HCMI Webinar

How to Build KPIs That Drive Financial Performance

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About the Presenter

Blake Cromar – Data Scientist, HCMI

As a professional, Blake works to perform detailed data analyses in HR reporting. His background in machine learning and statistics means that he pays special attention to the quality of the data. During his undergraduate years he studied computational statistics. His hobbies include exercising and hip-hop styled dancing. He's not shy and loves meeting new people. Don't be afraid to reach out to him.

About HCMI

The Human Capital Management Institute (HCMI) was founded on the belief that organizations can and must find better ways of measuring their investments in human capital. Our vision of the future is one in which human capital data is as integral to business decision making as financial information is today.
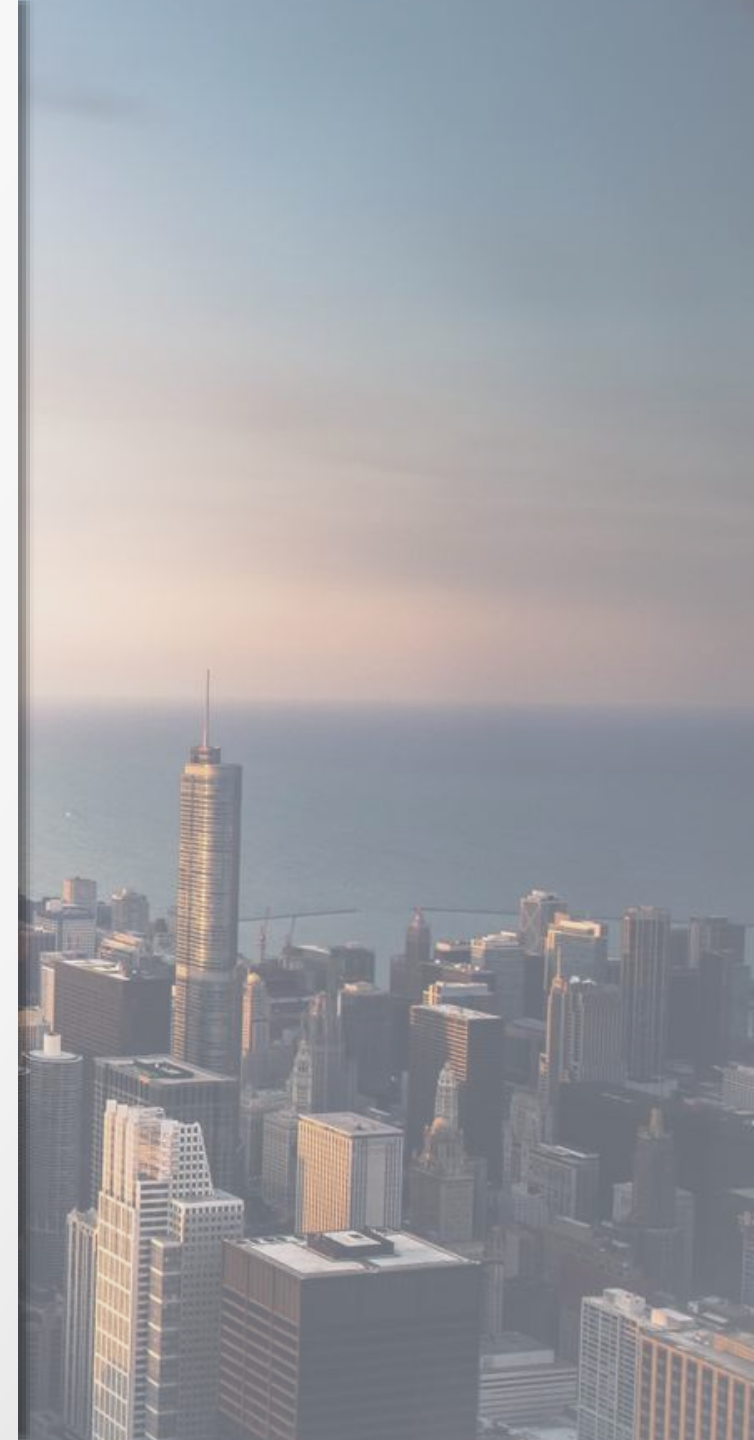
People Analytics for Business

HCMI Background:

- Specialized in HR analysis and measurement
- Deep expertise in Workforce Analytics and Planning
- Board made up of CFOs and HR heads

What We Do:

- Measure the immeasurable in human capital
- Transform workforce data into business intelligence
- Provide tools and training so HR can partner with Finance

What is a KPI?

- Stands for Key Performance Indicator
- Any metric that a company uses to determine the **performance** of their company
- They are often created after examining company goals and benchmarks
- Two Examples:
  - Headcount wouldn't usually be considered a KPI
  - **Profit per FTE** is usually considered a KPI

The Basics of KPI Creation: Defining Data

- It is important that your data and metrics are well defined.

- This prevents two types of **errors**:
    - **Data combination conflicts** – Different entities creating slightly different definitions
        - Is an FTE someone who works 40 or someone who has an annual salary?
    - **Calculation conflicts** – Employees that work with/manipulate data create errors because they don't understand the data definition.
        - Is a "month" an exact 30 days or the actual number of calendar days of the month?

The Basics of KPI Creation: Benchmarks

- Benchmarks are important because they allow you to compare your KPIs to existing standards

- There are two main types of benchmarks:
  - **Internal Benchmarks** – Example: The current company profit per FTE is $15,000 per employee.
  - **External Benchmarks** – Example: The company competitor has a profit per FTE of $17,000 per employee.

- **Important:** Ask yourself if you have benchmark data before you pick a KPI

The Basics of KPI Creation: General Guidelines

Consider using these 4 **guidelines** when creating your KPIs:

1. **Measurable** – Is your KPI something you can measure.
   - Human emotion is hard to measure, but profit per FTE is easier to measure

2. **Attainable** – Does your company history suggest you can reach a KPI?

3. **Relevant** – Does the KPI help you reach your company's objectives?
   - Profit per FTE would contribute to a company goal of increasing profit

4. **Time-Bound** – Are you aiming to reach a KPI within a specific time?
   - Example: Hitting a Profit per FTE of $10,000 per employee in 6 months.

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The Basics of KPI Creation: Metric Specific Guidelines

Consider using these 4 guidelines when thinking about your KPI metrics:

1. Are they **actionable**? – If you KPI gets too low or too high can you perform a series of actions to make improvements?

2. Do they empower you to address issues across the **employee lifecycle**?
   - The problems someone who just got hired are different than someone who is about to leave the company

3. Do they link to **business results**?
   - Example: While headcount may not link to business results sometime like Profit per FTE does

4. Do they address **leading versus lagging indicators?**
   - Example: Leading indicator - Turnover
   - Example: Lagging indicator - Profit per FTE

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Types of HR Metrics and Their Level of Complexity

Different types of metrics for your report

Capturing meaningful human capital data has been a challenge for most organizations, let alone finding advanced analytics insights or achieving workforce planning success

Complexity & potential impact

Input Metrics	Simple Calculation Metrics	Calculated Metrics	Advanced Calculation Metrics	Index Metrics
Basic elements or totals by time, cost, quality, or volume. Inputs are best used in constructing more advanced metrics.	Basic metrics gathered and used in HR and workforce reporting. They're the metrics most organizations have in abundance but yield the minimum value.	They represent the majority of metrics and are moderately complex to calculate but reflect a wide range of organizational complexity based on data, systems and analytic tools.	Highly complex metrics to calculate, requiring deeper workforce and HR data but also represent the highest level of value add for workforce decision making.	The most complex metrics and comprised of several metrics weighted by percentages as a means to assign importance to each metric in the index.
1	2	3	4	5

The Level of Complexity of Metrics: Input Metrics

- Lowest level of metrics
- A sign you have an input metric is if there's **no formula** to make it.
- Examples of input metrics are **profit, revenue, and employee headcount**.
  - Profit per FTE would not be considered an input metric. It has a formula associated with it.
- Often used to make calculated metrics.

The Level of Complexity of Metrics: Simple Calculated Metrics

- Lowest type of calculated metric
- Usually have a **simple formula** used to compose them
- Provide **minimal value** to a company
- An example: **Turnover rate**
  - Doesn't provide a strong link to determining productivity
  - Doesn't describe value impact effectively

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The Level of Complexity of Metrics: Calculated Metrics

- Provide a **moderate amount** of insight on productivity and value creation
- Are often used in most people analytic problems
- Ex. Profit per FTE and Revenue per FTE
  - Because those metrics involve headcount you can be **tempted to drop headcount** when you shouldn't.

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The Level of Complexity of Metrics: Advanced Calculated Metrics

- High quality level for a metric
- At this point of time, metrics like **this haven't been well adopted** into HR analytics
- Provide an **optimal amount of insight** on productivity and value creation impact
- Example: **HC ROI Ratio**
  - Determines how much revenue you are making for every dollar you put in an entity.
  - An HC ROI ratio of 3 means that for every dollar you put in an entity you are making 3 dollars in revenue.

The Level of Complexity of Metrics: Index Metrics

- Provide the highest amount of **impact and insight**
- They are a **combination** of many calculated and input metrics
- Often different metrics are **weighted** based on importance.
- Example: Quality of Hire Index (Made Up Index For Demonstrative Purposes)
  - Composted of years of experience, productivity rate, and average company tenure
  - In the most simple type of index you could sum up these numbers. This index could be used to compare potential employees

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In Your Experience What Percentage of Companies Use The Most Complex Metrics?

Top Metrics that Link to Productivity

Top metrics to include in your next report & dashboard

	Low	Medium	High
Direct	• Internal vs. External Cost per Hire	• Open Position Lost Revenue • High-Performer Turnover Rate • **Internal vs. External Hire Compensation Differential** • **Replacement Hire Cost Differential**	• High-Performer Productivity Differential • Training Performance Differential • Employee Engagement Revenue Linkage • **Human Capital ROI Ratio** • **Return on Human Capital Investment** • Quality of Hire Index • **TCOW[1] % of Revenue or Expenses**
Semi Direct	• Job Tenure	• Total Cost of Turnover • **Management Span of Control** • Profit per FTE[2] • Revenue per FTE[2]	• TCOW[1] per FTE[2] • Talent Management Index • Employee Engagement Index • High-Performer Rate • Managerial Bench Strength
Indirect	• Turnover Rate • Hire Rate • Time to Fill	• Mkt Capitalization per FTE[2] • Training Investment per FTE[2] • Career Path Ratio • Cost per Hire	• Training Effectiveness Index

Link to Productivity ↑

Productivity or Value Creation Impact →

[1] TCOW = Total Cost of Workforce

[2] FTE = Full-Time Equivalent Workforce

[3] Listed in Human Capital Financial Statements as Average Lost Revenue or Production per Day per Position

[4] Listed in Human Capital Metrics handbook as Internal vs. External Hire Compensation Difference

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Top Metrics that Link to Productivity

- How much does the metric link to productivity? Here are some examples (In order from low to high productivity link):

  - **Turnover** – Can you adequately link productivity with this metric? This metric indirectly relates to productivity.

  - **Job Tenure** – There is a moderate amount of productivity that can be linked to this metric. This can be observed due to a correlation.

  - **Internal Vs. External Cost Per Hire** – Internal hires are usually more productive than external due to them already understanding the company well and having the ability to place them in an optimal situation. This is an example of a metric that highly links to productivity

Top Metrics that Link to Value Impact

- How much does the metric **create value**? Here are some examples (In order from low to high value impact link):

  - **Hire Rate** – As the hire rate goes up there is sometimes an indirect link to value impact.

  - **Market Capitalization per FTE** – Since market capitalization is the value of your company (in terms of traded stocks) this has a moderate link to value impact.

  - **Training Effectiveness Index** – This measures the effectiveness of your training as it relates to financial impact. This is a direct link on value impact.

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Top Metrics that Link to Both Productivity and Value Impact

- **Human Capital ROI Ratio** - A HC ROI ratio of 1.5 means that for every dollar invested in an employee you're making $1.50 in revenue.
- **Return on Human Capital Investment** – A return on HCI of 1.7 means that for every dollar you invest in your workforce you're making $1.70 in operating profit.
- **TCOW % of Revenue Expenses** – If a company reported this metric as 0.40 that means that 40% of their revenue expenses are being used on their workforce

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Which Metric Has Made/Could Have the Largest Impact on Your Company?

TNB's KPI Framework

Outcome-based KPI Framework will ensure effective management of Performance Outcome & Strategy Alignment

- Understand Company/Division aspiration

① 1 TNB Direction

② Understanding Stakeholders
- Identify C.E.O
- C.E.O Expectation
- Setting/ Revisit Unit/Section aspiration

Strategy Alignment & Performance Motivation Outcome

⑤ Strategy Alignment
- Check & Balance
- Ensure Department/ Unit alignment

③ Identifying Outcome
- Identify Department Outcomes
- Formulate Strategies/Execution Plan by KRA

④ Performance Measurement
- Identify KPI
- Target Setting

TNB's KPI Framework

1. **Understanding Company Aspirations**

- Where do you see your company in 1, 2, 5, and 10 years?

- Make a list of all current goals. For example: Improving customer satisfaction

2. **Asking for stakeholder input**

- It is important you are aware of their goals. It's equally important that they understand what the company is doing to reach those goals.

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TNB's KPI Framework

3. **Identifying Outcome** – This is where you quantify what should be improved.

- For example: The company wants to improve customer satisfaction. An outcome could be improving customer satisfaction by 10%

4. **Performance Measurement** – At this step, your goal is to identify the KPIs that will help you meet your outcome

- For Example: If the desire is to increase revenue one might choose the HC ROI ratio

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5. **Strategy Alignment** – Ensuring that managers and stakeholders understand your strategy is important for meeting goals.

- It keeps the company's **goals consistent**. It prevents goals from changing too rapidly.
- It makes managers aware of where teams and departments are at. When they are aware, they can **effectively assist** these entities with the right resources.

- **Repeating the Cycle** – After completing your strategy alignment it is important that you repeat this process.

  - This is important because your company will change. Repeating the cycle will allow you to **stay up to date and flexible** to new challenges.

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Which Step in the KPI Creation Cycle Has/Could Have the Largest Impact on Your Company?