venetians evaluated the performance of their sailing expeditions by calculating the brought back goods by the journey.

1500 CE

Church

In the mid 1500s, Ignatius Layola instituted a procedure to formally rate members of the Jesuit Society.

1650 CE

Public Service

In 1648, the Dublin Evening Post in Ireland evaluated legislators by using a rating scale based upon personal qualities.

1800 CE

Military

Most Western armies did appraisals as early as the 19th century.

1907 CE

William Harvey Allan

One of the earliest books on performance measurement that used the term "measure" in the context of evaluating performance is: Efficient Democracy, by William Harvey Allen.

1920 CE
Return on Investment

DuPont started using Return on Investment as a performance measure, one in a long series of business and technology innovations that emerged from the company.

1950 CE
General Electric

General Electric introduced the use of key corporate performance measure, through an initiative commissioned by the then CEO, Ralph Cordiner.

1970 CE
New methodologies

Many different performance management systems were introduced such as Management by Objectives, Program Planning and Budgeting Systems and Management by Results

1990 CE
Balanced Scorecard

The usage of this method exploded after the publication of the book The Balanced Scorecard: Translating Strategy into Action by Kaplan & Norton

2000 CE
New Public Governance

A new control philosophy was introduced to modernise the public sector. Key in this trend was the measureable government and to copy management paradigms from the private sector.

2008 CE
Financial Crisis

After the financial crisis It became apparent that some companies and countries were too “big to fail” and more and more control were put in place to control the financial industry