WHAT ARE YOUR BUSINESS'S NUMBERS REALLY SAYING?

HOW TAKING A GOOD LOOK AT THE RIGHT KPIS CAN CREATE A ROADMAP TO SUCCESS

Accountfully

As accountants, we're used to thinking in terms of quantifying successes rather than qualifying them. We like numbers, that's why we got into this gig. But business owners get into business because they have great ideas, game-changing products or much-needed expertise to offer.

Business owners are driven by day-to-day challenges, the meeting they're scheduling next week, and the new client they land next month. If all that's going well, then we can understand why that feels good. Money's coming in, bills are getting paid, and everyone ends the day happy. But companies can go a bit too long coasting on entrepreneurial vibes, full calendars and good moods rather than taking a practical approach to financial health and growth. Getting caught up in the business minutiae of presentations or pitch emails distracts from the foundation of your business.

According to Bloomberg, 8 out of 10 entrepreneurs who start businesses fail within the first 18 months. And the U.S. Bureau of Labor Statistics notes, "About half of all new establishments survive five years or more and about one-third survive 10 years or more. As one would expect, the probability of survival increases with a firm's age. Survival rates have changed little over time."

For many managers, the idea that building and running a business for some time without interruption means they've cleared the important hurdles and by default consider themselves successful. Yet having a well-established business isn't a guarantee of success, despite the reassuring charts that equate age with safety.

Unfortunately, as accountants, we know that maturity and experience can't safeguard against flying blind.

While a business may be growing, its owners and managers may lack the tools they need to keep it progressing through changing markets or shifts in the industry. Though a business owner shouldn't be expected to translate spreadsheets to a perfect prediction of the future, they should, however, have access to all of the information. That's where your accountants come in. Access to your company's financials is essential; understanding what they represent becomes easier with the help of a smart accounting team.

Undertaking an inventory of key performance indicators (KPIs) is an important step in truly assessing your company's financial strength and sustainability. Moreover, those metrics become a roadmap for growth, help to define your goals, and can illuminate better strategies to reach the next levels of growth. While some of these percentages may seem familiar at first glance, other KPIs may benefit from your accounting team's insight.

Discovering less-than-healthy stats isn't a death knell; a proper evaluation should actually help you to develop ways to addresses weaknesses. Paired with your accounting team, you can leverage the data to make strategic decisions to strengthen your company in meaningful way.

First we'll dive into the financial metrics that all companies should be aware of, and then we'll split into service-based businesses and product-based businesses for more precise advice.

LET'S GET STARTED!

GATHER YOUR COMPANY'S FINANCIALS

PAIR UP WITH A SMART ACCOUNTING TEAM

DIVE INTO YOUR KEY PERFORMANCE INDICATORS

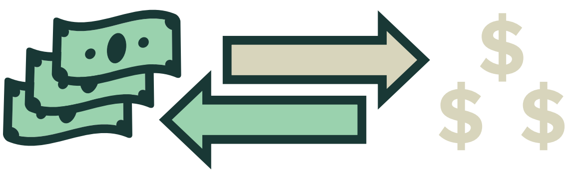
FOR EVERY COMPANY

Many businesses set benchmarks for expense ratios and budgets—making sure they're within reasonable limits, identifying costs when they aren't. These KPIs offer a starting point for gauging your company's operational health. If expenses are too high and that trend isn't subsiding, it should signal a serious reconsideration of strategy. Ignoring something at this step could mean egregious problems down the line.

If your company can't navigate reductions in sales or operates with poor ratios already, then this symptom deserves your attention. A company shouldn't wait until it has large debts or insurmountable cash shortages to realize signs of ill health. There's no escaping problems at this level.

KPIs for every company:

- **Gross Profit Margin:** the proportion of money left over from revenues after accounting for the cost of goods sold. This amount is available to cover overhead & operational costs.
- **Breakeven Margin of Safety:** the amount of sales that are above the breakeven point
- **Operating Profit as % of Revenue**: the sales revenue less the cost of goods and operations, divided by total revenue generated
- **Owner Pay as % of Revenue** (if owner operated): of total revenue generated, what proportion you're allocating to yourself as salary
- **Operating Cash Flow:** 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 payment to its suppliers.
- **Number of Paying Customers:** the number of customers who paid you for a given time period.
- **Average Sales per Customer:** the average sales transaction amount per customer for a given time period.
- **Key Expenses as a % of Revenue** (Marketing, Payroll, Software, Merchant Fees, Trade Show etc.): the ratio of ongoing costs generated from ordinary operations as a percentage of total revenue generated
- **Tax as % of Revenue:** of total revenue generated, what proportion should be allocated for state and federal taxes



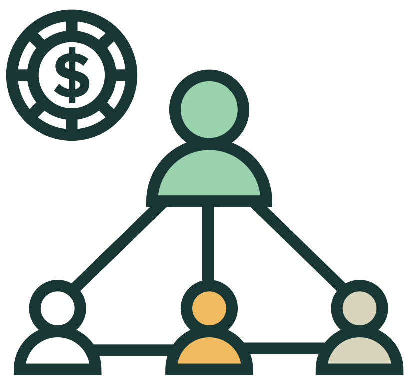
FOR SERVICE-BASED COMPANIES

Taken together, these particular KPIs represent the sum of success for service-based businesses. Is each employee or department within a desired profit margin? Is one department significantly under-performing? Can you afford to hire another employee? Are labor costs too high? By subdividing important data, you're able to process each piece of the puzzle that contributes to long-term success.

For service-based companies, the impetus is to build for efficiency and find apt comparisons to similar businesses. While there's no warehouse of goods taking up space and capital, there are employees who produce valuable albeit intangible work product. Assessing costs and revenue for service-based companies may seem easier with fewer moving parts, but an accounting team can help an owner shine some light on metrics that can widen the gap between cost and profit.

KPIs for service-based companies:

- **Revenue by Employee:** Dividing the labor costs by your number of employees and finding the ratio of revenue to a single employee
- **Revenue by Department:** Assigning revenues to particular departments to see differing income performance
- **Net Income by Employee:** The company's net income divided by the number of employees
- **Utilization:** The rate of billable hours versus available time (or a fixed number of hours per week)
- **Labor as % of Revenue:** The cost of your labor in relation to your total revenue
- **Break-Even Billable Rate:** The minimum rate to charge customers to cover your company's fixed costs. This is calculated using total billable hours, not total available hours.
- **Rate Spread:** The difference between the average billable rate charged to customers and the break-even billable rate.



FOR PRODUCT-BASED COMPANIES

For businesses that are product-based, there are particular data points that can reflect the company's health. Are your costs and revenue at odds? Is your brick and mortar shop outperforming your web orders? Is inventory shipping efficiently? By double-checking these KPIs, product-based businesses should have a better idea of where they stand and what to tweak for optimal outcomes.

Companies that are product-based may have more predictable supply and demand time periods, but a single error can throw a wrench into financials months down the road. Keeping a close eye on costs and variables can make recovering from mistakes bearable, but more importantly, an engaged owner and accounting team can pinpoint slices of the company's financials that are worth a second look for growth.

KPIs for product-based companies:

- **Sales by Channel** (i.e. Wholesale vs Retail vs Distributor OR Online vs. In Store): Assigning revenues to particular channels to see differing income performance

- **Product Lines as % of Sales:** Dividing sales among product lines to see differing income performance

- **Gross Profit % by Location and Product Line:** Revenue minus the cost of goods sold, sorted by locations or product lines to see differing income performance

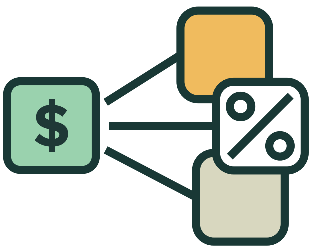
- **Freight and Delivery as % of Revenue:** The cost of freight and delivery in relation to the total revenue

- **Full Price vs Discount %:** The percent of sales that were at full price versus those discounted.

- **Inventory Turnover:** The measurement of how often inventory is sold and replaced

- **Average Inventory Cost:** The cost of inventory that the company has on hand at the end of a particular time period, averaged over time (for example, monthly costs averaged over a quarter)

- **Average Inventory Retail:** The retail value of inventory that the company has on hand at the end of a particular time period, averaged over time (for example, monthly values averaged over a quarter)



THE TIME IS NOW

As your company transitions from a start-up and takes each next step, additional complexities will be layered into your business—whether it's more staff, customers, or locations. To continue to succeed, your company will need to identify the KPIs that indicate strengths and weaknesses.

But to be clear, in any stage of business, leaders should expect this information from accountants. Access to data allows immediate insight on whether your company sinks or swims next quarter. If you have trouble understanding your company's KPIs or what the numbers might be able to tell you, accounting experts can and should guide you.

Accountfully has worked with companies of all types to identify pain points and thoughtfully re-orient companies on better paths to success. Giving business owners the resources to track existing KPIs is critical to the success of businesses large and small—and the economic eco-system surrounding them. With data in hand, you can make decisions on attainable objectives that represent success and sustainable growth.