KPI

DISCOVERY CHEATSHEET

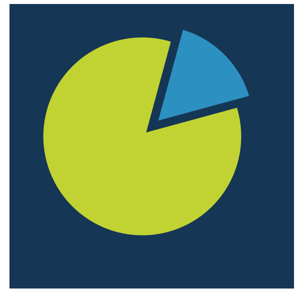
CREATED BY

STRATEGIC CFO™

Introduction

You know that monitoring your Key Performance Indicators (KPIs) is a powerful way to improve financial and operational results, but identifying these key drivers isn't always easy.

Following are the steps you should take to identify what's really driving your business.



REVIEW THE VARIOUS LEVERS THAT DRIVE SALES

Here are some of the levers you want to take a look at:

- **Number of invoices processed**
- **Number of customers serviced**
- **Product mix**
- **Gross margin %**

After you've identified your levers, determine which of them you can control. Those are your sales drivers.

(Note: Key Performance Indicators related to sales are often the most important. Why? Financial projections most often fail due to wrongly estimate revenue).

EXAMPLE

We once worked with a company whose revenue was based on memberships. The existing KPI that they measured was the **number of members**. However, due to changing demographics beyond their control, their membership number was declining. They were at a point where they would not gain new members due to these outside forces. All they could do was sell more to the existing, relevant members. Therefore, we began to track and fuel a new KPI – **revenue per member**. The company began to measure and drive the **engagement** of its core members.

REVIEW YOUR FINANCIAL PROJECTIONS

You do have your projections prepared, right? If not, now's the time!

Perform a sensitivity analysis: In Excel (or Excel equivalent), go through your large line items one by one and key-in an increase or decrease of 10%. Pay special attention to those line items that, when they change, cause an exponential (> 10%) change in net income. Those are your key financial drivers.

EXAMPLE

A retail client once needed our help. They sold product and installed it for their customers. Sales were growing but net income was not. As we performed a sensitivity analysis, we immediately checked their largest costs. The first was the cost of sales, which was set by the manufacturer and unable to be impacted. The next largest line item was installation labor. We came to find out that while the company's pricing was setup correctly for their target unit economics, something was breaking down in operations. The KPI they began to track was the **installation cost as a percent of revenue** on each job. The company tied incentive compensation to maintaining the proper installation costs per job. As a result, it realized a 33% increase in net income.

INTERVIEW YOUR OPERATIONS TEAM

Ask the folks in operations how they know if they've had a productive day versus a non-productive day. How do they measure it? Who are there most productive employees, machines, assets, etc.? What makes them the most productive? The answers to these questions will help you determine what your operational drivers are.

Your operations team uses KPIs, but they are oftentimes not documented or communicated to finance.

Take for instance the CBS television series, **Undercover Boss**. Every episode, a high-ranking execu- tive disguises himself or herself and goes to work in various operations of the company. Without fail, every executive is paired with an employee who unknowingly drives profits by utilizing his or her own system of measurement. While the show is entertaining, it points to the fact that spreadsheets are only half the equation – the business model must be executed in operations by real people who strive to work efficiently. And most of the time, they know something about making that business model work that you don't.

DEVELOP “MASHUP” DRIVERS

Not all KPIs are purely sales, financial, or operational. Some KPIs combine drivers from one or more of these areas into a “mashup” driver that, while not a meaningful number in isolation, can be used as a benchmark. For example, widgets produced per gross margin combines an operational metric (widgets produced) with a financial metric (gross margin) to come up with a measure of productivity. In order to get this metric to improve, a company would need to make better use of its resources. Often, these mashup KPIs are some of the most powerful because they require multiple departments to work together to achieve results.

Keep in mind that a “mashup” KPI means nothing on its own. The valuable information is in the KPI’s trend over a period of time.

EXAMPLE

One of our manufacturing clients was experiencing declining profits. Knowing the importance of visiting operations (as detailed in the previous step), we visited the plant manager and asked, “What does a good production day look like?” We found that the plant manager kept a note- book that showed the number of widgets produced... along with daily payroll, which he submit- ted daily. Therefore, he tracked the **widgets produced per full time equivalent**, and unknowingly managed the plant’s productivity. By focusing on this mashup KPI, the company was able to increase profits.

Once you have your KPIs all sorted out, **start tracking them!** You may start out following more metrics than you need, but the most meaningful ones will jump out at you and you can pare the list down as you go.

WHERE DO PEOPLE GO WRONG WITH KPIs?

- **Too many.** Detail-oriented people such as accountants, programmers, and engineers tend to make everything a priority, which begs the question– if everything is a priority, is anything a priority?

- **Too complex.** Measuring KPIs can end up looking like a mini-P&L. This is too complex to maintain.

- **Too little time.** Some give up without testing KPIs for long enough and seeing valuable trends. It’s not easy. If it were, everyone would be doing it.

Remember, KPIs help focus the organization on what is important. It is worth your while to discover and track them.

Want a convenient way to track your KPIs? Click here to get our Flash Report Tool & Implementation Guide