Improving Profits with Performance Measures

No margin: No money: No mission. Those were the words spoken to me on a mountain top in Luzerne, Switzerland almost 20 years ago. The speaker wasn't Jack Welch, Lee Iacocca or any recognizable business guru. She was an Irish nun who'd spent over 40 years working to raise money that funded education and health services in Africa.

Those words have stayed with me and remain the best summation of why profitability must be top priority for any endeavor – public or private, for profit or not for profit. Our industry historically has had poor profit performance. Not too long ago 2% net profit was commonplace. Recent years have seen much better profitability, but for many that profitability is still disappointing. Sustainability at acceptable profit levels is a real issue for many in the industry up and down the supply chain. Despite a softening market, some LBM dealers are improving profitability using performance measures.

Like many of you, these dealers are benchmarking performance against national industry averages and their peers in round tables. More importantly, these organizations all consistently benchmark against *their own past performance* to track progress. In addition, these companies are clearly focused on Key Performance Indicators or KPIs. They use the KPIs as tools to drive performance and profitability in their businesses.

What are Key Performance Indicators?

KPIs are measurable and focus attention on the key items that make or break your bottom-line. The downside to the benchmarking wave is that many organizations are measuring a number of metrics that, while interesting, simply don't impact profit performance. For example, sales per forklift is an interesting number but what's the value of knowing this? How does that information drive profits? What do you do with it that impacts your profitability today?

You may delve into your fleet and look more closely for alignment with your business needs if your ratio is significantly different from industry "averages" but it doesn't immediately help you improve profits. Further, individual business' physical facilities vary as do markets, business mix and service expectations. Averages here are interesting – but they clearly do not drive profits. This is what we'd classify as 'nice to know'. KPIs, conversely, provide information in real time that enables your employees to make decisions and impact the numbers before month-end (need to know). KPIs keep everyone focused on what matters most.

KPIs are measured frequently – daily or 24/7. Some may be measured weekly. They are understood by everyone in the organization. Accountability for performance can be identified to individuals or teams. KPIs directly impact the organization's ability to improve profitability. Two of my favorite KPIs are On-time delivery performance and In-full delivery performance. The majority of professional contractors and remodelers define satisfaction as having what they want when you said you'd get it there. In other words: on-time and in-full. These KPIs are tracked daily and order by order.

I particularly like these two KPIs because they inform you of how your organization has performed at every step. In order to deliver on-time and in-full everything leading up to the delivery had to be correct. When your on-time and in-full rates fall it's a clear indicator that there's a system issue further upstream requiring immediate attention.

How do you use KPIs?

While benchmarking typically involves many metrics, KPIs are limited. KPIs can be identified at many levels or functional areas. For example, operations may have KPIs that include truck turnaround time and overtime while credit/collections is focused on achieving and maintaining a zero balance in the 90 days past due column. Yet, for each area there are only a handful of KPIs (2 to 5). The point is to identify the most important metrics for a given area that impact profitability.

This includes those items that deliver customer satisfaction (i.e. order accuracy, inventory depth & breadth on-time, in-full, etc.).

Focusing associates' attention on area-specific KPIs can have a dramatic impact on the bottom-line. To achieve that impact we've found a couple of things need to take place.

First, as with any organizational effort, employees have to buy in. That means they have to understand, clearly, the impact of their function-specific KPIs. Often this requires some education on the business and how their area-specific contributions impact the whole company. What may be obvious to you as an owner/manager is not always apparent to others. It's vitally important to take the time to cover the selected KPIs, why they were chosen and how they contribute to the organization's success and profitability.

Second, target performance for each KPI should be established. We don't want to merely measure our performance; we want to measure it AND improve it. Just like you identify a sales and margin goal, identify a performance goal for each KPI and a timeline for achieving it. For example, operations is tracking inventory adjustments and their goal is to reduce it by 15% in 30 days or to keep it below a target level as a percent of sales.

When establishing target performance, it generally increases employee buy-in if they develop or participate in developing the performance goals.

Third, KPIs need to be visible on demand. Associates should be able to easily access information that tells them how they're doing on their KPIs. This is what we call a KPI Dashboard. Some organizations have dashboard software. You can also create your own as we've also developed them for dealers simply using Excel and Access. Dashboards are valuable tools and serve to make KPI data available in real time.

Access to performance data in real time is critical. It provides your associates with the ability to impact the bottom-line before the end of the month. If offers them live information on their particular KPIs. Supervisors and management have access to KPI performance across multiple areas whereas credit, operations, sales, admin, etc. have access to their area-specific KPI data.

The fourth step in implementing KPIs is educating your associates about the levers that drive their KPIs up and down. It's vital that management follow up on KPI performance on a very regular basis. In doing so you may well find that some of your associates need coaching on how to achieve their target performance. Helping them identify how to influence the levers that drive the KPI number enables them to achieve their goals – and do so faster.

Case Study

A successful LBM dealer with multiple yards, manufacturing and installed sales utilized KPIs to help improve profit performance – dramatically. This organization was performing well and was in the middle of industry profit norms at the outset. Like many dealers, sales were growing rapidly and expenses were growing too. Leadership at this organization was well aware that their rapid growth was leaving profit on the table.

We began by identifying KPIs by department or function throughout the organization. Working with associates, we agreed on the KPIs, developed measurement methods and established target performance goals.

At the same time we designed and management introduced the first ever performance-based incentive. Prior to this year-end bonuses were paid out at the discretion of management with no criteria in place other than 'Joe's a good guy and worked hard this year – let's give him $XX.' The change to a performance incentive certainly increased interest in KPIs and achieving the targets.

Teams of associates were identified at each location and charged with achieving the KPI performance – including sales and margin goals. Twice a month we met with the teams to review performance and hear their plans for achieving or maintaining their target. Coaching was provided as necessary. After six months meetings became monthly as the location teams became more proficient and comfortable in driving their target KPIs.

At the end of the first year this organization had lowered their expenses 2.1% and increased their margin 1.7%. Sales increased during this year as well. Isolating the impact of their KPIs is not an exact science. However, we do know that given a very similar sales growth the prior year the dealer saw expenses increase 4% vs. an increase of 1% the target year. We also know they were very successful in improving their margin – particularly on special orders.

This same dealer has been able to achieve improvements year over year for four years now. KPIs have become an integral part of their approach to business and keeps them focused on the basics. If you get the basics right – right material to the right place at the right time to the right spot at the job site in the right condition at the right price with a correct invoice – you win. The market will still reward the organization that outperforms others. KPIs are a valuable tool in helping your organization improve performance.

Our Round Table members have begun measuring some KPIs. "When we first started talking about measuring on-time and in-full performance we knew our operations personnel might see it punitively. But we also knew that it was a total company performance score card. It requires each step to be correct and starts with taking the order, to order processing, purchasing and the delivery system," comments Jon Hallgren of Curtis Lumber in Ballston Spa, New York.

Sam Collins of S.W. Collins in Caribou, Maine agrees, “The on-time and in-full KPIs really tell you how you’re doing throughout your organization.” Collins continues, “Measuring these two KPIs in particular has really focused everyone in the organization on getting the right product to the right place at the right time and the importance of doing so. We track our performance and use it to evaluate our procedures and make adjustments where necessary. If our performance dips we can look back and see where our process may have been inefficient or where a vendor may have disappointed us. It’s been a valuable tool to increase accountability in our organization – and with our vendors.”

There are a number of items owners and managers have to monitor in their businesses. Key Performance Indicators are highly effective tools that enable you and your team to see the vital signs at a glance, easily drilling down to details where needed. Simple and easy are always effective strategies. KPIs are both. Use them.

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