



M c K i n n e y R o g e r s

**Key predictive indicators:
the next step for senior
management KPIs**

The report's methodology

Our report combines our consultants' extensive experience with an analysis of the key performance indicators (KPIs) of the senior management teams from 18 businesses from America, Europe, Africa and Australasia – ranging from global giants through to fast-growth new businesses.

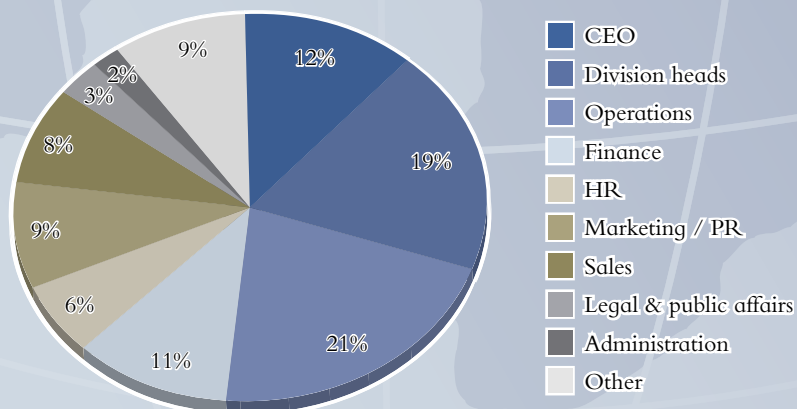
This involved reviewing and categorising over 1,000 objectives set in 2008 by 18 chief executives (or, in some cases, business unit heads) and around 130 senior executives in their leadership teams to identify the metrics CEOs and their leadership teams really see as critical.

In doing the analysis, often categorizing KPIs was straightforward, but in some cases subjective judgment was required. Similarly, just because a target had a dollar or euro sign next to it did not mean it was a financial target – for instance, sales targets were usually expressed in currency terms, but could equally be expressed in terms of market share or unit sales.

Throughout we use the term CEO to describe the most senior director, although a number of titles are included under this shorthand. Operations also includes a small number of senior directors with logistics and IT responsibilities, and Sales includes senior directors with export responsibilities.

Where we refer to the “average” in the report, it refers to the mean.

Our sample of around 150 CEOs and senior leadership team members comprised:



Foreword from Damian McKinney



It is a management doctrine that “what gets measured gets done”. However, just because something is measured, that does not make it important. In setting KPIs – key performance indicators – the really important question is not how much is being measured but *what* is being measured, and does it reflect the key steps that will make a dramatic difference to the business.

Our view, set out in this paper, is that there is too much emphasis at senior levels on reviewing recent past performance (how well the business was doing) and not enough on identifying and monitoring early indicators that warn when plans are already being thrown off track.

Financial key performance indicators currently favoured by CEOs and their management teams are rarely sufficient to give them the information to run their businesses effectively, particularly in volatile times such as the recent two years.

We argue that it is time more leadership teams invested their time to develop Key Predictive Indicators that help them look forward to impending problems, not backwards at how the business handled past problems.

This report draws on McKinney Rogers’ experience working with a range of CEOs and their senior leadership teams from around the world, and our sample includes the very large (three of the sample are in the Fortune 200) through to much smaller enterprises.

In our sample the typical CEO had between eight and ten main KPIs on which they judged whether they and their team were on track, focussing mainly on financial, operational, sales and marketing measures. This is a realistic number – our usual experience with businesses is that leadership teams have far too many goals and measures, preventing management from focussing on the really important issues.

I hope that this report is of interest and provides you and your leadership team with food for thought when considering your objectives and the measurements you will use to ensure your strategy is, and will continue to be, achieved.

Yours faithfully

Damian McKinney
Chief Executive
McKinney Rogers

Where KPIs fit in delivering your vision

Performance indicators have a critical role in ensuring a business is achieving the strategy that will realize the vision for the business. KPIs may be financial, such as profit and revenue growth, but these are very backward looking – if a business fails to achieve the intended growth, you can try harder for the future for new opportunities, but the income lost is gone for good.

Useful KPIs are predictive, helping management to identify early where the strategy is going off track or where it is not being operationalized. This allows adaption of the plan at an early stage – whether a new strategy, tactics or team members – to ensure the vision is achieved.

The chart below highlights how central KPIs are for management teams in enabling them to monitor and adapt their plans to ensure their strategy is on track.



Executive summary

Key findings



- Given the importance of people and leadership issues, the number of measures related to this is surprisingly low. Businesses invariably reiterate that “our people are our best assets” yet few have people-related KPIs, and even fewer have leadership ones. CEOs need to ensure leadership development features highly amongst their predictive indicators.

“Leadership” can mean many different things and it is often hard to “get a handle on”, particularly as many companies have a muddled and unfocussed view of what leadership means to them. If there is a very strong message about leadership goals, expectations, and the skills required then measuring it becomes a bit easier. Similarly, the absence of leadership is often easier to identify – high turnover, low morale, and the emergence of a dysfunctional culture may all be indicators of poor leadership, whether at the department, division, national or corporate level.

- Between eight and ten KPIs is the maximum for each member of a leadership team. More than this and focus is lost and they become ineffective.

There should be a healthy split between headline financial metrics, leadership & talent management ones, and KPIs that can provide early warnings of problems. However, senior management time is limited and executives (and those that support them with management information) need to do more in providing “summary indicators” that combine a number of factors into a single indicator.

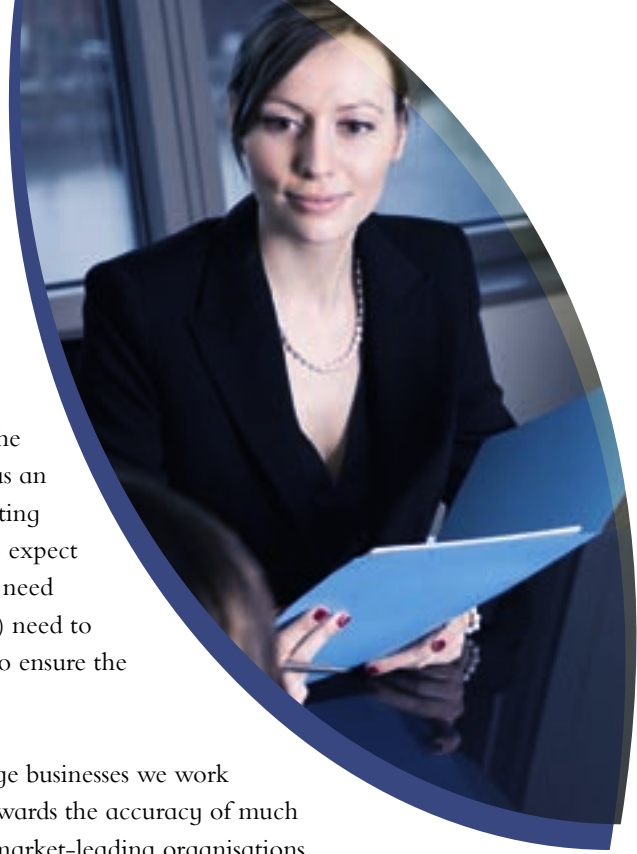
Competitor activity is a good example. For instance, if competitors dramatically increasing their advertising spend, drop their prices and/or up production, all will potentially affect marketshare and profitability. Major changes in these should definitely cause a big red light to flash immediately on a CEO’s desk – yet this is rarely the case. A big summary chart of data is certainly one way of presenting such information – although no one but a data maniac will notice changes. A simple KPI that highlights causes for concern, and allows those concerned to drill down into the data, is better.

- Most businesses exclusively use internally-generated data for their KPIs – typically financial and operational measures. Few use external data – despite the importance of external factors (for instance competitor activity, input prices, exchange rates, brand reputation and market share) in setting and monitoring objectives.

This lack of a link between external events and internal goals prevents businesses from being able to adapt their plans and strategy in a timely manner when important changes happen that undermine their ability to achieve key goals (for instance, if increased profitability is a key target, then new action will be needed to achieve this if important input prices unexpectedly rise).

Other points to note

- The most notable absence from many leadership teams was the HR director. This probably explains the lack of employee engagement and leadership KPIs at many businesses. The absence of a senior HR professional from the leadership team often reflects previous experience of HR as an inhibitor rather than an enabler, for instance by implementing processes in an overly rigid manner. HR professionals who expect to join the senior leadership team (and there is certainly a need for them given the importance of talent to a business) need to see the business through the eyes of the CEO and set out to ensure the business achieves its goals.
- The two most common problems we first encounter at large businesses we work with are data overload, often combined with scepticism towards the accuracy of much of it. The quality and credibility of data are essential and market-leading organisations we work with typically invest heavily in a supporting infrastructure to ensure management information is fast and accurate, often arriving in real-time.
- In the companies we reviewed for this report, the average CEO had nine key performance indicators. These not surprisingly had a strong focus on topline financial results – counting for nearly a third of all CEOs' KPIs. However, these are “rear-view mirror” measurements and are of little help in the day-to-day management of a business.
- Many CEOs in our sample also had a strong focus on marketing and PR targets (such as brand awareness, favourability targets and favourability amongst stakeholders). Many also watched the sales numbers closely.
- Many new CEOs want to make their mark with fast and prominent appointments to the leadership team, often bringing in close associates who they have worked with elsewhere. This can lead to problems, with the CEO having to carry the appointee and being unwilling either to have tough performance discussions or to remove them for fear of being seen to reverse a decision, damaging their credibility. Proper recruitment procedures should be followed at senior levels most of all to prevent buyer's remorse down the line.
- The failure of an executive to achieve particular targets should not by itself lead to arbitrary dismissal. They may be talented and failure may reflect an area being particularly challenging – in the same way that other team members may be hitting their performance with ease because the targets were set too low! As always in management, the science needs to be balanced with experience and judgment – good judgment based on sound facts is what great leadership is all about.



KPIs – Getting the data right

Two of the most common problems we encounter in large businesses are data overload combined with scepticism towards the accuracy of much of it. Often management information comes in the form of a monthly reporting pack prepared by management accounts. These tend to be an inch thick and cover everything ad nauseam. Often the data is less than fresh.

We'll discuss cutting this down to a manageable number later in this report. However, it does not matter what you measure if the data are not right, and achieving accuracy and consistency is vital.

Businesses with integrated systems such as SAP should have no problems getting data that is consistent (although it is still worth double-checking!). However, the normal position, when we follow the audit trail of the data down from the CEO through the organisation, is that we find the name of a particular metric will change several times during the journey. More importantly, every time the name changes there will also be a variation in what it covers and how it is put together, making its reliability completely suspect!

It should be possible for any piece of information to be traceable right from the CEO's KPI down through an unbroken chain to the person at the frontline whose actions go into it – whether they sit in sales, on the shop floor or in a call centre.

Our view is that, for any KPI to be of use to senior executives, the data must be immediate and accurate. Businesses should aim for the gathering and flow of vital management information to be analogous to the nervous system of our bodies. A change in the environment or a sensation at one extremity is immediately transmitted through to the brain so we can react. In the same way our decisions will be poor and confused if our senses provide inaccurate or late information, so it is for businesses.

The importance of accurate and timely information cannot be overestimated. In our observations, leading organizations invest heavily in a supporting infrastructure to ensure management information is fast and accurate, often arriving in real-time. If your organization does not have such information, then task number one is to ensure someone is going to make it happen as quickly as possible!



CEOs' key performance indicators

In the companies we reviewed, the average CEO had nine key performance indicators they monitored closely to ensure they were achieving the important goals for the business's success.

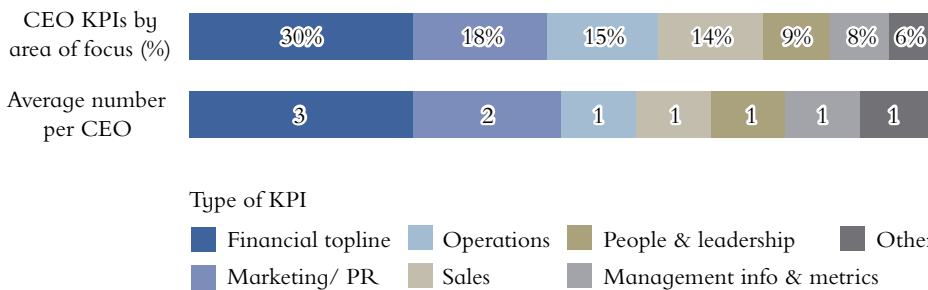
Not surprisingly, the CEOs in our sample had a strong focus on topline financial results – counting for nearly a third of all KPIs. Gross profit, Ebitda (earnings before interest and taxes and depreciation and amortization have been subtracted) and net income were the most favoured, with few using return on investment. They also focused on cost control and cash management measures.

After topline financial, many in our sample of CEOs had a strong focus on marketing and PR targets (such as brand awareness, favourability targets and favourability amongst stakeholders). Many also watched the sales numbers closely, probably for its ability to deliver an immediate warning of changes in revenue.

Given the importance of people and leadership issues, the number of measures related to this is surprisingly low. Successful businesses require the right people, with leadership developing at all levels to ensure continuity and capabilities, aligned around the corporate goals. Our experience is that at really successful businesses the CEO will spend a fifth of their time on such issues.



How they measure their success: CEOs' key performance indicators



If it's important, measure it (but what is important?)

If your organization has accurate and timely data, a vision of where you want to get to and a strategy for getting there, you also need metrics to ensure you are on track.

However, large businesses are complex organizations, with the CEO's attention being pulled in many different directions. How can the many things that need to be right for the business to succeed be boiled down into a few KPIs?

Rather than trying to monitor everything, our recommended approach is for the leadership team to be rigorous about defining (in words) what success actually looks like. Time taken on this will enable them to identify the measurements needed to ensure they are on track.

We also recommend CEOs reverse this and ask themselves “how would disaster manifest itself” – for instance would it be higher staff turnover, low utilisation, unprofitable pricing, high downtime or the late release of an important product. When looked at from this perspective, a whole different set of indicators emerges.

We recommend that there are three particular areas for CEOs to be on top of:

- 1 The context of the business. This covers big strategic areas like politics and regulation, the Green Agenda, emerging markets and competitor activity.

It is simply not enough for a CEO to think that if his business is run efficiently and profitably then it will be left alone indefinitely. The strike of a legislative pen or a mishandling of a public incident can wipe out whole markets for businesses that are not prepared. This is an area often over-looked by inexperienced CEOs, but it is very much one they need to monitor – if they are not looking after the big picture, almost certainly no one else is in a position to do it!

- 2 People. Talent-management and leadership issues are critical. If you have the right people then you can grow fast. In our experience if a CEO is not spending 20% of his or her time on talent and leadership issues, then ambitious plans will almost certainly fail. However, our research finds that there are few leadership and talent KPIs used by businesses, although some businesses are rigorous in measuring employee engagement.

- 3 Lead not lag indicators: if you rely on backward-looking indicators, a business will already be in trouble by the time management knows about it. So lead indicators such as customer satisfaction, sales today and inventory turnover are important to alert management to impending problems.

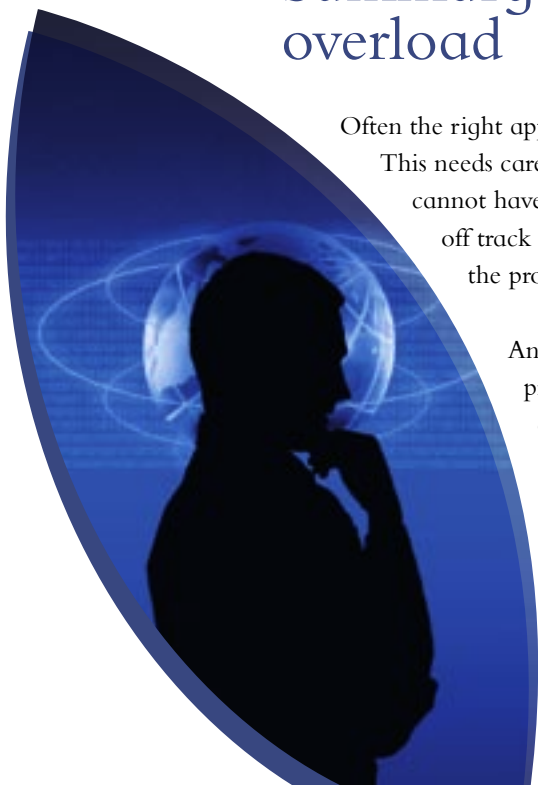
The lead indicators point is particularly important as there is a huge tendency for management teams to look at historic indicators (eg profitability over the last quarter). Instead, with KPIs executives should be looking for intelligence and looking for data that is telling them what is happening now, rather than accounting measures, which tend to report the result after the match has finished.

Summary indicators to prevent data overload

Often the right approach is for a number of different elements to be combined into one KPI.

This needs careful handling, but there is no reason why, with modern systems, an executive cannot have a key predictive indicator combining a number of elements – when one goes off track then a warning is flagged and the executive can drill down to investigate the problem.

An example of this would be input costs in those sectors where raw material prices are key to delivering profitable sales. An indicator could include the cost of different key ingredients (perhaps energy, raw materials and transport costs). If one of these starts going up then profits will be squeezed and early action is needed – whether an alternative supplier, efficiency gains or a reconsideration of the feasibility of the plan.



Identifying the right KPIs for your strategy

One of the big problems we find is the lack of a link between the measurements monitored and the corporate strategy – KPIs used by the management team often have little relationship to what is important to deliver their strategy. We often find that business planning processes add to this. Many begin the year working on a five-year plan, midway through the year they start on their annual planning process and towards the end of the year they start putting KPIs in place. Because it is done sequentially at different times of the year, often by different people, there is a complete misalignment in the plans, priorities and eventual measurements.

The hardest KPIs are often those that at first appear simple – the delivery of a project by a certain time. It is easy for the business to say it has saved money by delaying projects – for instance, by postponing a training programme there is a financial saving, and by leaving important leadership posts vacant the remuneration costs are avoided. However, this does not reflect the opportunity cost of things being late and progress delayed. Over-concentration on financial measures can hurt the business and measures need to show both sides.

Our experience is that eight to ten KPIs is the right number for CEOs and other leadership team members to have each. Amongst these there should be a healthy split:

- A few headline outcomes KPIs should feature (typically from such ones as Ebitda, revenue, profit etc).
- There will be some operational ones around key areas of focus and specific projects.
- Predictive indicators that will give early warnings to problems – sales pipeline, comparable sales and customer satisfaction fall into this category.
- As leadership development is so important, there should be at least one performance measurement capturing its effectiveness, such as having sufficient experienced managers coming through the ranks.

KPI pitfalls

Getting the wrong KPI can cause teams to create unintended and potentially harmful side effects as they set out in a single-minded manner to achieve it.

This was demonstrated with deadly consequences at a British hospital where a published investigation highlighted how non-urgent cases were being prioritised over emergencies to make sure the maximum waiting time was not exceeded. In banks the bonus culture based on high rewards for revenue not only encouraged (and indeed rewarded) excessive risk-taking, it also created an extreme lack of loyalty at many institutions amongst their high-flyers.

In one American business we assisted, the directors' bonuses had previously been based on cash generated, so the KPI they followed particularly closely was the business's cash position and what steps could be taken to maximize it. This included reducing inventories by as much as possible. The consequence of this over-emphasis was that inventories became so low that sales commitments



could not be kept and customer waiting-time went up – hurting the business financially and damaging its reputation with customers.

To counteract KPIs having unintended side-effects, work should be done to create KPIs that are balanced and contain a number of items to pick up if an over-emphasis (or an under-emphasis) is having knock-on effects on other important areas.

Who is on the leadership team?

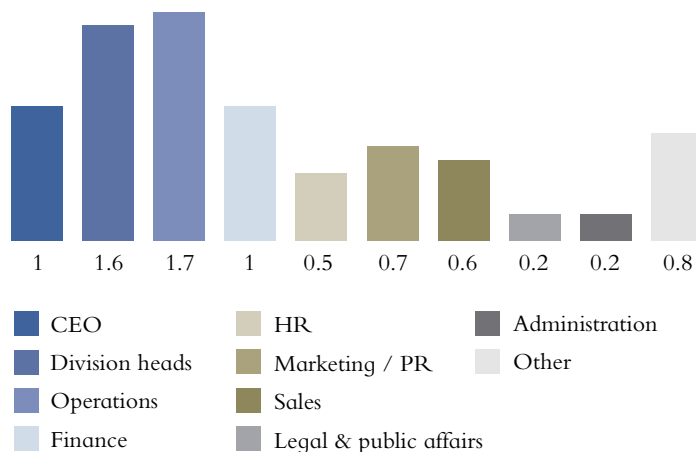
In our sample of 18 businesses, the CEO’s leadership team typically contained an additional seven or eight executives (although the smallest team had only four including the CEO, while the largest was 14 strong). Core members were generally divisional heads and at least one additional executive with a strong operational focus, together with the chief financial officer. After these, the team generally included a mix from Marketing, Sales and HR, while other roles (such as Legal, Administrative and Public Affairs) appeared infrequently.

The number of people on the team tends to represent the style of the CEO – the more hands-on their style, the more direct reports they have. Fewer direct reports, perhaps with a core team of the COO, CFO and a couple of others indicates a CEO who wants to take a wider view and wants a buffer between him and the operational issues.

The most notable absence from many leadership teams was the HR director. This often reflects past experience of the CEO of HR being an inhibitor rather than an enabler, for instance by implementing processes in a rigid manner. This may leave an important knowledge gap at the top, given the importance of people and talent in achieving success.

We often see marketing and sales roles being separated on the leadership team. From our observations this can lead to alignment problems among these departments that should be working closely in support of each other.

Average number, by role, on leadership teams



Getting the leadership team right

A hero CEO is not enough – getting the leadership team right is critical both in terms of creating a successful strategy and ensuring it is implemented. Indeed, in our experience the traits that stand out amongst really great CEOs is their ability to build great talent and harness it.

But who should be on the leadership team? In theory the business strategy will dictate what the structure of the leadership team should be. The question then would be “is the person in the role capable of fulfilling it” – so the strategy decides the structure, which decides the “who”.

However, life is rarely that simple, with CEOs starting from a point where there is already a structure with all, or at least most, of the seats occupied.

Our advice in these circumstances is to “go as you are” with the existing team creating a vision, since changing senior personnel often creates delay and more hiatus. Once your strategy is set, you are then able to answer the critical questions of:

- Who do I really need on the leadership team to implement the strategy?
- Is the person in the role the right person?

Where the person is not right, the problems are usually along one of the following lines:

- The person is too inexperienced – solutions include great coaching or ensuring they have a strong number two;
- The underperformers, who typically include:
 - 1 those whose behaviours are blatantly wrong;
 - 2 those who are too tired for the role; and
 - 3 those corporate animals who make the right noises, although aren't doing the right things.

The first are easy to spot, the second and especially the third are particularly dangerous – especially where the CEO has a long-standing relationship with them and may be oblivious to, or overly-protective of, their failings.

This is where clear key performance indicators aligned to delivering the strategy are vital. For instance, if sales are falling and the sales director blames marketing and operational problems, who is responsible? We have encountered exactly this problem twice in recent years, and in both cases the CEO was astonished to find that the underperformance was in fact coming from a strong and experienced sales director who was living off past achievements.



Getting the right leadership team – the pitfalls

In our experience leadership teams that are underperforming often suffer from:

1 The roles are set in stone. Here someone is on the leadership team simply because “that’s the way it’s always been” regardless of the strategic need or the ability of this person to be on the team. The team has no bearing on what the business needs, and nor do the capabilities of the people on it. Alternatively:

2 “Day one: change the world”. The converse is that a new CEO arrives and wants to make their mark quickly with new appointments – often close associates who they have worked with in the past. This can often be highly damaging through the wrong people being brought in. Problems include:

- Typically the CEO will not have tough performance discussions with such people.
- If the person is not performing, the CEO feels that their own credibility will be damaged if they have to reverse one of their early appointments (often having been made with a big fanfare). They end up having to carry the underperformer, to their own disadvantage.
- The associate brought in will look on the job as payback for past hard work. They see the job as their reward and coast towards retirement.
- Particularly where the new joiner has received shares, it can prove prohibitively expensive to get rid of them (and they know it!).

Many people who have been successful in previous roles are not successful at making the next step up, and this is where KPIs can be of particular importance in highlighting who is and who isn’t delivering, and allowing fact-based discussion and coaching.

What if a director is failing to hit their KPIs

The failure of someone to achieve a particular target should not by itself lead to arbitrary dismissal. They may be talented and failure may reflect that the area is particularly challenging at present – in the same way that other team members may be hitting their performance with ease because the targets were set too low!

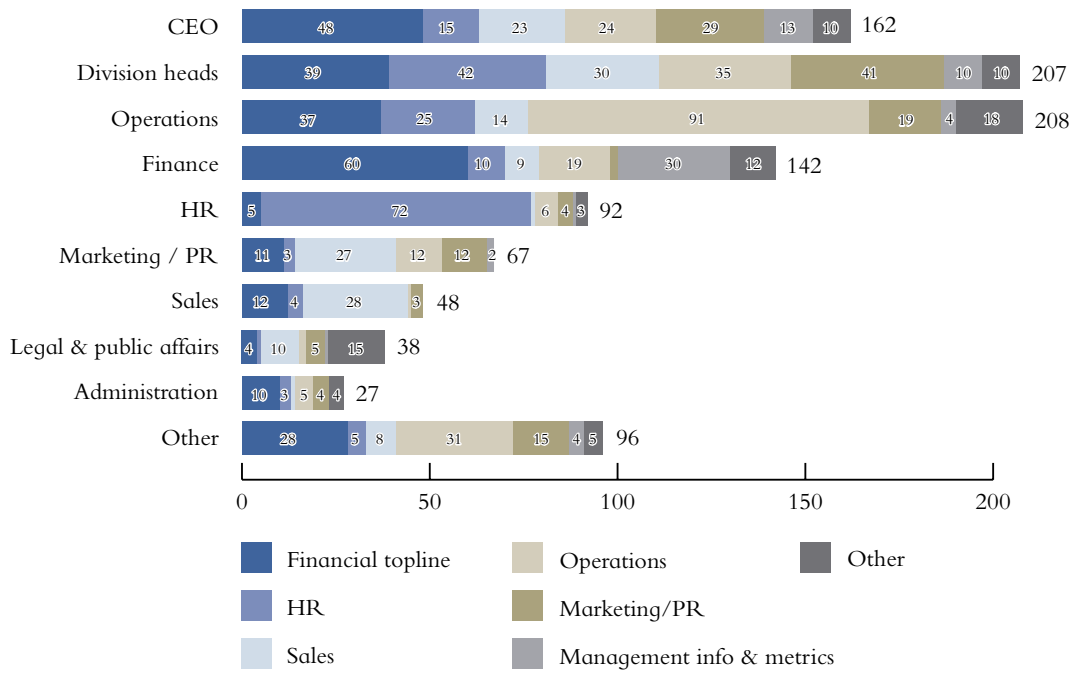
When targets are not met, clear KPIs allow an open discussion of:

- 1** Is the strategy wrong?
- 2** If the strategy is right, is it the execution that is wrong?
- 3** If the execution is wrong, is this down to the leader? In which case you can quickly move into a coaching conversation based on data.

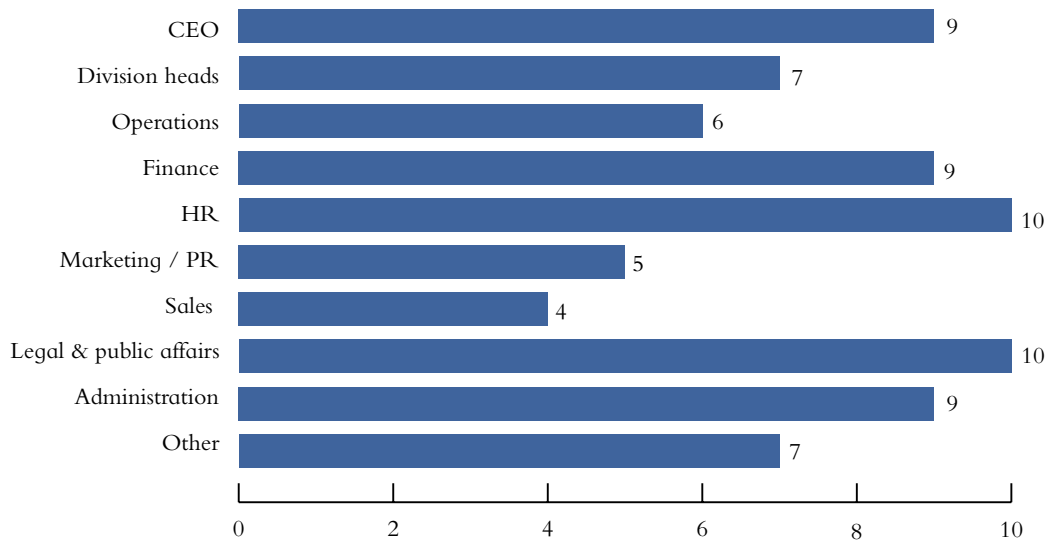
As always in management issues, science needs to be balanced with experience and judgment – but it is the balance that is important, and good judgment based on sound facts is what strong leadership is all about.

Appendix 1 - How leadership team members' KPIs compare

Areas of focus for KPIs, by management role



Appendix 2 – Average number of KPIs, by management role



Appendix 3 – CEO’s key performance indicators

Type of KPI	KPI category	% of KPIs in this category
Financial topline	Profit targets	5
	Income	5
	Ebitda	4
	Saving/cost targets (inc pay)	4
	Other cash management	4
	Debt management & capital raising	2
	ROI	1
	Creditor days/ aged debtors	1
	Misc topline financial	4
	People & leadership	Employee satisfaction
Leadership development		1
Retention & turnover		1
Training & mentoring		1
Recruitment/reduction		1
Misc		3
Sales	Sales totals	9
	Price/spend	2
	Sales pipeline	2
	Misc	1
Operations	Productivity & service levels	4
	Inventory	2
	Projects & planning	6
Marketing/PR	PR/publicity/awards	5
	New locations	4
	Customer satisfaction	3
	Brand	1
	Marketshare	1
	Alliances	1
	Misc	1
	New products	1
Internal financial management	Perform ratios	5
	Producing management info	2
	Misc	1
CSR Sustainability		1
Governance		2
R&D		1
M&A		1
Other		4

A global business performance consultancy

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McKinney Rogers is a global business consultancy with a proven track record for transforming performance. We are a team of highly experienced leaders who are passionate about delivering extraordinary results – taking a unique approach to turning strategy into action by embedding clarity and alignment throughout the client organization.

We do this through Mission Leadership®, which is a combination of practical tools and technology that focus on behaviors, process and performance.

Our ability to transform performance has been recognised by such global clients as Diageo, Pfizer, Wal-Mart and Thomson Reuters.



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