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WHITEPAPER

You are what you measure

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Introduction

In the most successful businesses, the finance department acts as a hub of insight that informs both strategic and operational decisions. After all, no other department is as well-suited to the task of generating and analysing metrics such as KPIs and providing the fundamentals for sound decision-making.

In many traditional businesses the finance team tends to absorb a high volume of data but only outputs small, measured and curated amounts of insights periodically: "Here's revenue vs target in the last quarter".

These are undoubtedly essential for proper business management, but periodic reports also mean it can be too late for the business to respond. It's like driving by looking only in the rear-view mirror. Looking at what's behind isn't going to let you spot a sudden bend in the road!

Essentially, the highly competitive and evolved business environment of today requires businesses to have proactive, indicative business metrics. Combined with more traditional metrics, these mean businesses have invaluable and complete insight in order to evaluate performance.

Proactive, indicative business metrics are found across most successful businesses–and especially amongst C-suite employees. These people know that the benefits are proven. Analytics-driven executives achieve 86% greater year-on-year increases in operating profit, 32% greater financial budgeting accuracy and 2x greater year-on-year growth in operating cash flow*.

Data will talk if you're prepared to ask the right questions. And if your competitors are making best use of this kind of deep dive into granular insights – and they almost certainly are – then you simply have no choice but to match their speed. The situation is sometimes compared to an analytics arms race where the quality, breadth and underlying intelligence of metrics used in a business is as accurate an indicator of its success as cash flow or overall profit.

Businesses who aren't using proactive insights to drive their strategy and operations need to rethink their approach to how they use the information they gather and hold. The finance department needs the courage to say that, actually, the way things are done right now is not good enough. And ultimately, the finance department needs to take a fresh insight-driven approach out into the wider business so it can inform decision-making

* Aberdeen, 2016

Part 1:
The problems with traditional business metrics

Cast your mind back to the dark old days. The finance department crunched the numbers arriving from the various departments and these were typically hand-written or typed, at best. At the end of every period, whether that was a year, quarter or month, they produced a printed report for the executives showing the essentials of profit and loss, or sales figures.

That was just fine back then, of course, because that's what everybody else did.

Now? Things have changed. Business has evolved so that granular data is generated and collected within the business on a second-by-second basis. The idea of a finance department producing a single report periodically is laughable. Some have moved across to dashboards, for example, that give an instantly-accessible view of the data.

However, many businesses still haven't got beyond the other problems surrounding the "periodic report" mentality and approach. They haven't grasped the myriad of ways their data can truly work for them in providing insights.

With such insights on its side, a business can be responsive and reactive. It can act on what's happening right now, rather than what happened days, weeks, or even months ago.

Problems with data

In a survey conducted by Sage, 86% of business leaders told us they blame lack of collaboration or bad communication for business problems and team failures . Many stated they have to consult with at least five employees to gain a somewhat complete picture of a customer or vendor, and it seems no two employees were focused on the same customer or business problem.

This begins to illustrate the issues with traditional reports and/or dashboards in most businesses, of which three can easily be identified.

1. Information gets old quickly

The information your business generates is like bread. The clock starts ticking as soon as it's mixed into a report, and although fresh the day the report pulled from the finance oven, the staler it becomes the further you get from this point.

Significant delays are introduced if information needs to be gathered from each department and then transferred somehow to the finance department, even if this is done electronically. It can then take days or even weeks if the finance department needs to work its magic compiling and interpreting the insights into a report, or to present it on a dashboard.

The report or dashboard eventually seen by the executive could be so out of date that it's essentially historic. Historic data has its uses, of course, but it can't be the default.

Even worse, old reports force the business decision makers to be reactive, rather than responsive. It forces executives to make guesses, rather than informed decisions based on what's happening right now. Every business decision is in some way a gamble, but successful gamblers know better than to use old information. Those betting on a horse race might study a horse's form in previous races–the old information–but they also monitor the condition of the turf on race day, and listen to the word coming from the stables right up until the horses enter the starting gate. The fresher the insights, the better the potential for making the right decisions.

So why are businesses still seemingly obsessed with old information?

2. Information is siloed

Because information is drawn from each department, there's little likelihood that it all matches up logically. For example, the sales figures will probably cover the period just ended, but the manufacturing of those products sold might've actually taken place before that period. Yet the information sent by them is likely to be for the period just ended because all that's being examined in their part of the report is cost.

It takes the experience and interpretation of the finance department to turn everything into something that makes sense, but this is also where bias or misunderstandings can be introduced. And considering massive business decisions are made using a typical report then these biases or misunderstandings can have disastrous consequences. It can lead to the logical fallacy wherein people believe something to be true simply because others do.

And none of this is to mention the implicit trust the finance department must have in the veracity of the information that each department chooses to send. The very act of creating reports invites manipulation and distortion because it involves active choices about what should be included, and what should be kept under wraps.

If all information was always "live"–always up to date–then the situations listed above could simply not happen in the first place.

3. Performance metrics are siloed

Each individual system within each department enforces its own approach to its data–a kind of culture surrounding the purpose for the data–making it hard to enforce an overall mission statement within the business. Each department might have its own KPIs built around their particular view of their data, rather than the goals of the entire company.

This makes it near-impossible for the business to act as one. It's not necessarily that the departments aren't trying to align to company goals. Their hands are tied by their systems.

The finance department runs an accounting system. The sales department relies on a customer relationship management (CRM) system. The fulfilment department runs a warehouse management system (WMS).

Between all these systems are a multitude of spreadsheets propping up certain functions or even entire departments, each vital in its own way but usually hoarded over by just one person who can understand its labyrinthine complexities.

The sales department finds it hard to be responsive to what the manufacturing department is doing because it can't instantly see the amount of inventory its producing. Customer support can't be responsive to issues arising in fulfilment if they can't track customer orders. Any attempt at inter-department cooperation is slow and often built around shared files or even printouts discussed in meetings. With time at such a premium nowadays in business, there simply isn't the luxury for anybody to take their time making a decision!

Successful businesses need to act as one.

The danger in monitoring traditional metrics alone

Even if the hurdles listed above are somehow overcome, there remain serious limitations with the use of KPIs or other traditional-style analytics – such as NPS for customer satisfaction – within most businesses.

Here are some examples of issues commonly cited.

Choosing the right KPIs: The KPIs you use evaluate what's important – and provide valuable insight – but how did your firm or the departments within it choose them? For many businesses the most important KPIs came straight from business school. Others might be ones that are considered by somebody, somewhere to be essential to your sector or type of business. Nobody can deny that most of these KPIs are useful or even essential, regardless of their origin. But because of their importance in running a business, these kinds of traditional KPIs tend to be given an elevated status that can elbow aside other insights or approaches to viewing information that might be equally important. The finance department might want to take a fresh perspective on all the data within a business to dig deeper and use more proactive metrics, if only to compare against traditional metrics–but traditional KPI culture might make this difficult, if not impossible.

KPIs tend to be narrowly focused: Traditional company performance metrics don't allow you to be proactive, or to catch issues to avoid business performance being affected. They don't allow you to be precise in predicting cash flow. And an inherent limitation of KPIs is that they can only tell one thing about one area. Attempting to understand the data in other ways is to enter the realm of interpretation, and that brings with it natural yet dangerous biases. Hopefully the KPI insight should be structured so that the message you're attempting to draw from it is unambiguous, but there is rarely the freedom to roam across the data or analyse the same topic from a different perspective. For example, if a KPI shows that sales performance is down, it would be good to be able to gain perspective on the problem from a fulfilment perspective, or a customer service perspective. Did they have an influence? Almost certainly. But unless you have KPIs setup for those departments to monitor the same data over the same period, this kind of flexibility is unlikely. And the business suffers accordingly.

KPIs can be demotivating: Let's say sales have a KPI for a particular product line. However, your competitor drops the price of their similar product. You're able to respond, of course, but there's little doubt the KPI figures will be dented because of the change. When that negative data is fed back to the sales team at the end of that reporting period, they're hardly going to feel encouraged. In a similar way, KPIs are unable to respond to changes in corporate culture or even reflect it – you might say you care about staff workloads but at the end of the day KPIs typically measure monetary values.

Part 2:
Better analytics in action: clients, cash flow and capital

In part one of this guide we looked at how traditional performance metrics may be hindering a business, preventing it from reaching its full potential. In this section we give examples of the types of performance metrics you could be using to complement your traditional KPIs.

In simple terms, it's time for businesses to stop being of the mentality where they anticipate fighting fires all the time–and it's time they gained the insight into their business so that fires aren't allowed to start in the first place.

Indicative, proactive and granular performance metrics can be harnessed to complement the traditional financial performance metrics your company may be using. The metrics allow a business to determine whether or not it is on track to hit its overall financial goals–and allow the business to put remediation plans in place in case it is not.

These types of metrics we look at are client retention, cash flow, and working capital.

Identify which clients should get most of your attention based on the ones you perceive are the most likely to churn.

Client retention

Clients are the primary source of company revenue. And, in the age of the customer, every business should have certain client metrics as part of their key performance indicators. These metrics can signal client behavior, which means they're often indicators of revenue performance and cashflow.

Client churn is an important business performance metric, and it can signal contraction. The full cost of client churn includes both lost revenue and the marketing costs involved with replacing those clients with new ones. Surveying clients for NPS or customer satisfaction is important, but suffer from the issues of traditional performance metrics discussed in part one of this guide – often the results come in long after the opportunity has passed to resolve a potential issue.

Do you know which clients may be at risk of churn? How do you focus on client retention? Here are some proactive performance indicators you should consider:

1. Identify your top tier clients
This can be done by analysing client revenue, client lifetime value, or client profitability. It may be important for you to have rosters for all three, or more, given that each grouping offers its own value. For example, clients with the highest lifetime value may not be generating the most revenue this year/month/week, but their loyalty may be an important fact in your year-on-year growth, or contribute to other factors like brand awareness.

2. Analyse indicative, proactive metrics
Look at current aspects of their behavior such as:

- Percentage of projects at risk.
- Average project overrun in terms of days.
- Percentage of work not invoiced.
- Percentage of invoices that were received but rejected.
- Date of last contact.

3. Action what you discover
Identify which clients should get most of your attention based on the ones you perceive are the most likely to churn. Is there a client project you should reprioritise or an order you should place to keep a client on-track? Share the data with your customer teams and regroup to build action plans to alter the way you're currently serving these clients and deliver the experience your team has promised to the client.

4. Drive these insights into the organisation
Institute changes in the organisation to reduce risk of retention going forward. This can be done by further segmenting clients into groups within your accounting software, or perhaps, by industry or product.

With data-driven insights, you'll know which clients are at risk of attrition, often a huge unknown, and devote time with your team and that client to get the relationship back on track. You'll also gain insight into what projects are underway, and which team members are involved in serving a particular client. With all of this client data throughout the client lifecycle – from opportunity to project completion to receiving payment – you'll be able to spot potential issues before they become a reality.

Cash flow

It's a sobering thought that most businesses fail due to issues surrounding cash flow. In fact, research suggests that a high percentage of small to medium-sized businesses fail due to poor cash flow management, and a lack of understanding of how to effectively manage it within a business.

Being unable to meet financial obligations can spell disaster for any business. Having key insight into cash flow is crucial for any business owner or finance manager, especially if the company is seeking to invest in future growth opportunities. Unfortunately, metrics like free cash flow are static, and companies need to be able to predict how free cash flow would increase or decrease based on the shifting dynamics of their business.

To truly gain insight into cash flow and the future financial health of your business, you need to be able to build scenarios around projects in progress, jobs that haven't yet started, opportunities that might close soon, and more. By understanding all of the elements of your business that impact cash flow, you'll have greater visibility into the financial health of your business – which builds confidence when growth opportunities arise.

1. Measure indicative, proactive metrics
You might choose to measure the following:

- Revenue from jobs in progress and revenue from jobs not yet started. Assuming the clients for these projects do not pay on high amounts of credit, this could give you a sense of incoming cash to the business.
- Percentage of sales on credit. If you have a high percentage of sales on credit, then you may look profitable but haven't actually received cash for sales. This can end up hurting your free cash flow.
- Days payable outstanding (AP/cost of sales). This indicates the average length of your collection times from suppliers. As days payable outstanding grows, AP declines, or grows more slowly than sales, becoming a source of cash.
- Inventory turnover ratio (sales / inventory). This indicates how efficient your team is at turning inventory into cash, or inventory relative to sales. Similarly, you could use the days inventory outstanding metric.

2. Build scenarios for how your cash flow will be impacted
Evaluate how accounts receivable, and ultimately your cash account, could be improved by upcoming invoices and the payment terms for clients. The more you can leverage historical and trend data to influence your predictions, the better.

3. Action these insights
If you have a large potential amount of revenue from jobs in progress then perhaps you should reprioritise other work. Or, if you have a relatively low average days payable outstanding, determine if you can work with suppliers and vendors to renegotiate payment terms. You could also focus your sales team on closing those current opportunities, rather than building pipeline.

Working capital

Cash flow can also be increased by improving efficiency ratios that effect changes in working capital. Working capital provides a snapshot of the present situation. On the one hand, working capital is important because it is a measure of a company's ability to pay off short-term expenses or debts. On the other hand, too much working capital means that some assets are not being invested for the long-term, so they are not being put to good use in helping the company grow as much as possible.

To truly monitor and measure working capital, you need to have a good handle on your accounts receivable. How is your A/R performing? How quickly do your best clients pay? How slow are your slowest paying clients? What is the average days to pay across all clients? How many days in A/R are your invoices—segmented by project type?

Improving your working capital can be achieved by optimising your A/R process. This can be done by automating billing and invoicing, requesting payments in person, understanding outstanding payments, and knowing when and how to restructure payment terms. If you can optimise A/R and move a late payment at the end of December to an early payment at the beginning of October, you'll not only increase working capital, but you'll be better able to invest that money to grow the business.

Here are some steps you can follow to identify, and mitigate potential issues resulting from poor working capital.

1. Measure indicative, proactive metrics

You might choose to measure the following:

- **Days sales outstanding.** Improved collection practices drive down days sales outstanding (A/R divided by total credit sales x number of days in a period), thus decreasing accounts receivable.
- **Average debt collection days.** This tells you how quickly your clients pay once they've been invoiced.
- **Average days to process a sales transaction.** This is the number of days it takes you to invoice and process the payment from a client. This is often calculated according to a company's payment terms and how a sale is confirmed.

2. Diagnose issues

Set performance goals for these metrics, based on values that are appropriate for your business. For example, for days sales outstanding you typically do not want the average to exceed your average payment terms by more than half. So, if you operate on average payment terms of 30 days and you're seeing payment in 45 days you're doing pretty well.

Analyse trends in your performance. For example, is it a certain group of clients that typically fall into delinquent status? Or perhaps they fall into delinquent status when they purchase a certain product such as a product that requires a longer onboarding time. Spotting trends can help you get closer to identifying the root cause of an issue. If your average amount of days to complete a sales transaction is longer this month than last, consider the reason. You may have internal processes that you have that need to be improved.

3. Action this information

You can improve your A/R, debt collection and credit management processes with process efficiencies, or even technologies. You may also find that you need to renegotiate payment terms with clients so that you're in a better position to optimise working capital and in a better cash position.

Part 3:
Run a smarter, faster, more connected business

Those who found much to identify within the previous sections might be asking how things can be done differently. How can you evolve your finance function to be able to gather and benefit from these insights listed in part two of this white paper?

There are a number of recommendations, as follows:

Powerful business insights

Choose a solution that provides specialised, accurate reporting to identify trends and opportunities that give you a competitive edge. Sage has fully integrated software solutions, providing a holistic view of your business, giving you the ability to track, analyse and manage customer and supplier interactions, allowing for fast and effective decision making.

Discover the reporting capabilities of our business management solutions

Sage 200

Sage X3

Sage Intacct

Breaking out of the siloes

Employees need to understand cause and effect. But when shared with the business, traditional business metrics such as overall profitability can tend to emphasise the negative–a fall in revenue might make the marketing department question its overall performance, for example, when the fault can easily lie elsewhere.

The data isn't necessarily causing the problem, and nor is sharing it. Instead, a far better approach is to make your traditional business performance metrics such as revenue goals the 'effect' and then help your employees understand the 'cause' by layering-in more indicative, proactive performance metrics. It may become easier for them to see how their activities contribute to the business.

For example, if metrics about profitable clients are shared with the customer service team then they can opt to help those clients rather than simply fulfilling their KPIs of, for example, dealing with a certain number of client enquiries within a set time period. If metrics about product inventory are shared with sales people then they can take proactive measures to push these product lines, instead of merely pushing blindly for product sales to meet their own KPIs.

Of course, it is up to business leaders to determine how much is shared, with which teams, how often, and in which formats. However, consider how much more effective teams could be if they were all working towards informed, common goals.

Being truly responsive and proactive

What if the metrics you used didn't always show old data? What if you could see near-live metrics, as the information was generated–and act upon it? What if you could spot trends as they happen, and act upon them before they became an issue within your business? Or what if the positive trends could be harnessed so they're encouraged to further growth?

Sage business management solutions give you this power. Connect your business with smart, scalable and secure business management solutions. Integrated solutions to manage your financials and customers while streamlining manufacturing, distribution and key supply chain processes.

Find out more about the business management solutions we offer

Sage 200

Sage X3

Sage Intacct

In summary

In today's hypercompetitive world a business relying solely on traditional performance metrics is in a vulnerable position. The full range of data available needs to be embraced and exploited on an everyday basis to ensure it's providing the insight the business needs. Additionally, managers within the finance department need to ensure the messages that these insights are telling are told to all those who could benefit from knowing, and that therefore all departments are able to unite behind the common goal of increasing profitability and pushing the business forward.

With proactive and pervasive use of data you can:

• Increase visibility into financial data.

• Reduce complexity when expanding the business.

• Eliminate operational silos that prevent collaboration.

• Reduce uncertainty about things like cash flow shortages and unpaid invoices.

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