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RULES FOR SELECTING AND USING KEY PERFORMANCE INDICATORS FOR THE SERVICE INDUSTRY

Theoretical article

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Abstract

There is no question that performance is the desired result of every activity or action. In order to correctly measure an organization's performance it is necessary to select key performance indicators (KPIs) that will deliver long-term value to the company. KPIs are presenting performance information for all levels of the organization and they are reflecting the progress made so far to achieve strategic objectives. The selection of the key performance indicators must be made according to the organization's industry and activity. The company must truly understand its business and its mission. Also, KPIs must be closely linked to the strategic objectives. The focus of this research is to present effective rules for defining key performance indicators for the Service industry. This sector of economy consists in generating intangible goods like experience, expertise and information. Therefore, monitoring this type of services requires a different approach when defining performance indicators compared to the manufacturing industry.

1. Introduction

Performance measurement can be the most challenging activity of an organization. This concept is defined as a way to collect, analyze and report information regarding a group, an individual, an organization, a system or a component. This involves the study of the processes or the strategies of a company. The performance is the criteria on which a company can determine its capacity to prevail. Performance measurement can estimate the parameters in which the investments and acquisitions achieve or do not achieve the estimated results. However, a performance measurement model that was chosen wrongly can represent a negative situation which does not support the organization or any objectives established by it. All performance measurement proccesses require the use of statistical modeling to determine the results. A full copy of the performance of a company can never be achieved because some of the parameters cannot be measured directly, they must be estimated by indirect observation. In order to provide a complete set of relevant information a company needs to compress the data into key indicators that have relevant meaning.

There are some aspects to consider when a company is choosing its performance management system, as follows:

- to define some priorities in the performance management;
- when an instrument is chosen, the organization must consider if this instrument is relevant to the strategy, structure and the culture of the company;
- each instrument has an important role in communicating the culture of the organization.

We have multiple performance management instruments available in the scientific literature. The first instrument is the Key Performance Indicators (KPIs) which monitors the key areas of an organization; the level of implementation is a strategic and individual one. The second instrument is the Performance Indicators (PIs) which is a set of metrics that measure the progress, success of a project, a process or an area; it has operational and individual level. The next instrument is the Performance Scorecard which is a catalogue of key performance indicators that can create simple views of different analysis indicating possible risks. The level of implementation is a strategic and individual one. The forth instrument is the Performance Dashboard which represents a catalogue of operational indicators that allows you to view information and analysis at an operational level. The last instrument is the Scoreboard that contains a set of linked indicators.

The Key Performance Indicators help a company to define and measure its progress in achieving its organizational objectives. Once an organization has analyzed its mission, has identified all business partners and has defined its goals, it needs a way to facilitate the progress toward these goals. Key Performance Indicators are that way; they are quantified measurement systems, determined in advance, reflecting the critical success factors of an organization. They will vary from a company to another, for example, a company from the manufacturing industry may indicate the percentage of revenue that comes from loyal customers. A school will focus on graduation rates of students as a performance indicator. A customer service department can take as an indicator the percentage of calls taken in the first minute of the call. Therefore, the performance indicators are different for each type of organization. Also, the key performance indicators reflect actions with strategic value, not just actions and non-critical business processes. The KPIs align all levels of an organization (business units, departments and individuals) with clearly defined objectives and criteria that create responsibility and track progress. The KPIs accelerate collaborative and integrated planning across the organization to ensure that each operates with the same purpose. The success of any performance management program is, thus, conditioned by proper selection of key performance indicators. A poor selection of indicators can generate negative effects and can influence the results.

2. Types of Performance Measures

„Performance can be expressed as a set of complementary indicators that describes the process by which certain results are achieved. Also performance can be defined as a dynamic causal model that describes how certain actions affect future results. Performance is closely related to decision making because performance has no intrinsic value, it exists only when an individual or more use it to make decisions. If the description of performance has no impact on a system or organization then the performance has no value. Also, the description of performance is relative to the perspective from which it is analyzed, it can be an accounting, operational or strategic perspective." Rus neanu (2013)

Every performance management indicator must reflect the objectives of the organization, must be quantifiable and measurable. The definition of what it is and how it is measured does not change, but the goal of a particular indicator may change depending on the objective of the company, or depending on its progress toward achieving objectives.

According to David Parmenter's study "Key Performance Indicators" there are three types of performance measures:

1. Key Result Indicators, or KRIs, represent the result of an action;

2. Performance Indicators, or PIs, help you to take decisions about certain processes or actions;

3. Key Performance Indicators that help you increase a company's performance significantly.

As David Parmenter suggested in his book by using an image, KPIs are the core, the PIs are the middle and KRIs are the cover of the performance measurement system. The Key Result Indicators are commonly mistaken by the Key Performance Indicators and, therefore, are used in a wrongly manner. This type of indicators provides information resulting from actions, but it does not provide the necessary information to act to improve results. Such indicators are ideal for top management, not for department management that needs information to take decisions and immediate action. Key result indicators report results associated with a longer time compared to key performance indicators. They are monthly or quarterly reviewed compared to the KPIs which are daily or weekly reviewed. Among the key indicators of result we can mention the following: customer satisfaction, net profit, employee satisfaction etc.

The Key Performance Indicators "represent a set of measures focusing on those aspects of organizational performance that are the most critical for the current and future success of the organization." according to Parmenter (2007).

In practical terms and for strategic development, key performance indicators are expressed in the objectives to be targeted. Monitoring key indicators may prove costly or difficult for organizations. Some indicators, such as staff morale, may be impossible to quantify. These types of indicators can be considered a rough guide rather than a guide with a precise reference.

Selecting and defining key performance indicators is not so easy. In today's market, every time a company purchases Business Intelligence software, Enterprise Resource Planning (ERP), Supply Chain Management (CRM) and Business Performance Management (BPM), there is a dilemma of choosing the 15-20 performance indicators from a range of hundreds or even thousands of metrics that are included in the software package. The company must find a way to differentiate those key performance indicators from other less important metrics and making sure that those selected metrics are indicators that will help achieving strategic objectives. It is also important to know how to validate if those selected metrics lead to optimization at the enterprise level, but not only at a specific level.

3. Major challenges when it comes to KPIs

"What is measured is managed" or "What is not measured deserves little or no attention" are two of the most common phrases in management literature. Indeed, it is critical that performance indicators must measure only those vital activities and processes which monitor the health of an enterprise. Also, the indicators must be defined as business standards, not in functional terms. In addition, there are some problems that need to be raised when talking about the design and development of performance indicators:

- What should be measured?
- How many metrics are needed?
- How often should you measure?
- Who is responsible for metrics?
- How complex should the metrics be?
- How to normalize the metrics?
- What reference point should be used?
- How do you ensure that the metrics reflect strategic directions?

KPIs must start at the top of the organizational pyramid, from the vision, and to descend to the base of the pyramid. The following figure shows the strategic alignment pyramid in which it can be seen that in order to reach the performance indicators level it is necessary to go through several steps like creating the strategies, objectives and critical success factors - Figure 1.

4. Service Industry and Key Performance Indicators

The Service Industry, or the tertiary sector of industry, consists of companies that primarily provide intangible goods or services where employees offer their knowledge and time to provide productivity, performance and sustainability. Some examples of tertiary sector industries are Government, Telecommunication, Entertainment, Information Technology, Accounting, Consulting, Financial services, Real Estate, Education and so on. An economy that has a big percentage of tertiary sector businesses is considered a developed one. There are several issues when it comes to the service industry. Service providers can have difficulties when selling their services because services are intangible, therefore some customers may find difficulties in understanding them and their purpose, what they will receive and what value it will have for them. A simple example can be the consulting companies which provide information and guidance in different sectors like real estate, investment or banking services. The consultants cannot offer any guarantee that the value matches the price paid by the customer.

On the other hand, it is hard for a company to measure its performance in this sector since their services are not tangible and cannot be quantified as easy as tangible products. Companies from the tertiary sector need special performance indicators that can capture and estimate its real value.

Companies that sell products, or tangible goods, are focused on performance indicators like sales,

manufacturing costs,or profit margins. But companies in the service industry must focus on pricing, cash flow and staffing in order to measure their performance on the market. For example, a company that offers consulting services can adjust their prices by comparing them with other company's pricing system in the same area. Service oriented organizations need to center their attention on staffing performance and pricing. The main component of a service company is their staff/employees. On one hand, employees are the productive component of the organization, using their knowledge the company is generating income and its value is rising. On the other hand, staffing is the largest expense that needs a carefully attention and management. There are several indicators which capture the main area of interest:

- Realization Rate - the revenue earned by each employee per hour for the company;
- Gross Profit Margin - the gross profit per client per person;
- Utilization - the percentage of time spend by each employee on a client.

These three indicators can help companies identify their top performers from the staff and reward them and also, to try to encourage others to became part of top performers.

5. Rules for selecting the KPIs

First rule: **The key performance indicators must capture the strategic objectives of the organization**. Each company has several strategic objectives on which all its activities are based. Therefore, in order to monitor the progress in achieving the objectives all the indicators must be built starting from these objectives. For example, a restaurant has the main purpose to satisfy their customers by offering great food and great services. In this regard, the company must define indicators that monitor the quality and diversity of the food and the quality of the services, waiters' training and attitude towards the customers. On the other hand, the main objective of a bank is to offer affordable products and services. For example, a credit card service must have specific requirements that can be accepted by the client and also that can generate return for the bank. The key performance indicators must measure the factors that influence achieving strategic objectives and, therefore, the success.

Second rule: **The key performance indicators must lead to the organization's success**. Performance indicators are not all about measuring. Many activities and processes can be measured, but do not lead to organizational success. In selecting suitable performance indicators is critical to limit the selection criteria to the factors that are essential to the organization's way to success. It is important to have a medium number of indicators to be able to maintain focus on achieving objectives. In order to support the idea, an example can be presented: if one of the key performance indicators of a company is to "increase customer satisfaction", it will be interpreted by each department in a different way. The Consulting department will have as an indicator the number of satisfied customers or the number of complaints received. The Sales department will have as an indicator "minutes that a client expects to be picked up by a sales representative". A Credit department from a bank will have as an indicator the "number of loans offered that have a good return without delay". If these departments will have good results for these indicators, then the key performance indicator will have good results.

Third rule: **The key performance indicators must be quantifiable.** Each performance indicator must have clear characteristics regarding the way in which it is defined and measured. For example, loyal customer indicator is useless if there is no way to distinguish between new customers and loyal customers. It is important to adopt permanent definitions of performance indicators; it is not profitable to be changed. It also requires the adoption of targets for each indicator; after its establishment it must have a target like "reduce human resources costs by eight percent per year".

Forth rule**: Companies must focus on fewer key performance indicators that are relevant for the business, rather than having too many key performance indicators that are hard to monitor.** When a manager creates a list of key performance indicators he needs to focus on the relevance and on the resources needed for monitoring the accuracy of the KPI. It is better to have less KPIs that have a solid base and a high relevance to the organization strategy.

Fifth rule: **The key performance indicators must adapt to all organization's departments.** Each department at each organizational level is led by the executive manager. They must have on their activities list strategic planning sessions to identify the positive actions, goals and plans for the group. Each performance indicator and its corresponding action is related to another indicator to a lower level. At the organizational level each performance indicator from the highest level, the strategic level, to the lowest level, the individual level, is interconnected with other key performance indicators.

Sixth rule: **The key performance indicators must be defined by department managers, or executive managers**. The main reason for this rule is that executive managers define actions that lead to success in the planning sessions where strategic directions are determined for short and long term. In order to take advantage of these actions, managers should define how they measure the department's performance. Unfortunately, too many managers complete these planning sessions

before defining the performance management system that includes the KPIs.

Seventh rule: **The key performance indicators must be based on valid data.** Most companies have specific performance indicators among corresponding actions. In fact, most industries have in common a set of metrics for measuring success. But the fact that companies know what needs to be measured does not mean it is already measured. Before managers establish performance indicators, they should consult the technical analysts to determine if there is valid data for the selected performance indicators, if the KPI can be calculated and the result is a relevant one. In many cases, the answer to these questions is no, so managers must allocate funds to store new data for calculating KPIs or deleting existing data or try to revise the key performance indicators. The costs of each measure will decide what action is needed to be taken into account.

Eighth rule: **The key performance indicators must be easy to understand by all employees.** The main problem with key performance indicators is that with time, or if the company has many departments or the activity will develop, the number of KPIs will increase. At that point the KPIs will lose their impact on employees and on their behavior that leads to the company's success. At the same time, KPIs should be easy to understand. The employees must know what is being measured and what to do to influence in a positive way the indicator. It is not enough to publish a scorecard with all the indicators, it is necessary to organize special trainings for employees who are directly involved and monitor their development using reviews to be sure that they understand their role in the system and to act as such.

Nine rule: **The key performance indicators must be controllable**. A company selects a list of key performance indicators, they decide on the actions needed to influence the KPIs and on a group of employees to monitor the KPIs. The main issue that occurs here is if the selected actions will truly influence the KPI in a positive way. In fact, there were several cases in which selected actions have influenced the KPI in a negative way. So when selecting a KPI, a company must verify if there are real actions that influence in a positive way the evolution of that KPI and if not, it needs to adjust the KPI in order to be more controllable by real actions.

6. Conclusions

Once a company established the key performance indicators suitable for the area in which the company operates, the KPIs will be used as a performance management tool. These performance indicators give to all employees a transparent view on the key activities that will lead to achieve all strategic objectives. A good selection of KPIs is transformed in a good management tool which will drive the organization to success.

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Figure 1. **Source: http://www.information-management.com/issues/20040901/1009207-1.html**