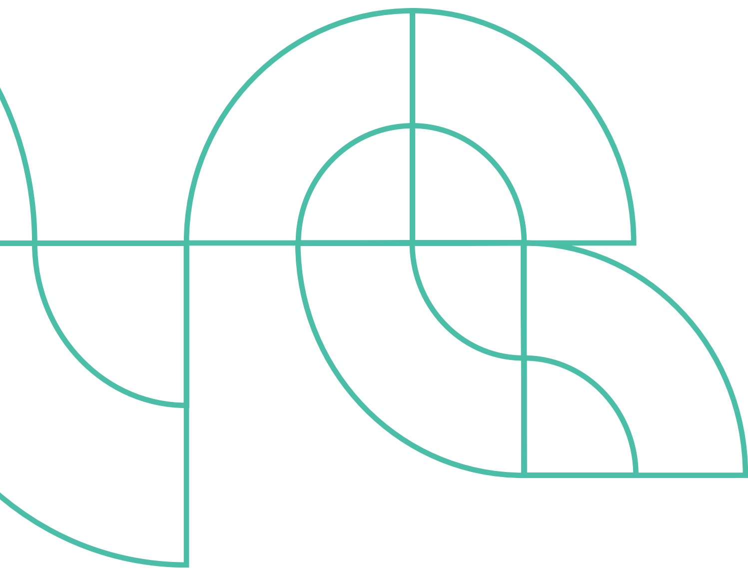
Know Your Numbers

A Guide to Tracking Key Performance Indicators (KPIs) in Uncertain Times



Introduction

Running a business is like steering a ship through uncharted waters. It can be exciting, challenging, and even risky at times. But just like a captain needs to know their ship's position, speed, and direction, business owners and their accountants need to know how their company is performing. This is where Key Performance Indicators (KPIs) come in. KPIs are metrics that measure a company's performance against its **goals, objectives, and targets**. They provide valuable insights into a business's financial health, operational efficiency, customer satisfaction, and overall success.

In this guide, we'll explore the importance of **staying on top of your Key Performance Indicators** and why tracking them is essential for businesses. We'll discuss which metrics to track, how to interpret the data, and how KPIs can help you to navigate a business through the choppy waters of these uncertain times. Whether you're a business owner, a financial professional, or an advisor, this guide will help you understand how KPIs can drive business success and improve your bottom line.

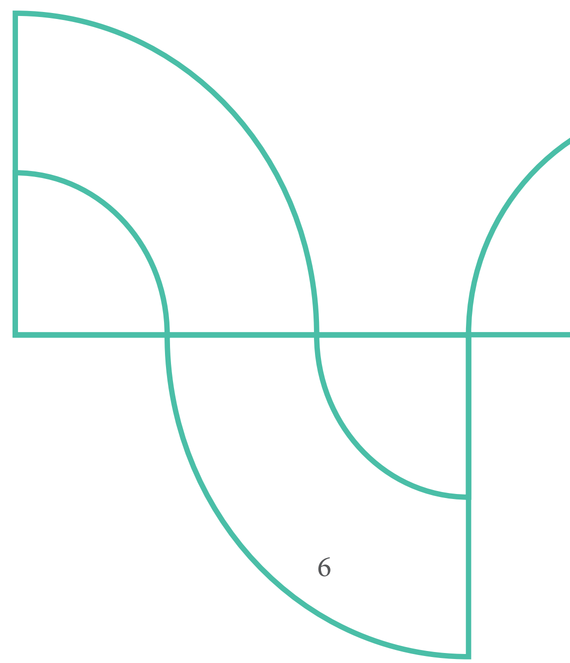
First, a few orientation questions: **Do you know where your business stands financially?** Do you know what's going on in each department, division or location? Do you know the true position of your consolidated group?

The ability to understand and leverage insights from financial data is essential for business managers. And in the current business climate, it is even more imperative for decision makers to understand their business's financial position before making decisions.

This process starts with measuring the metrics that matter for your business. We believe that Peter Drucker's well-known management adage, "You can't manage what you don't measure", holds true in the current business climate.

So, what are the numbers that matter most to your business? Which financial KPIs are most important to focus on in the current economic climate? Which metrics provide a holistic view of **financial health and stability?**

> **"You can't manage what you don't measure.**



In today's environment, **metrics which track financial health and resilience will be of greater importance.** To evaluate the financial health and long-term sustainability of your business, a number of financial metrics are useful.

This guide highlights **20 KPIs** which we think you'll find important. These KPIs assess financial health from a variety of perspectives, including: **Revenue, Profitability, Activity, Efficiency, Liquidity, Debt servicing, Cash flow, Growth / Contraction.**

Finally, we'll also highlight the importance of tracking lead KPIs in these uncertain times. **Lead KPIs** are typically non-financial KPIs which can act as relevant early warning indicators.

> Tip: Each of these financial KPIs are available in Fathom. To update the KPIs that you are tracking in your Fathom reports, simply go to 'Step 4' of the company setup to make changes.

20 Financial KPIs

Top-line

KPIs to measure if the business is effective in generating sales and revenue.

1. Total Revenue

What is Total Revenue?

The total amount of money received by the company for goods sold or services provided. Revenue is also a key indicator of growth or contraction.

Why is it important?

As a result of economic conditions, revenues for some businesses will reduce. Tracking this KPI helps to assess if the business is still effective in generating sales and revenue. Revenue is also useful in determining the financial strength of the business. Dependable revenues allow for more confident financial planning and forecasting.

How can Total Revenue be improved?

Strategies to improve revenue may include increasing the volume of sales through marketing initiatives or finding alternative sources of income. Business managers may also need to search for creative ways to improve efficiency and reduce costs, such as streamlining processes, reducing waste, and cutting unnecessary expenses.

2. Revenue Change %

What is Revenue Change?

A measure of the percentage change in revenue for the period. Also known as 'Revenue Growth %'.

How to calculate:

= (Current Revenue – Prior Revenue) ÷ Prior Revenue

Why is it important?

If your business has been impacted by current economic conditions, such as reduced customer demand, then it is useful to measure the quantum of this impact on the business's top-line. Watching for an upward trend in this KPI may indicate a positive rebound.

Profitability

KPIs to measure how effective the business is at generating profit.

3. Gross Profit Margin %

What is Gross Profit Margin?

A measure of the proportion of revenue that is left after deducting all costs directly related to the sales. The gross profit serves as the source for paying remaining operating expenses.

How to calculate:

= (Gross Profit ÷ Revenue) x 100

Why is it important?

Profitability is a significant measure of a company's financial health. Any reduction in turnover can negatively affect business profitability.

4. Operating Profit Margin %

What is Operating Profit Margin?

A measure of the proportion of revenue that is left after deducting all operating expenses.

How to calculate:

= (Operating Profit ÷ Sales) x 100

Why is it important?

This KPI assesses the operating efficiency of the business. As a response to the current business conditions, many business managers will seek to stop or reduce non-essential expenses. This metric helps to provide an indication of how well management controls operating costs.

5. Expense-to-Revenue Ratio %

What is Expense-to-Revenue Ratio?

Also known as the Efficiency ratio, this measures how efficiently the business is conducting its operations. This metric measures both sides of the profitability equation: revenues and expenses.

How to calculate:

= (Total Expenses ÷ Total Revenue) x 100

Why is it important?

If revenues decline, then management may need to undertake actions to reduce costs. A significant rise in the expense-to-revenue ratio may indicate the eroding of margins and should prompt action.

6. Revenue per Employee

What is the Revenue per Employee ratio?

Revenue per employee is important for determining the productivity and efficiency of employees working in the business.

How to calculate:

= Revenue ÷ # of FTEs

Why is it important?

For many businesses, staff costs (ie. wages, salaries and employee benefits) are the largest expense. During any business downturn it's important to monitor the productivity and utilisation of employees.

7. Breakeven Margin of Safety

What is the Breakeven Margin of Safety?

Breakeven Margin of Safety represents the gap between the revenues and the breakeven point. This is the amount by which revenues can drop before losses begin to be incurred.

How to calculate:

= Total Revenue – Breakeven

Why is it important?

A higher margin of safety indicates that the business is better positioned to handle a decline in revenues. Understanding the quantum of risk here is useful for planning.

Activity

KPIs to measure the overall
efficiency of working capital.

8. Accounts Receivable Days

What is Accounts Receivable Days?

A measure of how long it takes for the business to collect cash from customers. A shorter time to collect from debtors will have a positive impact on cash flow.

How to calculate:

= Accounts Receivable x Period Length ÷ Revenue

Why is it important?

Many of your customers may have been adversely affected by the economic climate. So it's important to monitor any upwards trend in this metric, while carefully managing the collection of amounts owing from customers. Any increase in this number indicates that it's taking longer to collect amounts due from customers. Successful cash management requires monitoring all the elements of the working capital cycle. It's important to understand how to optimise the working capital cycles so that the operational aspect of your business is cash flow positive.

9. Accounts Payable Days

What is Accounts Payable Days?

A measure of how long it takes for the business to pay its creditors.
A stable higher number is generally an indicator of good cash

management. A longer time taken to pay creditors has a positive impact on cash flow. However an excessive lengthening in this ratio could indicate a problem with the sufficiency of working capital to pay creditors.

How to calculate:

= Accounts Payable x Period Length ÷ Total Cost of Sales

Why is it important?

Optimising your working capital during this time is imperative, but it is also important to maintain positive on-going business relationships with existing suppliers. The excessive lengthening in this ratio could threaten continuity of service from suppliers.

10. Inventory Days

What is Inventory Days?

A measure of how efficiently the business converts inventory into sales. A lower number of days is generally an indicator of good inventory management. A shorter time holding inventory has a positive impact on cash flow.

How to calculate:

= Inventory x Period Length ÷ Cost of Sales

Why is it important?

A high result may indicate overstocking, conversely a low result can mean there is a shortage of inventory. It is important to track your inventory so you don’t purchase more or less than you need.

11. Cash Conversion Cycle (Days)

What is Cash Conversion Cycle?

A measure of the length of time between purchase of raw materials and the collection of accounts receivable from customers. The Cash Conversion Cycle measures the time between outlay of cash and cash recovery.

How to calculate:

= Accounts Receivable Days + Inventory Days + WIP Days – Accounts Payable Days

Why is it important?

Cash flow is the lifeblood of any business and how it's managed can mean the difference between your business's success or failure. Successful cash management requires monitoring all the elements of the working capital cycle. This cycle includes Receivable days, Payable days, WIP days and Inventory days. It is important to minimise the time that working capital is tied up in the operating cycle of the business.

Liquidity

KPIs to measure availability of assets which can quickly be converted into cash.

12. Quick Ratio

What is the Quick Ratio?

The quick ratio is sometimes referred to as the acid test. It measures the availability of assets which can quickly be converted into cash to cover current liabilities. Inventory and other less liquid current assets are excluded from this calculation.

How to calculate:

= (Cash + Accounts Receivable) ÷ Total Current Liabilities

Why is it important?

This metric tells you about a business's ability to ride out short-term rough patches. Specifically, the ability to pay short-term creditors immediately from liquid assets. A quick ratio of 1:1 or more is considered 'safe'. A result less than 1.0 indicates that the business is dependent on less current assets (ie. inventory) to meet short-term obligations.

13. Current Ratio

What is the Current Ratio?

Is another measure of liquidity, which compares Current Assets and Current Liabilities. The higher the current ratio, the greater the 'cushion' between current obligations and the business's ability to pay them.

How to calculate:

= Total Current Assets ÷ Total Current Liabilities

Why is it important?

Generally a current ratio of 2 or more is an indicator of good short-term financial strength. In other words, the current assets of the business should be at least double the current liabilities.

Debt Service

KPIs to measure the ability to meet debt obligations.

14. Debt-to-Equity

What is the Debt-to-Equity ratio?

A measure of the proportion of funds that have either been invested by the owners (equity) or borrowed (debt). An appropriate mix of debt financing and equity financing will vary for each industry and business.

How to calculate:

= Total Debt ÷ Total Equity

Why is it important?

If the business borrows additional funds, then it's important to monitor if higher debt levels indicate a weakening of financial strength. Debt servicing costs may weigh on the company and increase its risk exposure.

15. Interest Cover

What is Interest Cover?

A measure of the ability to service its interest payments from the profits earned by the business. It is a measure of the business's ability to meet its debt obligations.

How to calculate:

= EBIT ÷ Net Interest

Why is it important?

For businesses funded by debt or those which have loan covenants in place, then it will be important to assess the ability to continue to service these obligations. A high result indicates that the business can easily meet its interest payments. A lower result indicates that the business is becoming more burdened by debt expense. A lower result may also identify the potential risk that profits will be insufficient to cover interest payments. Generally a result of more than 2 is considered to be safe, but businesses which are experiencing volatile earnings in the current business conditions may require a higher level of cover.

Cash Flow

KPIs to measure the cash generated or absorbed by the business.

16. Cash on Hand

What is Cash on Hand?

A measure of the cash and cash equivalents in possession by the business at a particular time.

Why is it important?

Cash is the lifeblood of the business, the fuel that keeps the engine running. Insufficient cash may indicate an inability to pay creditors and cover current liabilities.

17. Operating Cash Flow

What is Operating Cash Flow?

Operating cash flow is simply the cash generated by the operating activities of the business. Operating activities include the production, sales and delivery of the company's product and/or services as well as collecting payment from its customers and making payments to suppliers.

How to calculate:

See the Cash Flow waterfall chart in Fathom.

Why is it important?

In the current business climate, where possible, it is important to ensure that the operational aspect of the business is cash flow positive. Negative operating cash flows, period after period, may signal that cash will become insufficient to cover expenses or other obligations.

18. Free Cash Flow

What is Free Cash Flow?

Free cash flow is the cash generated by the business, after paying its expenses and investing for future growth. It is the cash left after subtracting capital expenditure from operating cash flow. The term "free cash flow" is used because this cash is free to be paid back to the suppliers of capital.

How to calculate:

See the Cash Flow waterfall chart in Fathom.

Why is it important?

Business managers need to reduce cash flow shortfalls through measures that increase cash inflows or reduce cash outflows. To protect Free Cash Flow these measures should include only essential 'investing activities'. Management may wish to investigate delaying the purchase or renewal of long-term assets such as property, plant, and equipment; or other capital expenditure.

19. Net Cash Flow

What is Net Cash Flow?

Net cash flow is the cash left after subtracting expenditures from financing activities from Free Cash Flow. This includes the cash impact from financing activities. Financing activities include the inflow of cash from investors such as banks or shareholders, as well as the outflow of cash to shareholders as dividends.

How to calculate:

See the Cash Flow waterfall chart in Fathom.

Why is it important?

Net Cash Flow indicates whether the business is generating or absorbing cash after all operating, investing and financing activities. Ultimately this metric indicates if the business is cash flow positive or negative.

20. Net Variable Cash Flow

What is Net Variable Cash Flow?

A measure of the additional cash that will either be generated or used up by the next $1 of products or services that the business sells.

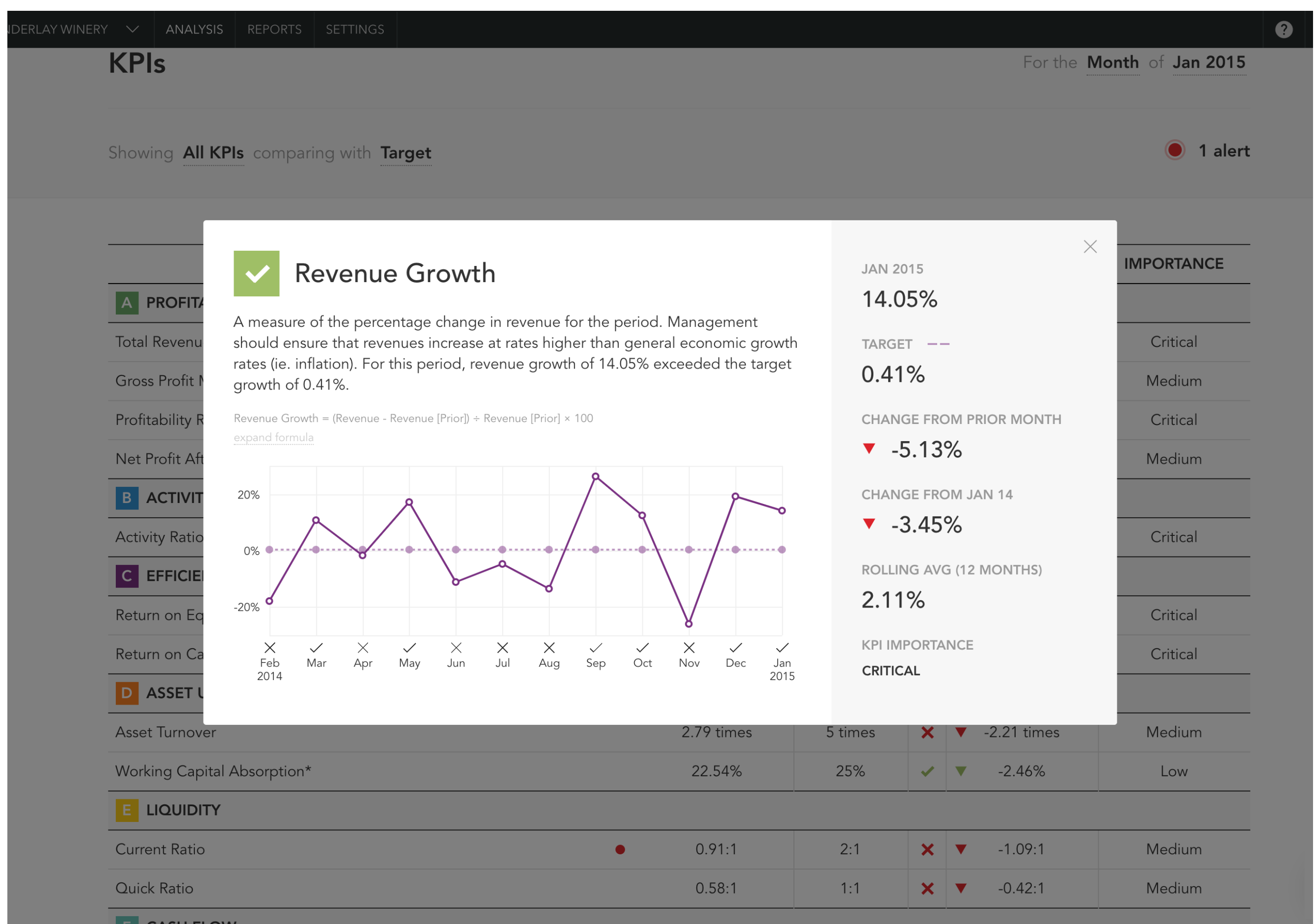
How to calculate:

= (Total Revenues – Variable Expenses – Variable Cost of Sales – Operating Working Capital) ÷ Total Revenue

Why is it important?

If net variable cash flow is negative, the business will absorb cash with each additional sale of products or services. This means that for every additional $1 of revenue the business will require additional cash funding.

> Tip. Using the KPI Analysis tools in Fathom, you can view further commentary and explanation of each KPI. You can also view results for each metric against target or budget; and view the trends for each metric. For example:



Non-financial KPIs

In these times, it's important to keep a pulse on relevant early warning signs. Measuring 'Lead KPIs' are useful for this purpose. KPIs can either be classified as **lead indicators** or **lag indicators**.

Non-financial KPIs

Leading indicators of business performance.

What are lead vs lag KPIs?

Lag KPIs report exclusively on the outcome or result – they are useful for assessing if business goals were achieved. Conversely, lead KPIs are critical for identifying the inputs or causes of business performance. Lead indicators measure immediate progress and show the likelihood that the business will achieve its goals. In other words, they help to predict future financial results.

Monitoring the right lead indicators helps to make sure that your business is on track to achieve your lag KPIs. In the current business climate, lead indicators serve as useful early warning indicators.

A summary of differences:

	LEAD INDICATORS	LAG INDICATORS
What is measured	Causes	Effects
Timeliness	Early warning	Historical
Units of measurement	Mainly non-financial	Mainly financial
Main use?	To predict change and future outcomes.	Scorecard

As an example, if your business is vulnerable to a downturn in trade, then it will be important to track the lead indicators which influence revenue. Metrics which help to see if future revenues will be tracking in the right direction may include:

- Sales calls (or meetings)
- Pipeline value ($, £)
- Bookings
- Proposals
- # of deals won (or # of deals lost)
- # of units sold
- Conversion %
- # New Website visitors
- # New Customers
- Customer Churn rate
- Number of delayed projects

The effectiveness of the above lead indicators to provide early indication of expected financial results, will depend on the length of your typical sales cycle. For example, if you have a 6 month sales cycle, then the above indicators may provide up to 6 months of warning. The trick is determining which lead KPIs will influence your primary lag KPIs.

> Tip. In addition to tracking financial KPIs, Fathom also enables you to define and track non-financial KPIs. Using Fathom, you can combine both financials (Lag KPIs) and non-financial results (Lead KPIs) in a single report or dashboard.

We hope the KPIs suggested above, both financial and non-financial, help you to shape and refine the measurement of your business's performance, so you can plan for the future with greater clarity and confidence.

Want to learn more about how Fathom can help you?

Let’s talk

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