OCX Cognition™

A New Framework for Designing Customer KPIs

Effective Metrics for Competitive Advantage Through Customer-Driven Growth

# A New Framework for Designing Customer KPIs

Why has the business world poured so much time and money into customer experience for so many years? And why is growth in the CX management software market expected to achieve an 18.1% compound annual rate by 2030?[1] The answer is easy: Business leaders look to CX to improve customer retention and attract new customers.

But most businesses go about CX – and especially the metrics associated with CX – all wrong. While 93% of companies in one study used a survey-based metric to track CX, only 6% of leaders said they were confident that their measurements adequately support both strategic and tactical decisions.[2] Clearly, traditional CX metrics fail to provide the confidence, clarity, and forward-looking guidance executives need. Despite high and growing spending on technology and ongoing lip service to the importance of CX, most companies necessarily treat CX metrics as akin to interesting market research, largely unimportant beyond occasional reactive fire-fighting, and irrelevant to their growth strategies.

A more effective approach is not only possible, but key to gaining competitive advantage through customer-driven growth. In this paper, we explore the elements of a comprehensive framework for what we call customer key performance indicators, or customer KPIs.
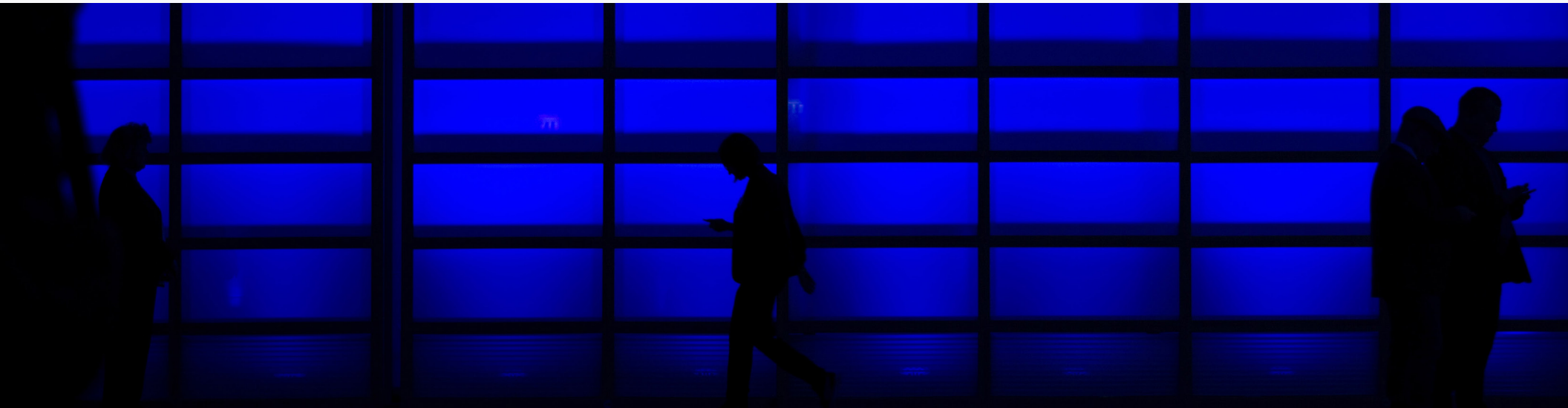
Why Traditional CX Fails to Deliver

Most companies use the Net Promoter Score®, CSAT, or some similar survey-driven metric as their primary customer satisfaction metric. It is used in two main ways:

1. As an overall brand-level satisfaction indicator, collected once or twice a year.

2. As a measure of transactional experiences, collected as interactions occur.

When measured at the brand level, NPS has been shown to correlate well with revenue and market share trends. According to the research used to establish NPS in the first place, NPS trends explain up to 60% of revenue and market share trends, depending on the industry. NPS is also a good predictor at the level of a business unit or product family for a large company. After the likelihood to recommend question (NPS) or overall satisfaction question (CSAT), either open questions, or so-called driver questions are asked, to discover reasons for the scores, and potential improvement actions.

All of this sounds far better on paper than it is in practice. Few companies use their hard-won survey insights when setting out their company strategy. Where survey insights indicate the need for action across different corporate teams, companies rarely allocate the necessary people and other resources.
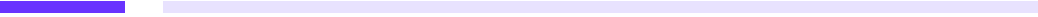
Companies' failure to drive strategy and decisively allocate the needed resources can be attributed to shortcomings inherent in survey-based insights. These core problems are largely responsible:

- The nature of survey-based insights is that they are reactive. It is all too easy to dismiss some major issue that has been observed in the past as no longer relevant.

Short-Termism Contributes to CX Failures

Some of the problems are driven by short-termism, for example concentrating all corporate efforts on this quarter and next. Using traditional survey and improvement processes takes time to deliver results, and many organizations are unwilling to wait that long. The HBR article "The Real Reasons Companies Are So Focused On The Short Term" (Dec. 13, 2017) provides three explanations for the situation, and there are probably other reasons too.

1. Boards choose new CEOs from outside companies and the new person feels a strong need to deliver quick results.

2. Decentralizing R&D from a central group to divisions, mainly to save money. The result is that companies no longer invest in early-stage technologies.

3. Related to the second point, companies, especially those that have decentralized R&D, concentrate on development, rather than research.

- Survey-based customer insights don't align teams around customer experience. That's because tend not to align very well with the metrics organizations use to measure themselves, making it difficult or impossible to operationalize improvement by assigning ownership for solutions. Findings about "poor service," for example, could indicate late delivery, unfriendly phone support, or unfortunately phrased email communications; each problem requires a different owner because it has a different operational cause.

- It's difficult if not impossible to use-survey driven insights to assess the levels of performance that would make a difference to customer experience. That means the operational feasibility of proposed changes is hard to assess.

Designing an Effective Set of CX Metrics

An ideal set of customer KPIs give business leaders the insights they need to first make strategic decisions about improving the customer experience, and then align teams around the practical steps to achieve those improvements. In other words, effective customer KPIs support business leaders in their strategic and tactical decision making and give them tools for leadership (not just management), as suggested by Michael Schrage and David Kiron in their report "Leading With Next-Generation Key Performance Indicator," published in the MIT Sloan Management Review. These customer KPIs give companies an essential tool for becoming advanced users of KPIs.

When mapping the characteristics of effective CX metrics, the first consideration is financial. If there is no relationship between the performance indicators and financial outcomes, it will be difficult to persuade people to improve their performance. Second, the operational metrics used for this purpose must be about customers. While measures like warehouse operator efficiency are important to your company's P&L, it is hard to see how they could drive customers to become Promoters or Detractors.

Timeliness also earns a place on the list of important characteristics. The performance metrics we use must be as close to real time as possible. This characteristic has special relevance for seasonal businesses, and for those that have substantial differences between weekday and weekend customers, but all businesses benefit from immediate insights.

The removal of human bias from the decision-making equation delivers benefit as well. This means we want software to analyze the data, and not humans. Without human bias, we may be able to observe, for example, that Salesforce data proves that customers who do not renew their contracts have received fewer visits from our salespeople than in the six months before renewal than those who do indeed renew. The data is robust, verifiable, accurate, and therefore unbiased.

Machine Learning Can Turn KPI Underachievers to KPI Leaders

"[M]ost companies do not deploy KPIs rigorously for review or as drivers of change," write Michael Schrage and David Kiron in their report "Leading With Next-Generation Key Performance Indicator" in MIT Sloan Management Review (June 26, 2018). Their global survey of more than 3200 senior executives, supplemented with extensive interviews, found that business leaders struggle to strike the right balance in their KPI sets to support both strategic and tactical planning.

The authors note that although most companies are "KPI underachievers," rapid advances in machine learning will soon transform what's possible for business decision makers. Leaders, they contend, stand to gain extremely significant competitive advantage by leaning into predictive algorithms and prescriptive indicators. The advantage conferred by sophisticated use of KPIs will be particularly substantive for executives tasked with growth.

Shrage and Kiron write that their study "reveals six behaviors common to advanced users of KPIs:
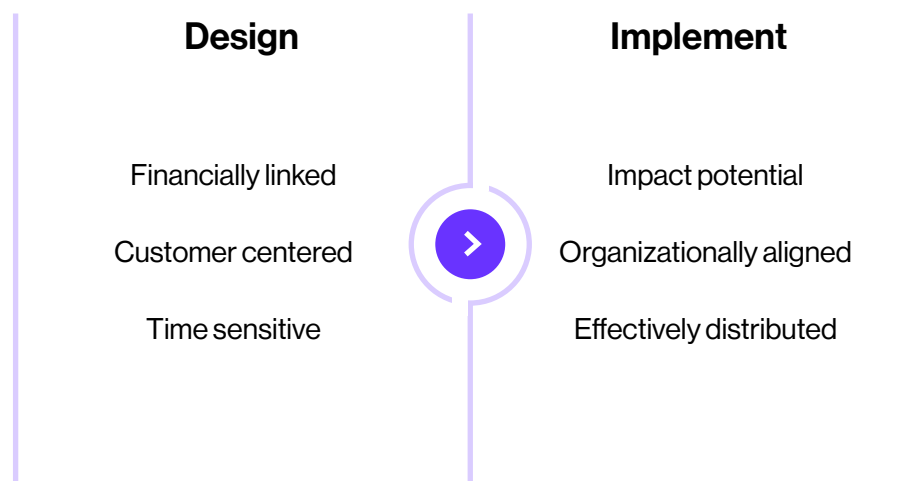
1. Use KPIs to lead, as well as manage, the enterprise.
2. Develop an integrated view of the customer.
3. See KPIs as data sets for machine learning.
4. Drill down into KPI components.
5. Share trusted KPI data.
6. Aim for KPI parsimony."

Solution: A New Customer KPI Framework

The heart of the solution to the various issues described above lies in designing and implementing customer key performance indicators, or customer KPIs, in a new way. Our framework for customer KPIs has two major elements: design and implementation, as seen in our simple model.

Design	Implement
Financially linked	Impact potential
Customer centered	Organizationally aligned
Time sensitive	Effectively distributed

Correctly designed, customer KPIs have clear financial linkages, are centered around the customer, and are time-sensitive, meaning they show what is happening now, and what will happen in the future if nothing is done. Correctly implemented, customer KPIs are prioritized by potential impact, aligned with the existing organization, and effectively distributed to the correct people. We'll look at each attribute in some depth.

Simple Customer Valuation

There are a couple of sophisticated valuation methodologies that are accepted as part of standard accounting practices. A simpler approach is possible: accept that the value of a company and the value of its current and future customers are one and the same thing. If a company is quoted on a stock exchange, the calculation is quite simple. If the only source of income is customers, then the value of customers is the same as the market capitalization. Otherwise, just use the average 'revenue multiple' that companies in your industry achieve when they are sold. These are quite easy to find, no matter where you live. If key leaders disagree with the suggested valuation, discuss it fully and agree a number.

Once an approximate valuation has been agreed, the next step is to agree the proportion of that value that comes from the existing customers. A reasonable number is 100%, as your existing customers usually buy more, and are the means you use to attract new customers. For example, if you have agreed that your company is worth 2.5 times its annual revenue, then a customer with a contract that brings you $2 million each year is actually worth $5 million. The critical inference is this: It's worth $5 million to you to have them renew their annual contract. At an overall company level, the value of losing 1% of customer revenue at contract renewal time is the same as losing 1% of your company's value.

Financially Linked

We begin on the "design" side of the framework. In a great design, company leadership is confident that improvement in the highest-priority customer KPIs will indeed drive improved financial results. We often hear CEOs say something like "Customers are our most important asset." Oddly, most have placed no explicit value on this asset. Modern AI solutions make it much easier to do so. The software identifies the top operational performance indicators that affect customer retention. For each one, it suggests the percentage impact it has on retention rates. This makes it easy to assign a financial value to improving the most important KPIs. Some investments will be worthwhile, and others will not. In any case, prioritizing operational improvement investments becomes much easier than it is today.

Of course, operations are not everything. Renewal rates are also affected by so-called 'brand image' factors. Experience with our initial customers suggests that operational performance indicators have a weight of about 70% in predicting customer attitudes. Brand image factors explain the rest. Crucially, addressing the two categories has one major difference: timing. It tends to take 18 to 36 months to address brand image items, while many operational improvements can be achieved within one or two quarters. Fixing high-profile operational issues may of course have a positive impact on brand image as inaction may come across as arrogance or ignorance.

The Problem of Organizational Self-Dealing

Customer-calibrated performance metrics are a powerful solution to the all-too-common problem of organizational self-dealing. When different functions are allowed to set their own performance metrics and targets, they often lose sight of their CX focus.

In one large IT company, we were discussing product delivery performance with the corporate VP of distribution. Customer surveys had suggested that customers wanted faster delivery. He had told us by email that he was achieving his corporate standard of 92% of deliveries shipped by the date promised to the customer. Our investigation showed that delivery performance had been deteriorating slowly but steadily over the prior three years. We set up a face-to-face meeting.

Once we were with him, the VP's story changed quite radically. He told us that he had two major pressures: First, he felt he owed it to himself and to his team to meet the delivery performance standards. He felt the team would feel down and people might leave if they were not achieved. Second, he was primarily measured on cost, rather than customer-centric performance. He had found a simple way to deal with the conflicting objectives. He had gradually dropped the performance standard from 98% to 96%, 94%, and finally to 92%. Now he was showing bright green performance for both his cost and quality goals. He even admitted that his next step might be to count incomplete deliveries as being on time.

Customer Centered

Customer KPIs must be selected and calibrated to reflect customer, rather than internal perspectives. An arbitrary standard of performance, even if it is based on research, cannot be applied to all companies and businesses. Similarly, the practice of setting standards based on achievable performance (given staffing levels or the like), is disconnected from customer experience. In the new KPI system, target performance standards depend solely on the relationship with customer retention, and therefore the results you want to achieve. Customer calibration also prevents the practice of using existing internal or external standards to prevent actions geared toward improvement of CX.

A great advantage of using AI to surface and calibrate important metrics is that the customer-centric data will speak to the leaders directly. Nobody can hide behind arbitrary performance standards. Nobody will have to fear telling senior leaders and their teams something they don't want to hear. Customers tell the story by their actions, based on operational KPIs. Senior leaders must listen. Where necessary, inappropriate cost reduction goals will have to be modified.

Time Sensitive

Effective KPIs respond quickly enough to changes in performance to enable in-time actions.

Consider the contrast between using prioritized operational performance indicators and treating NPS as the only customer KPI. NPS results change slowly. A stable overall trend can also hide operation items that are heading in opposite directions. To pick a simple example, delivery accuracy could be improving while lead time is deteriorating. The two could balance each other out and become invisible at the top level. Leaders may believe no action needs to be taken on something that is in fact highly important. We can't allow that to happen.

Acting on the basis of obsolete data is worse than not acting at all. Outsourced benchmark surveys represent an extreme case in the traditional CX approach. They use respondent panels and two or three months may go by between the first answers obtained and the publication of the final report. This makes it relatively easy to invest in actions that may no longer be relevant. Working directly with live operational data eliminates this problem.

In traditional CX programs using survey-based insights, the first step toward taking action is almost always the formation of a team to validate the issues. This wastes valuable time. Starting with the operational data usually means no validation is necessary. The numbers already come from the reference systems and are immediately accepted as accurate. Even when operational data is not perfectly accurate, it's usually the best data you have.

Impact Potential

Now we move to the "implement" side of the framework. Goals are formulated based on impact, improvement potential and cost.

From an implementation perspective, clarity is critical. It must be easy to determine and communicate the impact of a customer KPI, how much it can be improved, and the cost of any such improvement. As mentioned previously, the essence of business strategy is to concentrate scarce resources on a small number of things that have the highest impact. The list cannot be endless. Ideally, you should be able to count your priorities on the fingers of one hand, two hands at most.

In customer experience, the high-impact items may come from unexpected sources. For example, our customers often find that Salesforce data, when incorporated into the analytic engine, reveals high-potential actions. For example, frequency of calling on each customer can be an excellent predictor of contract renewal rates. KPI analytics may show that lower renewal rates in one sales region are linked to 20% fewer customer visits, and that this is in turn linked to having fewer sale people per million dollars of revenue than in other regions. In this example, it is obvious that it should be easy to calculate the potential impact of increasing the number of salespeople, or shifting their schedules to support more visits.

Organizationally Aligned

Effective customer KPIs align with the accountability structure and bring teams together.

As distinct from all survey findings, customer KPIs come from existing systems, representing and quantifying the day-to-day operations of the company. They already appear in existing performance dashboards. So, while a survey might tell you that telephone support is unacceptable, the operational data will provide predictive trend information on drop rates, hold times, repeat calls for the same event, and so on. AI driven analytics tell you which of those factors matter to the customer experience, providing insights much more actionable than what we learn from surveys alone. And the insights are presented in terms of metrics that are already in use.

Another advantage: In most cases, the owner of a customer KPI is clear. 'Owner' means the person who must be praised when it is going well, and who must act when it is going poorly. Ownership can be tricky. While a performance indicator may be listed on a single function's performance dashboard, that may not be the only function that impacts it. For example, a distribution center manager can be meas-

ured on order turn-around time (TAT) but have limited control over what inventory is actually held. A procurement function targeted on cost reduction may have a substantial impact on order TAT without it appearing on the procurement dashboard.

So though there is usually a primary owner for a given operational metric, improving it may involve multiple teams in a business. It is absolutely critical that the corporate-wide action owner for the customer KPIs identified as most critical be agreed. If an improvement initiative is required, that person must have the authority to lead a team that crosses organizational boundaries. Each team member should of course be formally measured on the success of the improvement initiative. If not, they will miss the project reviews and deprioritize actions to which they have agreed. Overall, however, a KPI-driven approach to CX management has the advantage that KPIs usually align with existing corporate RACI models.

Distributed

Customer KPIs must be continuously updated and distributed through effective technology channels.

In traditional approaches, customer survey results are distributed to department heads and discussed in senior leadership team meetings. The person or people who can take direct action may never learn anything. The old methodology also takes time, making it easy to dismiss the results as obsolete. For customer KPIs to be effective, they must reach the people who need to take action, in time for them to do so. The ability to distinguish between when an alert should and should not be sent is highly important.

Any good system should allow for experimentation too. One of our SaaS software customers has found that software utilization rates are a critical predictor of NPS and renewal rates. They are able to conduct a sort of A/B test on the utilization KPI to learn how quickly and with what frequency changes in utilization rates should trigger alerts.

Beyond slow pace and difficulties reaching the correct people, the survey-based approach suffers from another defect: language. When (and if) the messages finally reach the correct people, they are in a language that is not seen as relevant to daily work. "Your Customer Effort Score has declined from 6.1 to 5.7. Customers are finding it harder to get things done with your department." There is a complete disconnect with the KPIs the department in question uses to manage its work from day to day. Alerting the department head that average time to respond to insurance claims logged online has gone up by 42%, resulting in a high probability of losing $16.7 million at contract renewal time if it does not return quickly to the previous level would be far more effective.
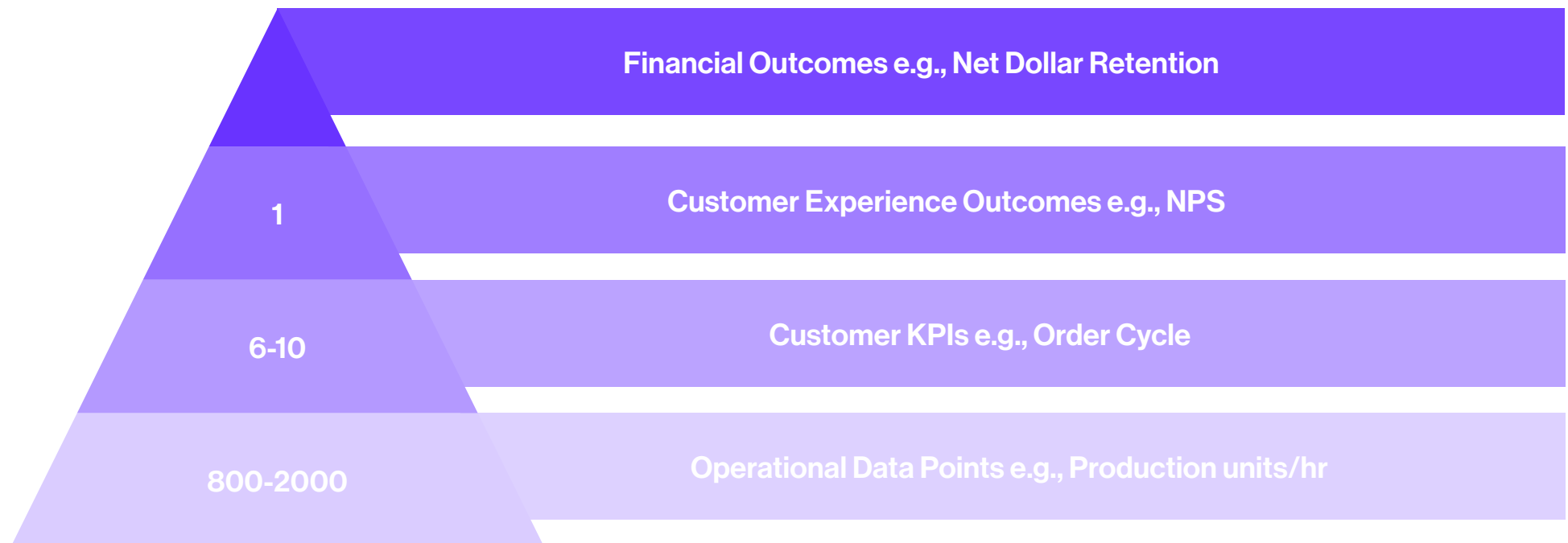
Data Hierarchy Drives Design

The customer KPI framework described here relies on a machine learning model that combines attitudinal and operational data to:
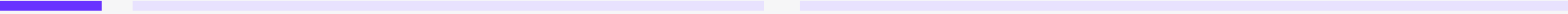
- Select important metrics based on customer relative impact

- Calibrate performance targets around NPS outcome sensitivity

- Predict the CX or financial outcome for individual accounts or the portfolio.

The design process depends on a clear hierarchy of data that creates an attribution chain connecting financial outcomes to operational data points, as seen below.

At the bottom of the data hierarchy are the hundreds of operational data points that typically exist within the business across the entire customer journey. In a typical company, you could probably document anywhere from 800 to 2000 data points that are constantly being captured from the start of the sales cycle through all forms of initial customer contact, onboarding, through to consumption of products and support services. In an order and production cycle, for example, these metrics might include production units/hour, order date, shipping time, and more.

That complete data set is vital to the business but doesn't represent a useful actionable KPI set.

Financial Outcomes e.g., Net Dollar Retention

1 — Customer Experience Outcomes e.g., NPS

6-10 — Customer KPIs e.g., Order Cycle

800-2000 — Operational Data Points e.g., Production units/hr

For a start, there are simply too many, and it becomes too confusing to use them as goals. They aren't describable in a simple way that would enable team members to understand the metrics and how team members impact them. They are trapped in different systems, and inconsistently measured. The real world is a mess; if yours isn't, then you should count yourself lucky – and an outlier.

This large set of data points need to be put together into composite metrics, or customer KPIs – the next level in the data hierarchy. Each KPI pulls together multiple data points into a single objective metric. In our example, several data points might create a KPI for "order cycle." A large part of the work of the machine learning model is stripping that large dataset down to a much smaller, more potent group.

In the next level of the hierarchy, the optimally designed customer KPIs have a direct link to customer experience outcomes. In our example,

we use NPS, but another metric could serve this purpose. Many people think that NPS is essentially part of the customer KPI group, but it's not: NPS is an aggregate metric that reflects the entire customer experience. Because it quantifies the summary impact of KPIs on the customer experience, NPS (or its equivalent) also gives us some highly effective techniques for figuring out how to design the customer KPIs. If we know that our customer KPI set, weighted and calibrated appropriately, links to NPS, we know we have the right metrics. At the end of the day, we're creating a recipe that reliably generates promoters.

Finally, at the top of the hierarchy, we need to understand the leverage that that NPS gives us over net dollar retention or churn or customer lifetime value. These metrics aren't completely correlated. Customers have long term contracts, which means that loss of a customer may not happen in a given year, even if they're a detractor. Other factors that are external to the nature of the customer experience a major impact on financial performance. So we need to model additional factors so as to bridge customer experience to financial outcomes. But that doesn't fundamentally alter the design of the customer KPIs.

Conclusion

If the primary intent of customer experience work is to select and implement improvement actions that drive short-term growth, using KPIs that come from existing systems and are included in existing management reports is the way to go. The main historic challenge has been in the prioritization of the operational data trends. Until recently, we relied quite a lot on personal experience and intuition. New software solutions allow accurate predictions about the relative impact of each data point trend on customer retention. This makes it relatively easy to select the few investment areas that will drive the most growth.

The new software and operating model can indeed align all teams behind a single set of strategic goals. Correctly selected KPIs do indeed drive top-level CX metrics such as NPS, and financial outcomes. The KPIs do of course provide essential information about customers who have not responded to your surveys.

As spending and effort related to CX continue to increase, companies that take an innovative approach to their customer KPIs stand to pull ahead of their competitors and gain critical tools for internal team alignment. With smarter technology investments and a rethinking of the metrics they use to guide growth, today's leaders can make the radical choice to rely on data, rather than intuition, to drive the optimal design of customer key performance indicators.

Predict customer futures.

AI that turns operational data into predictive CX analytics.

OCX Cognition™

success@ocxcognition.com

OCX Cognition predicts customer futures. Our breakthrough SaaS solution, Spectrum AI, lets enterprises transform what's possible in customer experience. Reduce your customer risk, break down silos, and drive speedy action – when you can see what's coming, you can change the outcome. Building on more that 15 years of CX-focused expertise, we've harnessed today's advances in AI, elastic computing, and data science to deliver on the promise of customer-driven financial results. Learn more at www.ocxcognition.com.