Financial KPIs: What They Are and What You Need to Know

As a small business owner, the importance of making purpose-driven decisions is something that cannot be overstated enough. Every choice that you make must be one with a particular goal in mind – whether it's to attract new customers, increase revenue, decrease expenditures, increase liquidity, etc. But simply making the decision itself is not enough – you also have to find a way to measure the result of your action against what you were trying to accomplish in the first place.

This, in essence, is what KPIs are all about.

Also commonly referred to as "key performance indicators," they represent the best kind of measurable value that reflect how we'll you're doing in a particular context – the kind that is objectionable, black and white, and provides you with a clear indication of what you need to be doing moving forward. Thanks, in particular, to the evolution of cloud computing and the advent of real-time accounting, it's easier than ever for business owners to monitor the health of their organization through financial KPIs.

When doing so, however, you need to keep a few key things in mind.

Financial KPI Considerations

Part of the reason why KPIs are so powerful in the first place is because they're malleable – based on exactly what you're trying to accomplish, you can take a micro look at a particular aspect of your finances to tell you how close or how far away you are from that goal.

With that in mind, it's important to realize that there is no "one size fits all" approach to KPI selection. If you looked at the financials of your closest competitors, they might be tracking wildly different data than you are – even though you're both operating in the same industry.

Because of this, you need to figure out the long-term goals that are most important to you first. Then, you can reverse engineer the KPIs that you should be watching to help guide you and your business in the right direction.

KPIs to Watch Out For

Now that you've got a deeper understanding of what KPIs measure in relation to your goals, it's time to learn more about the specific KPIs that you should be paying attention to monitor those goals in real-time.

- **Operating Cash Flow.** Also referred to as OCF, this points to the total amount of money your company is generating on a daily basis. This can be a great way to determine whether you're able to maintain the positive cash flow needed for growth, or if you should start looking for external funding. OCF adjusts your net income for factors like depreciation, inventory fluctuations, accounts receivable changes and more.

- **Current Ratio.** This KPI is an indication of whether or not your company can pay all of its financial obligations in one year. This takes into consideration all of your current assets and compares them with your current liabilities. A Current Ratio of less than one tells you that you will NOT be able to fulfill all financial obligations, thus requiring additional cash flow. For the best results, try to keep Current Ratio between 1.5 and 3.

- **Burn Rate.** This clues you in on the rate at which your company is spending money on a weekly, monthly or annual basis. This is particularly helpful for companies that don't necessarily go through extensive financial analysis, as it's a quick look into whether or not your current operating costs are sustainable in the long-term.

- **Income.** This, simply put, looks at how much money you're generating. Based on how much money you'd like to be generating, you can then make a determination about how much you need to increase sales and, thus, set about trying to figure out how to do that.

- **Profit/Loss.** This is a quick look into whether your company's expenditures are MORE than your income.

- **Cash Flow Forecasting.** Remember that improper cash flow is literally the number one reason why most businesses close prematurely. If you want to get better at cash flow management, you need to start taking a deeper look at what your cash flow is predicted to be both in the short and long-term. Diving deeper into this topic now can help you mitigate some fairly significant risks later on.

If you have any additional questions about KPIs that you'd like to see answered, or if you have other concerns that you'd like to have addressed in a little more detail, please feel free to contact our office today – someone is ready and waiting to provide you with the personalized level of care and attention to detail that you deserve.