While you may not have a background in finance, a basic understanding of the key concepts of financial accounting can help you improve your decision-making process, as well as your chances for career success. With a better understanding of how your organization measures financial performance, you can take steps to provide additional value in your daily activities. Finance can be intimidating for the uninitiated. To help you become more comfortable understanding and speaking about financial topics, heres a list of the top financial metrics managers need to understand. What Are Financial KPIs? Financial KPIs (key performance indicators) are metrics organizations use to track, measure, and analyze the financial health of the company. These financial KPIs fall under a variety of categories, including profitability, liquidity, solvency, efficiency, and valuation. By understanding these metrics, you can be better positioned to know how the business is performing from a financial perspective. You can then use this knowledge to adjust the goals of your department or team and contribute to critical strategic objectives. For managers, these metrics and KPIs should be made available internally and distributed on a weekly or monthly basis in the form of email updates, dashboards, or reports. If theyre not readily distributed, you can still become familiar with the metrics via financial statement analysis. Free E-Book: A Manager's Guide to Finance & AccountingAccess your free e-book today. DOWNLOAD NOW What Is Financial Statement Analysis? Financial statement analysis is the process of reviewing key financial documents to gain a better understanding of how the company is performing. While there are many different types of financial statements that can be analyzed as part of this process, some of the most important, especially to managers, include the: Balance Sheet: A statement that lists a businesss assets, liabilities, and owners equity at a specific point in time. Income Statement: A statement that summarizes a businesss revenues, expenses, and profits over a period. Cash Flow Statement: A statement that captures how cash flow is affected by activities from the balance sheet and income statement, categorized into operating, investing, and financing activities. Annual Report: A document that describes the companys operations and financial conditions, and typically includes the documents listed above, in addition to other insights and narrative from key figures within the company. 13 Financial Performance Measures to Monitor The metrics below are typically found in the financial statements listed above and among the most important for managers and other key stakeholders within an organization to understand. 1. Gross Profit Margin Gross profit margin is a profitability ratio that measures what percentage of revenue is left after subtracting the cost of goods sold. The cost of goods sold refers to the direct cost of production and does not include operating expenses, interest, or taxes. In other words, gross profit margin is a measure of profitability, specifically for a product or item line, without accounting for overheads. Gross Profit Margin = (Revenue - Cost of Sales) / Revenue * 100 2. Net Profit Margin Net profit margin is a profitability ratio that measures what percentage of revenue and other income is left after subtracting all costs for the business, including costs of goods sold, operating expenses, interest, and taxes. Net profit margin differs from gross profit margin as a measure of profitability for the business in general, taking into account not only the cost of goods sold, but all other related expenses. Net Profit Margin = Net Profit / Revenue * 100 3. Working Capital Working capital is a measure of the businesss available operating liquidity, which can be used to fund day-to-day operations. Working Capital = Current Assets - Current Liabilities 4. Current Ratio Current ratio is a liquidity ratio that helps you understand whether the business can pay its short-term obligationsthat is, obligations due within one year with its current assets and liabilities. Current Ratio = Current Assets / Current Liabilities 5. Quick Ratio The quick ratio, also known as an acid test ratio, is another type of liquidity ratio that measures a businesss ability to handle short-term obligations. The quick ratio uses only highly liquid current assets, such as cash, marketable securities, and accounts receivables, in its numerator. The assumption is that certain current assets, like inventory, are not necessarily easy to turn into cash. Quick Ratio = (Current Assets - Inventory) / Current Liabilities 6. Leverage Financial leverage, also known as the equity multiplier, refers to the use of debt to buy assets. If all the assets are financed by equity, the multiplier is one. As debt increases, the multiplier increases from one, demonstrating the leverage impact of the debt and, ultimately, increasing the risk of the business. Leverage = Total Assets / Total Equity 7. Debt-to-Equity Ratio The debt-to-equity ratio is a solvency ratio that measures how much a company finances itself using equity versus debt. This ratio provides insight into the solvency of the business by reflecting the ability of shareholder equity to cover all debt in the event of a business downturn. Debt to Equity Ratio = Total Debt / Total Equity 8. Inventory Turnover Inventory turnover is an efficiency ratio that measures how many times per accounting period the company sold its entire inventory. It gives insight into whether a company has excessive inventory relative to its sales levels. Inventory Turnover = Cost of Sales / (Beginning Inventory + Ending Inventory / 2) 9. Total Asset Turnover Total asset turnover is an efficiency ratio that measures how efficiently a company uses its assets to generate revenue. The higher the turnover ratio, the better the performance of the company. Total Asset Turnover = Revenue / (Beginning Total Assets + Ending Total Assets / 2) 10. Return on Equity Return on equity, more commonly displayed as ROE, is a profitability ratio measured by dividing net profit over shareholders equity. It indicates how well the business can utilize equity investments to earn profit for investors. ROE = Net Profit / (Beginning Equity + Ending Equity) / 2 11. Return on Assets Return on assets, or ROA, is another profitability ratio, similar to ROE, which is measured by dividing net profit by the companys average assets. Its an indicator of how well the company is managing its available resources and assets to net higher profits. ROA = Net Profit / (Beginning Total Assets + Ending Total Assets) / 2 12. Operating Cash Flow Operating cash flow is a measure of how much cash the business has as a result of its operations. This measure could be positive, meaning cash is available to grow operations, or negative, meaning additional financing would be required to maintain current operations. The operating cash flow is usually found on the cash flow statement and can be calculated using one of two methods: direct or indirect. 13. Seasonality Seasonality is a measure of how the period of the year is affecting your companys financial numbers and outcomes. If youre in an industry thats affected by high and low seasons, this measure will help you sort out confounding variables and see the numbers for what they truly are. Its important to note theres no absolute good or bad when it comes to financial KPIs. Metrics need to be compared to prior years or competitors in the industry to see whether your companys financial performance is improving or declining and how its performing relative to others. The Bottom Line There are many other financial KPIs you can track and monitor to understand how your company is doing and how your actions impact progress toward shared goals. The financial KPIs listed above are a great place to start if youre unfamiliar with finance. Understanding how these metrics influence business strategy is a critical financial accounting skill for all managers to develop. Are you looking to develop or hone your finance skills? Explore our online finance and accounting courses to develop your toolkit for making and understanding financial decisions. If you aren't sure which course is the right fit, download our free course flowchart to determine which best aligns with your goals. We look at financial indicators of businesses very closely. They show whether the company has the ability to generate sufficient cash to maintain operations. Financial indicators (also known as financial metrics) are critical tools. Heres what they allow you to do.1. Track your performanceThey give a standard to measure your performance, see how youre trending over time and where you can make improvements.2. Compare with peersThey allow you to compare your company against the competition. You can see where you excel and lag, helping you hone your competitive edge.3. Make decisionsIndicators let you model out decisions and make the right call instead of just winging it and hoping for the best.4. Stay financially healthyThey reveal how financially healthy your company is. A business owner may not understand how to calculate the cash conversion cycle, but I guarantee you they understand the pressures of not having enough money to make payroll, Blackwood says. Financial indicators help you avoid such problems.5. Get loans and respect loan conditionsWhen you apply for loans, lenders typically want to see your companys financial indicators and carefully review them. After okaying a loan, lenders also often require the borrower to stay in covenant, which means respecting specific levels in the indicators.For example, a bank could ask you to maintain a 4-to-1 debt-to-equity ratio. If the ratio goes above that, the bank could require you to repay the loan or give additional security.We look at financial indicators of businesses very closely, Blackwood says. They show whether the company has the ability to generate sufficient cash to maintain operations, which is effectively what pays back long-term debt.What are the four main types of financial indicators?Financial indicators generally fall into four areas that cover key aspects of a companys financial health.Growthhow quickly sales are increasing (or not)Profitabilityhow much money the business is makingLiquidityhow much cash the company generates and has on handLeverageits level of short- and long-term debtSome financial indicators are financial ratioscomparisons between two numbers to show the relationship between them. For example, a companys debt-to-asset ratio is its liabilities divided by its assets. This tells you if your debt level is reasonable for the size of your company.Other financial indicators arent ratios, such as net profit and sales.Financial indicators are part of the broader category of all of the key performance indicators (KPIs) that measure various aspects of a companys performance. Non-financial KPIs cover functions such as sales, marketing, operations and human resources.What financial indicators should I monitor?Numerous financial indicators are available to track your financial performance. Below are key ones its especially important to track for most companies, small or large. Bigger or more complex businesses may need to monitor additional indicators.Some indicators fall into more than one category. See the following section for formulas to calculate all of these indicators.GrowthMonitor your companys growth to see if youre on track with your targets and business strategy. Here are the two main indicators for doing this.1. SalesThis figure (also called revenue) is at the top of your income statement. (This is why its sometimes called the top line.) You can track both year-over-year sales growth on your annual statements and monthly or quarterly growth on interim statements.2. Net profitNet profit is also known as net income or the bottom line because its typically the last line in your income statement. Its whats left over from your sales after the deduction of fixed and variable costs, interest, amortization, depreciation, non-operating items and taxes.Its important to track both sales and net profit, Blackwood says. Its possible for your sales to go up while profits are actually going down. You could be losing money because your input costs have gone up higher than your sales, he says.ProfitabilityTrack your profitability to make sure youre actually making money, not blowing through all your sales on expenses. Here are the main metrics to monitor that.1. Net profit(see above)2. Net profit marginYour net profit as a portion of sales. This metric may be listed on the income statement below net profit, but not all income statements include it.Net profit margin is useful for comparing net profit from one time period to the next, or against other firms. Comparing the raw dollar figure alone can be misleading.For example, if your net profit increases from $500,000 to $600,000, it may look like cause for celebration. But if sales in the same period increased from $5 million to $10 million, your net profit actually fell from 10% to 6% as a portion of sales. Heres how to calculate net profit margin: X 100 (EXPRESSED AS A PERCENTAGE) The amount of sales left after direct (variable) costs are subtracted. A lot of people just go to the bottom line and say, Whats my net profit? Blackwood says. But you could be missing a whole host of things that influence that, such as changes in various costs. Looking at gross profit helps you understand whats happening better.Usually indicated on your income statement below sales and cost of goods sold (for manufacturers) or cost of sales (retail or wholesale businesses).4. Gross profit marginYour gross profit as a portion of your sales. Its important to calculate this to better compare your performance over time and against the competition. The raw gross profit number isnt as useful for such comparisons. This is also sometimes called the gross margin.This number is sometimes given on the income statement below gross profit. How to calculate it: (SALES DIRECT EXPENSES) SALESX 100 (EXPRESSED AS A PERCENTAGE) A measure of your companys ability to generate income. EBITDA stands for earnings before interest, taxes, depreciation and amortization. It usually doesnt appear on income statements, but its commonly used to calculate a companys core profitability. EBITDA is also often the basis for calculating a businesss valuation.EBITDA is a standard thats widely used because its the normalized level of income that the company created in a certain time period, Blackwood says.How to calculate it: Net profit + interest + taxes + depreciation/amortization Companies should have a good understanding of how long its taking them to get their money. While profitability is important, it doesnt tell you how much cash you have available in your business from day to day. You may be highly profitable at year-end, but still have serious cash flow problems in the interim.If you made a sale but havent yet received the money from it, you show the profit from that sale, but your cash flow wont reflect it yet, Blackwood says. Companies should have a good understanding of how long its taking them to get their money. Liquidity indicators tell you when your money leaves and how long it takes to come back into your business.Here are six of the most commonly used liquidity indicators.1. Current ratioThe current ratio is sometimes called the working capital ratio. This is your companys current assets (cash and short-term assets that could be converted into cash within 12 months) divided by current liabilities (short-term liabilities due within 12 months). The higher the number, the better. Heres the formula: CURRENT ASSETS CURRENT LIABILITIES Available assets (cash, securities that can be immediately converted into cash and healthy accounts receivable) divided by current liabilities. This is more conservative than the current ratio because the quick ratio includes fewer assets. The higher, the better. How to calculate it: AVAILABLE ASSETS CURRENT LIABILITIES The average number of days it takes your company to get paid by customers. A lower number is better. Also known as the average collection period. This calculation has two steps.Step #1: Calculate your average accounts receivable. (ACCOUNTS RECEIVABLE VALUE, START OF THE PERIOD + ACCOUNTS RECEIVABLE VALUE, END OF THE PERIOD) 2 Step #2: Calculate days receivable. (AVERAGE ACCOUNTS RECEIVABLE NET CREDIT SALES*)X NUMBER OF DAYS IN THE PERIOD (USUALLY 365) * Net credit sales are revenues your business generates on credit, less any returns.4. Average days payableDays payable is the average number of days you take to pay suppliers. Within limits, a higher number is generally betterthough taking too long to pay a supplier can hurt your relationship with them. How to calculate it: (DAYS IN THE PERIOD X AVERAGE ACCOUNTS PAYABLE) PURCHASES ON CREDIT How many times a year your business converts its inventory into sales. Sometimes referred to as inventory turns. The higher the number, the better. How to calculate it: COST OF GOODS SOLD (OR COST OF SALES) AVERAGE INVENTORY How many days it takes your business to convert its investment in production and sales into cash. The cash conversion cycle combines days receivable and payable and inventory turns. A lower number is good. How to calculate it: AVERAGE DAYS INVENTORY + AVERAGE DAYS RECEIVABLE AVERAGE DAYS PAYABLE Although not a financial indicator, Blackwood also strongly advises businesses to use a cash flow forecast. This projection allows you to determine ebbs and flows in your cash flow through the year so that you can anticipate and plan for any shortfalls. You can also use it to model out major investments and business decisions.There's almost no better statement for someone to prepare than a cash flow forecast, Blackwood says. It doesnt matter how profitable you are in December if you cant make payroll in March. A cash flow forecast will show you ahead of time that you may run into problems. LeverageYour level of indebtedness is an essential aspect of your companys financial health. Being overleveraged can put pressure on cash flow due to high interest payments. It can also put your business at risk if interest rates rise and make it harder to get additional needed financing.Leverage indicators show how much financial flexibility a business has to weather different economic climates, Blackwood says. If youre carrying too much debt, banks may not be supportive. Leverage is an important part of success for businesses. On the other hand, he says, being underleveraged may mean youre missing opportunities to invest in your companys growth. Most businesses, when they sell more of their product, make more money than the cost of debt, Blackwood says. The concept of leverage is that youre making a profit off someone elses money.Leverage is an important part of success for businesses. Its important to manage your debt and be lean and meanespecially when economic uncertainty is highbut youre less likely to be able to grow (as quickly) if you dont have some leverage.Here are common leverage indicators.1. Debt-to-equity ratioHow much long- and short-term debt your business has compared to the amount invested by the owners and accumulated earnings. A lower debt-to-equity ratio is generally better. How to calculate it: Total short- and long-term liabilities divided by total short- and long-term assets. Again, the lower the debt-to-asset ratio the better. How to calculate it: TOTAL LIABILITIES TOTAL ASSETS This is your total liabilities divided by sales, with a lower number being best. How to calculate it: How much EBITDA a business earns for every dollar of interest and principal paid. A higher number is better. The debt service coverage ratio is sometimes calculated with EBIT (earnings before interest and taxes) instead of EBITDA. If capital lease expenses are included in the calculation, the resulting metric is called the fixed-charge coverage ratio.How to calculate it: EBITDA (INTEREST + PRINCIPAL PAYMENTS DURING THE PERIOD) Its very common for businesses to make calculation mistakes and faulty assumptions in their financial indicators, such as misallocating costs and assets. These can materially affect the conclusions you draw.Ask a financial expert to validate the methodology you use to calculate your indicators. This is especially important for interim statements and other figures not validated by an accountant.Mistakes can happen with financial indicators and can lead to poor business decisions, Blackwood says.Also be sure that the figures you use to calculate your indicators accurately represent your business. Verify whether the numbers reflect reality, Blackwood says. In your inventory, is it real inventory that you can sell, or is it unsellable inventory that you havent written off yet. Do receivables include a bad debt? Are you being realistic about when youre going to receive the money?How often should I monitor financial indicators?Its important to review financial indicators regularly through the year, not just in your year-end financial statements. The figures could be dated by the time those statements are available. As well, many of the indicators above arent included in the statements and have to be calculated separately.In an economy thats shifting so quickly, year-end statements may not be relevant by the time they are finalized, Blackwood says. If youre making decisions based on your year-end result and interest rates have gone up three or four times since then, you need to take this into account.Blackwood recommends tracking indicators through interim monthly or quarterly financial statements and other summaries. Again, validate the methodology with a financial expert to avoid mistakes. Indicators help you validate if your decisions make sense. Financial indicators tell you how effectively youre running your business and inform sound business decisions. They also let you watch your cash flow and gauge how much financing you may need or could take on.Using financial indicators to their fullest takes some practice and thought about their place in your decision-making. Here are three keys for doing so successfully.1. Compare and contrastYou can analyze financial indicators in two ways: horizontally and vertically.Horizontal analysis means comparing the current periods numbers to earlier periods.Vertical analysis is drilling down into numbers. For example, you could review costs by going through individual items in an income statement.Both approaches are important. Get behind the numbers and ask questions, Blackwood says. The comparison is the important part. Step back and ask, What does this mean for my business? Are sales higher because it was an anomalous year or a longer-term trend? What changed in my variable costs?As an example, he cites a business that had $50 million in annual sales, but only $300,000 in net income. A closer look revealed the reason for the low profits: The company was taking on too many projects with low margin.You may even have to look beyond your financial statements and check numbers for individual products or departments to understand the reasons for certain results. Just taking the ratio and comparing it is only the first step, Blackwood says.2. Determine an appropriate standardDetermine a target level (known as a standard) for each indicator thats appropriate for your business and industry. Standards can vary widely by industry.An accounting textbook may say the standard for a ratio is 1-to-1, but that may not be true for your industry or how you operate your business, Blackwood says.You dont want to compare yourself to a highly volatile business if youre a more conventional kind of company that sees nominal growth every year. You may say, Why am I not growing as fast as I should be? But you might be making an unfair comparison.For example, Blackwood says, liquidity needs can vary greatly between the hotel industry and manufacturers.If you're in the hotel business, you're getting cash all the time and liquidity might not be as important to you. But if youre a manufacturer, you have to invest in people and raw materials, you have to convert that into a finished product, you have to cover overhead, transport your product and get paid possibly 60 or 90 days later. Do you have the cash available to cover these upfront costs?3. Integrate indicators in decision-makingUse financial indicators to help you weigh and game out important decisions. Plug in anticipated costs and sales of a decision to see how it could impact the financial indicators.Indicators help you validate if your decisions make sense or if youre putting your business at risk, Blackwood says.Next StepDiscover how to use financial indicators for your business to track and analyze data and take the guesswork out of financial planning. Download BDCs free guide, Monitor your business performance.

What are financial indicators. List of financial indicators. Financial indicatiors. Financial indicators examples. Types of financial performance indicators.