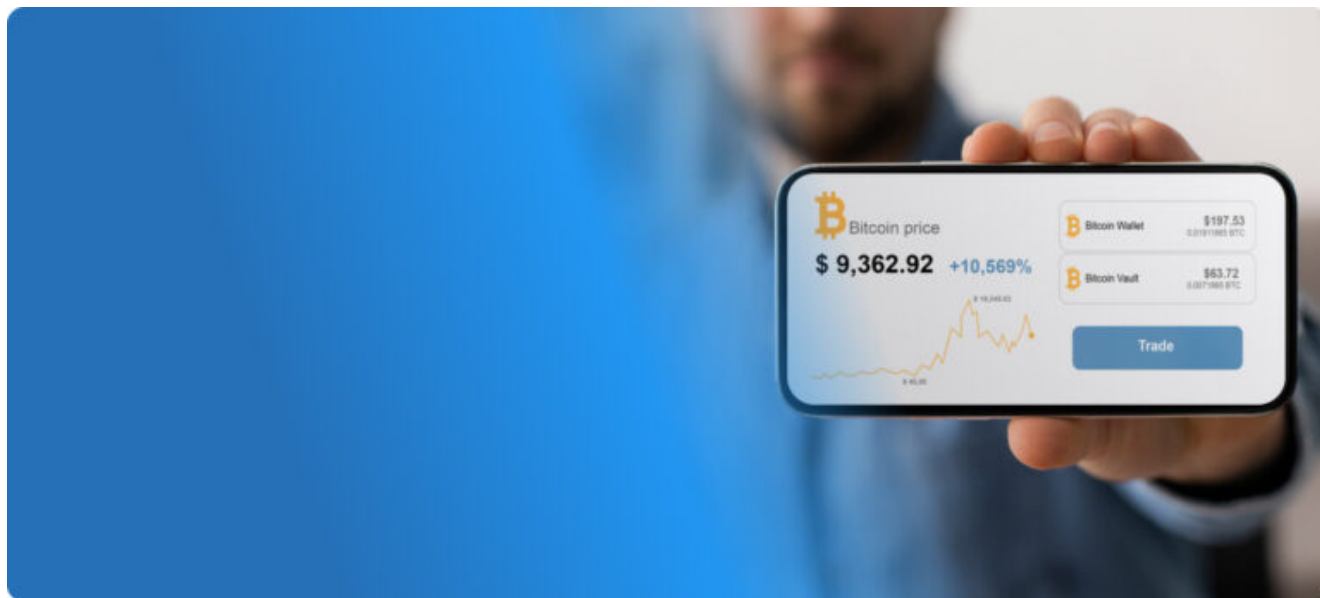


Finance KPIs: The Financial Metrics To Track and Measure Success



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As a business owner, regularly reviewing financial statements helps you understand how well your business is performing.

While financial reporting is important, if you're looking for better insight into your business, using KPIs provides a more complete view of financial performance.

What Are Financial Key Performance Indicators or KPIs?

KPIs are metrics tied to specific measures of the following:

■ What Are Financial Key Performance Indicators or KPIs



Profitability



Liquidity



Efficiency



Valuation



Leverage

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- Profitability
- Liquidity
- Efficiency
- Valuation
- Leverage

KPIs are usually reviewed at regular intervals which can be weekly, monthly, or quarterly, and are always tied to a specific goal or business strategy.

KPIs help managers, CFOs and other financial professionals track and analyze business performance, measure progress towards their stated goal, and gain a better understanding of a company's operations.

What Is the Difference Between a Key Financial Metric and a KPI?

Though the terms KPI and metric are often used interchangeably, there are some key differences.

The following table highlights some of the differences between KPIs and metrics.

The Difference Between a Key Financial Metric and a KPI

KPIs	FINANCIAL METRICS
Are directly tied to a specific business goal	May not be directly tied to a specific business goal
Target specific departments within a business	Applies more generally across a business
Are tied to a specific business outcome or result	Are used to measure performance, but may not be used to achieve a specific outcome
Are measured when used to monitor a specific outcome	Are always measured at regular intervals (weekly, monthly, quarterly)
Are always considered business metrics	Can be but are not always KPIs

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KPIs	Financial Metrics
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Can be but are not always KPIs

What Are the Top 3 Financial Metrics in Any Company?

Though they may vary from business to business, the three most critical financial metrics that should be measured regularly for any company are:

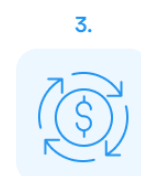
■ What Are the Top 3 Financial Metrics in Any Company



Revenue



Cost of Goods



Net Profit

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1. Revenue
2. Cost of Goods
3. Net Profit

These are considered the most important financial KPIs because they're directly tied to the financial health of your business.

As a business owner, you need to track revenue to determine how well your products or services are selling.

But you also need to know if you have enough cash on hand to cover your financial obligations.

But along with revenue, you also need to take into account your cost of goods sold. Are your costs too high, reducing your revenue?

And finally, after revenue and cost of goods have been factored in, how much net profit has your business earned? Using KPIs can provide the answers to these

questions and more.

Whether you choose to employ these three metrics or others, the results must be tracked and measured regularly.

For example, regularly measuring COGS provides you with the information needed to set prices.

The information obtained from these KPIs and metrics also provides a basis for modifying current processes and procedures or even introducing new products and services.

What Are the Most Common KPIs Used for Financial Analysis in a Business?

Using KPIs and related metrics to better understand financial data is considered a best practice for any business, regardless of size.

Below we've listed 22 of the most commonly used key performance indicators and financial metrics along with the formula for calculating them.

While you may not need to run all of them, consider which ones will work best for your business.

The Most Common KPIs Used for Financial Analysis in a Business

1	Gross Profit Margin (GPM)	12	Accounts Payable Turnover Ratio (APT)
2	Net Profit Margin (NPM)	13	Days Payable Outstanding (DPO)
3	Working Capital	14	Days Sales Outstanding (DSO)
4	Operating Cash Flow (OCF)	15	Inventory Turnover Ratio
5	Return on Sales (ROS)	16	Days Inventory Outstanding (DIO)
6	Current Ratio	17	Debt-to-Equity Ratio
7	Quick Ratio	18	Cash Conversion Cycle (CCC)
8	Operating Profit Margin or EBIT	19	Return on Equity
9	Current Accounts Receivable Ratio (CAR)	20	Average Invoice Processing Cost
10	Accounts Receivable Turnover Ratio (ART)	21	Average Invoice Approval Cycle Time
11	Current Account Payable Ratio (CAP)	22	Invoice Exception Rate

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1. Gross Profit Margin (GPM)

Gross profit margin measures the profitability of your core business operations.

Gross profit margin looks at two areas; sales and cost of goods sold to determine how profitable operations are in any given period before subtracting other administrative costs.

The formula to calculate gross profit margin is:

$$(Net\ Sales - COGS) / Net\ Sales \times 100\% = Gross\ Profit\ Margin$$

2. Net Profit Margin (NPM)

Net profit margin calculates profitability after all associated business

expenses have been subtracted.

Considered the 'bottom line,' when calculated along with gross profit, both ratios provide you with insights into total profitability.

For example, if your gross profit margin is high, but your net profit margin is low, that may indicate that you need to better manage operating expenses.

Net profit margin is calculated using the following formula:

$$(Net\ Income / Revenue) \times 100\% = Net\ Profit\ Margin$$

3. **Working Capital**

The working capital ratio looks at whether your current assets are enough to cover your current liabilities, with the calculation providing the total amount of cash available.

Current assets include cash, short-term investments, accounts receivable, and inventory, while current liabilities include accounts payable and short-term loans.

The formula to calculate working capital is:

$$Current\ Assets - Current\ Liabilities = Working\ Capital$$

4. **Operating Cash Flow (OCF)**

Similar to the working capital ratio, instead of measuring current assets, the operating cash flow ratio looks at current cash flow to determine whether your business has enough cash on hand to cover current liabilities.

You'll need to use totals from your statement of cash flows to determine your operating cash flow ratio, with the formula:

$$Operating\ Cash\ Flow / Current\ Liabilities = Operating\ Cash\ Flow\ Ratio$$

5. **Return on Sales (ROS)**

The return on sales ratio calculates how much profit your company generates from each dollar of sales revenue received.

This is a great way to determine how efficiently your company turns total revenue into profit. The formula for calculating return on sales is:

(Earnings before Interest and Taxes / Net Sales) x 100% = Return on Sales

6. **Current Ratio**

The current ratio calculates the ratio between current assets and current liabilities.

Similar to the working capital metric which calculates the amount of working capital available, the current ratio looks at assets and liabilities side by side.

A ratio of less than one may indicate that a business does not have enough cash-based assets available to cover its liabilities.

The formula for calculating the current ratio is:

Current Assets / Current Liabilities = Current Ratio

7. **Quick Ratio**

The quick ratio, also known as the acid test ratio measures how quickly current assets can be converted into cash.

The quick ratio uses the total of all current assets minus inventory in its calculation and is used to determine your company's ability to quickly generate cash to cover current liabilities.

The formula for the quick ratio is:

Quick Assets / Current Liabilities = Quick Ratio

8. **Operating Profit Margin or EBIT**

Operating profit margin or EBIT (Earnings Before Interest and Taxes) is used to measure overall profitability after all operating costs have been paid.

Tax liability and interest revenue are not included in the calculation.

The formula for calculating the operating profit margin is:

Operating Profit / Gross Revenue = Operating Profit Margin

9. **Current Accounts Receivable Ratio (CAR)**

The accounts receivable ratio looks at total sales to determine how many customers pay their invoices on time.

A higher result indicates that your company is collecting AR balances on time while a lower ratio indicates that there are problems collecting invoice payments.

The formula for calculating the current accounts receivable ratio is:

(Total Accounts Receivable - Past Due Accounts Receivable) / Total Accounts Receivable = Current Accounts Receivable Ratio

10. **Accounts Receivable Turnover Ratio (ART)**

The accounts receivable turnover ratio also looks at how quickly customers pay by determining how quickly your AR balance is converted to cash.

Though larger companies may calculate this ratio quarterly, ART is usually calculated annually.

The formula to calculate the accounts receivable turnover ratio is:

Sales / Average Accounts Receivable Balance = Accounts Receivable Turnover Ratio

11. **Current Account Payable Ratio (CAP)**

The current accounts payable ratio is used to determine whether a company is paying its bills on time.

A higher ratio indicates that bills are paid promptly while a lower result indicates payments are made late.

The formula for calculating the current accounts payable ratio is:

(Total Accounts Payable - Past Due Accounts Payable) / Total Accounts Payable = Current Accounts Payable Ratio

12. **Accounts Payable Turnover Ratio (APT)**

The accounts payable turnover ratio calculates how quickly you pay your vendors and suppliers by measuring how quickly your accounts payable account balance turns over throughout the year.

A higher ratio result indicates that you're paying your bills quickly, while a lower one indicates that bills are not paid promptly.

Like the accounts receivable turnover ratio, this calculation is typically done annually. The formula to calculate your accounts payable turnover ratio is:

Net Credit Purchases / Average Accounts Payable Balance = Accounts Payable Turnover Ratio

13. **Days Payable Outstanding (DPO)**

This calculation offers another way to see how quickly you're paying your bills. A lower days payable outstanding result indicates that you're paying your bills quickly.

The formula to calculate days payable outstanding is:

(Accounts Payable x 365 Days) / COGS = Days Payable Outstanding

14. **Days Sales Outstanding (DSO)**

Days sales outstanding measures how quickly your customers pay their bills.

A lower days sales outstanding result indicates that your customers are paying you quickly.

The formula to calculate days sales outstanding is:

(Ending Accounts Receivable Balance / Gross Revenue) x 365 Days = Days Sales Outstanding

15. **Inventory Turnover Ratio**

If you're selling products, the inventory turnover ratio is an important metric to calculate since it measures the average number of times during a specific period of time – typically a year, that your inventory is sold.

A higher number can indicate stronger sales while a lower one can indicate too much inventory on hand.

The formula to calculate the inventory turnover ratio is:

COGS / Average Inventory Balance = Inventory Turnover Ratio

16. **Days Inventory Outstanding (DIO)**

Days Inventory Outstanding can also be used to measure how quickly your business is able to sell its inventory, with the result measuring the average number of days it takes to sell an inventory item.

The formula to calculate DIO is:

(Average Inventory / COGS) x Number of Days = Days Inventory Outstanding

17. **Debt-to-Equity Ratio**

The debt-to-equity ratio measures the total debt your company is carrying

compared to the amount of equity.

The calculation should include both short-term and long-term debt.

The formula to calculate the debt-to-equity ratio is:

$$\text{Total liabilities} / \text{Total Equity} = \text{Debt-to-Equity Ratio}$$

18. **Cash Conversion Cycle (CCC)**

The cash conversion cycle is used to calculate how long it takes a business to convert inventory into cash.

The CCC calculation uses the results of three other metrics; DIO, DSO, and DPO in its formula, which is:

$$\text{Days Inventory Outstanding} + \text{Days Sales Outstanding} - \text{Days Payable Outstanding} = \text{Cash Conversion Cycle}$$

19. **Return on Equity**

Return on equity shows how efficient a company is at managing investor capital.

The formula to calculate return on equity is:

$$\text{Net Income} / \text{Shareholder Equity} = \text{Return on Equity}$$

20. **Average Invoice Processing Cost**

An important metric to measure the efficiency of your accounts payable department processes, the average invoice processing cost is determined by adding the cost of the following:

- Labor
- Office supplies
- Accounting software
- Postage

Other costs such as time spent searching for a lost or misplaced invoice,

voiding and reissuing an erroneous payment, or approval delays can also directly impact the total cost of processing an invoice.

A higher average cost usually indicates the need for AP automation.

21. **Average Invoice Approval Cycle Time**

While this metric measures the amount of time it takes to get an invoice approved, the results also directly impact other metrics such as the cost of processing an invoice.

The higher the invoice approval time, the higher your average invoice processing cost is likely to be.

22. **Invoice Exception Rate**

Your invoice exception rate directly impacts both your average invoice processing time and your average cost.

A high exception rate means more time spent processing an invoice and a higher processing cost.

When using KPIs, keep in mind that you'll need to choose a suitable timeframe for calculating them.

While some KPIs and financial metrics should be calculated annually, larger businesses may find it more useful to run these metrics more frequently.

How Do You Identify Key Financial KPIs for Your Business?

KPIs should always align with your internal business goals. For example, if you're looking to increase customers, you'll want to track customer acquisition numbers.

However, if you're more concerned with your bottom line, you'll want to use financial KPIs to provide the information you need. For those concerned about

cash flow, the quick ratio is helpful.

To choose the right KPIs to track for your business, consider what you wish to accomplish and choose the KPIs and metrics that align with your goals.

For example, are you worried about employee productivity levels or if your credit customers are paying you on time?

Maybe you're concerned that your current accounts payable processes are costing you both labor hours and money.

Whatever objectives you set for your business, there is a KPI (or several) that can assist you in reaching your goals.

How Do You Measure the Financial Health and Success of a Company Using KPIs?

While there are KPIs for just about any business category that you can think of, there are a few that can help you determine the financial health of your business.

For example, using the current ratio or quick ratio quickly measures whether you have enough current assets on hand to cover your current liabilities, while the gross profit margin measures the financial health of your core business operation.

KPIs also help track your company's current growth rate and calculate your accounts receivable turnover ratio to see how quickly your customers typically pay you, while the inventory turnover ratio lets you know how quickly your inventory is moving off the shelf.

Why Using KPIs and Metrics Is So Important

Setting goals and objectives for your business is an important part of management.

Using KPIs can help you measure your progress towards reaching those goals and whether there are adjustments that need to be made along the way by providing the following information:

Why Using KPIs and Metrics Is So Important



Measuring Progress



Trend Analysis



Measuring the Overall Financial Health of Your Business

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- **Measuring Progress** - Setting goals is important, but equally important is tracking your progress towards meeting those goals.
- **Trend Analysis** - KPIs and financial metrics are designed to be tracked regularly.

Doing so provides an opportunity to view not only the progress you have made toward your goals but allows you to view any potential issues that need to be corrected.

- **Measuring the Overall Financial Health of Your Business** - It's easy to check your bank balance to see how much money you have in your account, but the overall health of your business relies on several other factors, all of which can be tracked using KPIs and financial metrics.

Using KPIs and metrics in your business may sound scary, but for business owners, CFOs, and other stakeholders, information gleaned from KPIs helps businesses maintain solvency, create accurate financial forecasts, and track sales growth while managing important benchmarks in real-time.

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