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BUSINESS GUIDE

Make or Break Metrics

20 KPIs Every Growing Business Should Track

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Key performance indicators (KPIs) are quantifiable business metrics that track and measure an organization's progress toward its strategic objectives. More than just numbers, KPIs tell a story about how well a company is performing. Understanding KPIs as they relate to your industry, company, and even separate departments within a company is essential for any growing business.

Business leaders increasingly realize they can leverage this information to make better decisions.

The immense amount of information available to decision-makers today can also be overwhelming, so we pared it down to 20 widely used KPIs relevant to most businesses. This business guide explains why KPIs matter, the characteristics of a good KPI, and provides a list of popular financial and operational KPIs.

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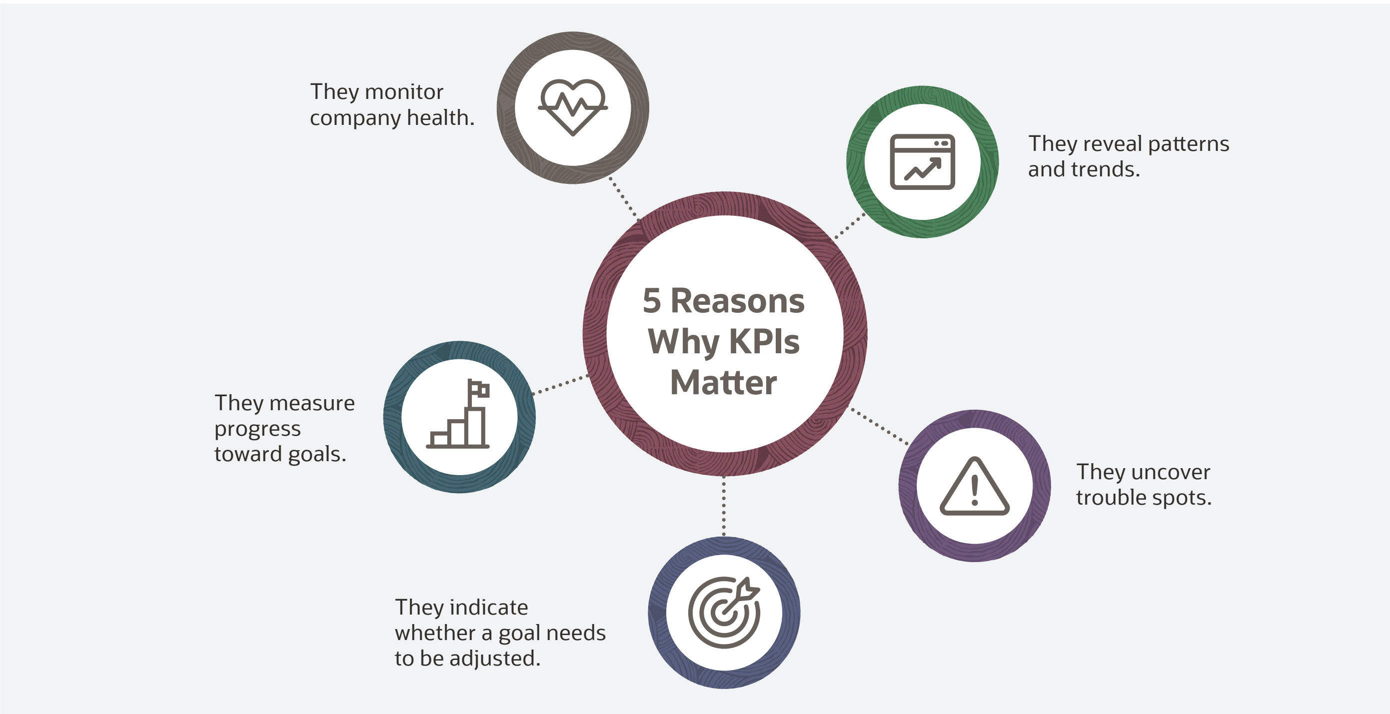
CHAPTER 1

What Is a KPI?

A KPI measures a company's performance against its primary business objectives. High-level KPIs focus on a company's overall performance, while lower-level KPIs focus on departmental processes, products, and productivity. A company doesn't need to monitor too many KPIs — no more than 10 as a general rule. After all, measuring everything clouds the picture of what matters most to the organization.

There are many different types of KPIs. Many focus on financial performance metrics, such as revenue growth rate and net profit margin. Others focus on customers, such as customer satisfaction or customer churn. Some KPIs measure operations, such as time to market and average order fulfillment times, while others concentrate on employee or talent management metrics, such as workforce retention and turnover.

KPIs fall into two categories: leading and lagging. Leading indicators predict what may happen in the future and offer businesses the opportunity to prepare accordingly. For example, an increase in deal size or employee headcount may portend revenue growth. Lagging indicators reflect past results, measuring the aftermath of actions. Monthly recurring revenue and employee turnover are two examples of this type of KPI. Lagging indicators can uncover trends, help companies evaluate their progress, and influence future decisions.



10 Popular Financial KPIs

While organizations need a firm grasp of what will make them successful and which industry-specific KPIs matter to them, there are metrics relevant to most businesses. Here are 10 popular financial KPIs used by growing businesses.

1. Gross Profit Margin

Gross profit margin measures the amount of money left over from product sales after subtracting cost of goods sold (COGS). A higher gross profit margin indicates the company is efficiently converting its product or service into profits. The cost of goods sold is the total amount to produce a product or service, including materials and labor. Net sales are revenue minus returns, discounts, and sales allowances.

$$\textbf{Gross profit margin percentage} = \left(\frac{\text{Net sales} - \text{COGS}}{\text{Net sales}}\right) \times 100$$

2. Operating Profit Margin

Operating profit margin shows the percentage of profit a company makes from operations before accounting for taxes and interest. Increasing operating margins can indicate better management and cost controls within a company. To find your operating profit, subtract COGS, operating expenses, and depreciation and amortization from total sales.

Operating profit margin percentage =
(Operating profit / Revenue) x 100

3. Operating Cash Flow

Operating cash flow (OCF) is the amount of cash a company generates through typical operations. This metric can give a business a sense of how much cash it can spend in the immediate future and whether it should reduce spending. OCF can also reveal issues like customers taking too long to pay their bills or not paying them at all. There are two ways to calculate it: the direct and indirect method.

Operating cash flow (indirect method) =
Net income + Depreciation and amortization – Net working capital

Operating cash flow (direct method) =
Cash revenue – Operating expenses paid in cash

4. Current Ratio

The current or working capital ratio measures the liquidity of a business to determine if it can meet its financial obligations. A working capital ratio of 1 or higher means the business's assets exceed the value of its liabilities. Companies often target a ratio of 1.5-2, and anything below 1 signals future financial problems.

Working capital ratio = Current assets / Current liabilities

5. Quick Ratio

The quick ratio, also called the acid test ratio, measures whether a business can fulfill its short-term financial obligations by evaluating whether it has enough assets to pay off its current liabilities. Quick ratio is written as a number, with a ratio of 1.0 meaning a company has just enough assets to cover its liabilities. Anything below 1 could mean the company's business model is not viable.

Quick ratio = (Cash + Cash equivalents + Marketable securities + Net accounts receivable) / Current liabilities

6. Return on Assets (ROA)

Return on assets measures the profitability of a business compared to its total assets. This return on investment (ROI) metric shows how effectively a company uses its assets to generate earnings. A higher ROA means a business is operating more efficiently. To calculate average total value of assets, add up all assets at the end of the current year plus all the assets from the prior year and divide that by two.

ROA = Net income / Average total value of assets

7. Days Payable Outstanding (DPO)

The average number of days it takes a company to make payments to creditors and suppliers is days payable outstanding. This ratio helps the business see how well it's managing cash flow, whether it's taking advantage of discounts for early or on-time payments from vendors, and if it's a business that will build strong relationships with suppliers.

DPO = (Total accounts payable in given period / COGS) x Number of days in period

8. Days Sales Outstanding (DSO)

This metric shows how long it takes, on average, for customers to pay a company for goods and services. A higher days sales outstanding indicates a company takes longer to collect payment, which can lead to cash flow problems. Generally, the lower your DSO, the better, but this number usually climbs during times of economic uncertainty or recessions.

Days sales outstanding = (Total accounts receivable in given period / Total credit sales in period) x Number of days in the period

9. Cash Runway/Net Burn Rate

Cash runway shows how long a company has before it runs out of cash based on the money it currently has available and how much it spends per month. This metric helps businesses understand when they need to cut back spending or get additional funding. If your cash runway shortens over time, it's a sign your company is spending more money than it can afford to.

Cash runway is closely tied to burn rate, which measures how much money a company spends over a certain period (usually monthly). Burn rate is frequently used by investor-backed startups that lose money in their early days.

Net burn rate = (Monthly revenue – COGS) – Monthly expenses

Cash runway = Total capital / Monthly expenses

10. Budget Variance Rate

Just as it sounds, budget variance rate compares a company's actual spend or sales in a certain area against the budgeted amounts. Although budgets are usually tied to expenses, budget variance can also compare actual and forecasted revenue. This variance analysis helps small business leaders identify areas where they're overspending that may need further attention. It also reveals areas of the business that outperformed expectations and warrant additional investment.

Budget variance percentage = (Actual / Forecast – 1) x 100

CHAPTER 3

10 Common Operational KPIs

Operational KPIs show how well your business is running. Improved internal business processes and metrics lead to more satisfied customers, which is imperative for growing businesses.

1. Cost Per Unit

Cost per unit is how much a single unit of product costs a company to produce or buy. It is best used in companies that manufacture or sell large amounts of the same product. Knowing the cost per unit helps companies understand if they are making products in a cost-effective manner, how to price products, and when they'll turn a profit.

Cost per unit = (Total fixed costs + Total variable costs) / Number of units produced

2. Lead Time

Lead time measures the amount of time that passes between the beginning and end of any supply chain process. This could be the time between a business ordering a product from a supplier and receiving it, between a customer placing an order and receiving it, or between the start and end of a production process. In that way, this KPI measures the efficiency of the entire supply chain or certain steps within it. Lead time is important because it determines the amount of inventory a company needs to have on hand to fulfill orders and therefore impacts stock availability and customer satisfaction.

While the formula below is for total lead time, it can easily be adjusted to measure customer lead time, supplier lead time, or production lead time. Also note that manufacturing time only applies to companies that make their own products.

Cumulative lead time = Procurement time + Manufacturing time + Shipping time

3. Cash Conversion Cycle

This metric tells you the length of time between when you pay suppliers for materials and when your customers pay for the final finished product. You want the cycle time to be as short as possible. Tracking this metric will help identify potential causes of cash flow issues. Although this metric varies depending on what you sell and your customer base, some of the most efficient companies have cash conversion cycles of less than one month. However, it can be much longer, especially if you're in an industry with long lead times.

Cash conversion cycle = Days sales outstanding + Days of inventory outstanding – Days payable outstanding

4. Inventory Turnover Ratio

Inventory turnover ratio is the number of times a company sells and replaces its stock in a certain time frame, usually one year. It measures how well a company turns its inventory into sales. Businesses can use their turnover ratio to determine if they're carrying too much inventory compared to how much of their stock is selling.

Inventory turnover ratio = [COGS / (Beginning inventory value + Ending inventory value) / 2)] x 100

5. Sell-Through Rate

Sell-through rate is a comparison of the amount of inventory sold versus the amount of inventory produced or received from a supplier. Sell-through rate is important because it helps you understand how efficiently you're selling through inventory. A high sell-through rate is positive because it means you're moving product quickly. A low sell-through rate, on the other hand, suggests you're paying to stock excess inventory.

Sell-through rate = (Number of units sold in period / Number of units received in period) x 100

6. Gross Margin Return on Investment (GMROI)

The gross margin return on investment measures how much money a company makes on a specific inventory investment. Tracking this metric gives your company insight into which inventory items are especially strong or weak performers so you can plan accordingly. In general, a GMROI of 200% or higher is a good target.

Gross margin return on investment = (Gross profit / Average inventory cost) x 100

7. Cost of Stockouts

Running out of some goods will be more costly to your business than others. To measure the impact of stockouts, you can use the cost of stockouts metric. Companies can use this to calculate the money lost when they run too lean or experience an unexpected surge in demand, leading to stockouts. The cost of stockouts may also affect the amount of items a business keeps on hand.

Cost of stockouts = Number of days out of stock x Average units sold per day x Price per unit

8. On-Time Delivery Rate

On-time delivery rate measures the percentage of orders that arrive on time to customers (either on or before the scheduled delivery date) and analyzes supply chain efficiency. A low on-time delivery rate could be a sign of slow processes in your supply chain, shipping bottlenecks, or slow and unreliable delivery methods. Regardless, it will hurt customer satisfaction and could keep the customer from buying from you again.

On-time delivery rate = ((Total orders – Late orders) / Total orders) x 100

9. On-Time Shipping Rate

The on-time shipping rate shows how often orders go out to customers within the promised shipping window. Tracking this metric is important in assessing the efficiency of your order fulfillment and shipping processes. It can also help you pinpoint the proper on-time delivery benchmarks for various products.

On-time shipping rate = (Number of items shipped on time / Total items shipped) x 100

10. Perfect Order Rate

Perfect order rate is a measurement of how many orders a company ships without any issues, such as damage, inaccuracies, or delays. While every company aspires to a perfect order rate close to 100%, what's realistic for your organization will vary. This metric is strongly linked to customer satisfaction and operational efficiency.

Perfect order rate = [(Number of orders delivered on time / Total orders) x (Number of orders complete / Total orders) x (Number of orders damage-free / Total orders) x (Number of orders with accurate documentation / Total orders)] x 100

CHAPTER 4

How to Choose the Right KPIs for Your Business

Before a business can select any of these KPIs, it must first establish its overall goals. Only then can it know the aspects of the business and functions on which to focus. From there, choosing the right KPIs helps an organization gauge whether it's on track to achieve its business goals.

But what does a good KPI look like? What characteristics should you look for? Consider the following criteria:

- Goal alignment. A strong KPI reflects a business's strategic goals. Goals will vary by the type of company, such as business-to-business (B2B) or business-to-consumer (B2C), and business model. A software company, for instance, will have different measures of success than an industrial manufacturer. If the goal is to increase ecommerce revenue by 30%, a company might choose metrics that measure average order value, conversion rate, and cart abandonment.

  KPIs can also align to the goals of different departments, teams, and individuals. If the purchasing department wants to improve inventory management to lower costs, the most effective KPIs might include inventory turnover ratio and perfect order rate.

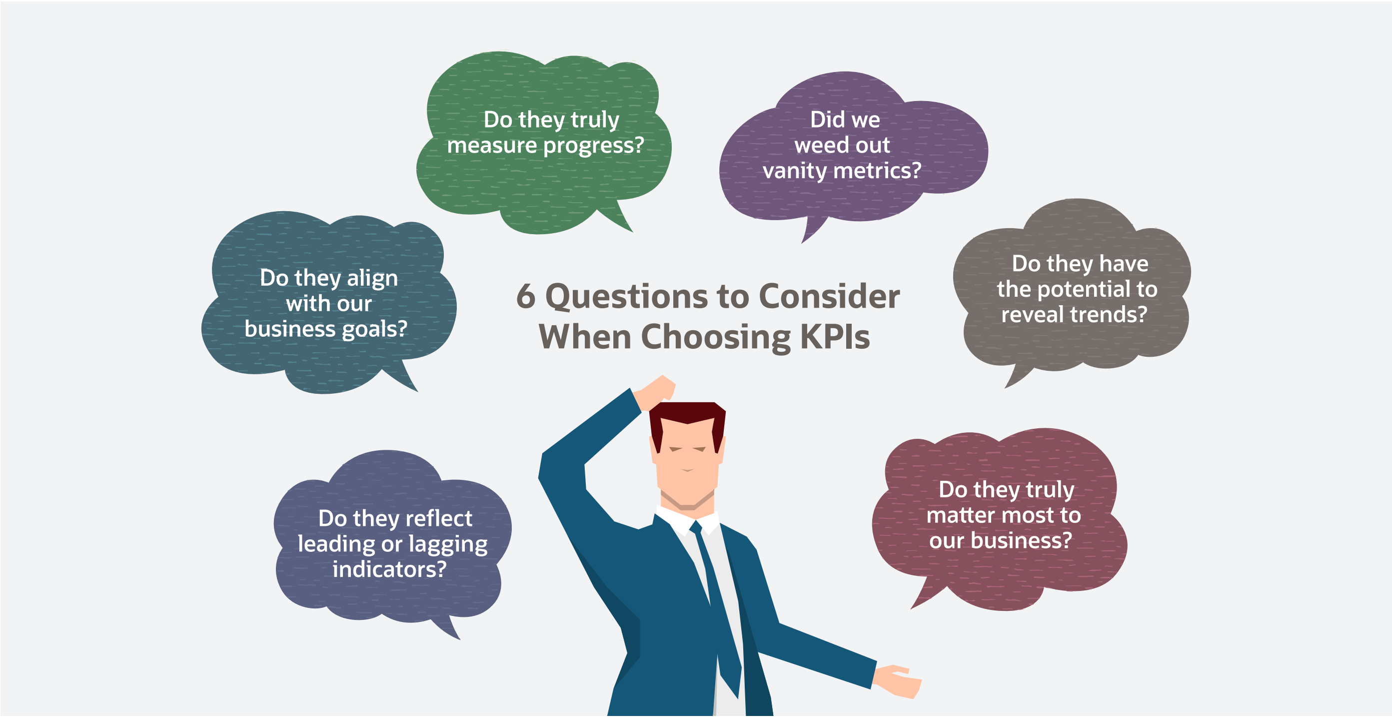
- Growth-stage alignment. A good KPI also matches where a business is in its life cycle. The metrics for a growing business, for instance, might center on customer feedback and business model validation. KPIs for more established companies could be monthly recurring revenue, customer retention, and customer acquisition cost.

The Difference Between Metrics and KPIs

While the terms metrics and KPIs are often conflated, each has a distinct meaning. Metrics are any quantifiable data a company monitors to track performance and improvements across the business. Once an organization starts tracking an important metric, it has a baseline against which it can compare future numbers to see how the performance of various processes or teams has changed over time. As a business grows, it often starts tracking more metrics, including ones specific to certain initiatives or departments.

KPIs are metrics that are particularly important to your business because they measure progress against critical company objectives. A distinguishing feature of KPIs is they usually have predetermined goals, which is not true of all metrics — a company might monitor certain metrics for years without specific targets in mind. At least a few KPIs should be financial metrics, like revenue growth, profit margin, and cash flow.

In short, KPIs reveal if a business is achieving its primary objectives or targets. Metrics simply track the status of different processes that are of varying importance to the company.



- Quantifiable and measurable. Good KPIs are easy to measure and based on clear, trackable goals. They can be expressed as ratios, percentages, or rates so teams can see at a glance where they stand and where they need to go. For example, "lower customer acquisition cost by 15%" is a measurable goal, but "lower customer acquisition cost" makes it harder to determine whether you reached that goal or not. KPIs for this goal might include conversion rate and lead generation cost by channel.
- Substance. Does the KPI concentrate on what truly matters to move the business forward? Or does it focus on surface-level vanity metrics that appear to cast a product or the business in a successful light, such as number of downloads for a free app or social media followers? In most cases, the majority of these users will not become paying customers, so the value is limited. The right KPIs offer value, point to a trend, or inform next steps.
- Attainability. A good KPI measures achievable goals rather than unrealistic targets. Attainable also means the data needed to calculate the KPI is available, accessible, trusted, and presentable to stakeholders.
- Actionable. An actionable KPI indicates measurable tasks that lead a business toward its goals. Without a goal, the KPI is just a metric, not an indicator. KPIs can inform decisions, such as whether to adjust a sales plan based on how well a product is performing in the market. They also reveal trends that impact future strategies.

CHAPTER 5

How Can Software Help Set and Track Financial and Operational Metrics?

Tracking even basic metrics like revenue, expenses, and income can become cumbersome with spreadsheets or other manual methods. It's difficult to keep all this information up to date, especially as a company grows and its transaction volume increases. That leads to inaccurate information and, consequently, numerous other problems that could inflict lasting damage.

Manually calculating more complex metrics, such as some of the financial and operational KPIs discussed above, is even more challenging and error-prone. Leading ERP systems like NetSuite collect all the financial and operational data needed to calculate any and all KPIs your business might want to track.

NetSuite can display this information in dashboards that update in real time and automatically distribute reports to all relevant stakeholders.

Growing businesses must set clear KPIs and track a wide variety of metrics to excel in today's turbulent environment. Without insights, these companies have no real sense of how they're progressing toward goals and whether they're financially healthy or headed in the wrong direction.

Business leaders must make it a priority to pinpoint the KPIs that matter most to their organization, monitor them, and continually adjust based on what the data tells them.

Back-end business systems with integrated reporting and analytics capabilities can go a long way toward helping companies track these numbers and spot changes that will have a positive or negative impact on their financial health. Growing businesses need a way to constantly check on these metrics, because they can be a deciding factor in whether they make it.

Why Do KPIs Matter for Your Business?

KPIs help companies achieve their short- and long-term business goals and make adjustments to stay on track. They are particularly meaningful when analyzed in the context of and alongside other KPIs, often in a dashboard that provides a comprehensive view of how different aspects of a company are faring.

KPIs provide a variety of insights, and businesses rely on them to:

- Measure progress. By their very definition, KPIs measure progress on a company's key business objectives. If a company has the goal to increase annual sales by 20%, then KPIs like monthly sales growth and monthly sales bookings can help it gauge progress toward that goal.

- Adjust goals and targets. Circumstances may change after a company establishes its goals. By monitoring KPIs often, even daily, a company may realize an objective is unrealistic or no longer aligned with its revised plan. This insight gives leaders a chance to rethink their plans to better match an organization's goals.

- Identify problems to solve. Analyzing KPIs can uncover an issue that might otherwise go undetected. For example, marketing KPIs related to the company's website, such as a high bounce rate or a drop in daily active usage, can signal that pages are loading too slowly or your site has broken links.

- Spot patterns. When these numbers are measured over time, such as month over month, patterns and trends often emerge that can shape decision-making. If sales for a particular product aren't growing, perhaps a new marketing campaign is in order. If the rate of returns for a certain product has decreased over a six-month period, that could indicate an issue with manufacturing.

- Pinpoint inefficiencies and cost-cutting opportunities. When KPIs are applied to business processes, companies can more easily identify bottlenecks, resolve them, and reallocate resources. All of this should boost efficiency and lift the bottom line. For example, if it takes five business days for inventory received to be available to sell, then you may want to consider hiring more warehouse employees or moving to a new warehouse management system to stock items faster. This should reduce inventory carrying costs and expenses related to putaway.

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