

Metrics, metrics on the wall—which one should I use for my business?



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Financial dashboards is one of the most saleable feature of an accounting software. Filled with colorful graphs and data visualization tools, these dashboards provide quick insights on how a business is performing. However, dashboards are as helpful as a blueprint—these provide extensive useful information for engineers but clueless chatter for lay persons. Similarly, with extensive information, lay persons, without extensive knowledge on reading blueprints, can make significantly wrong decisions relying on usually reliable information. There is nothing really wrong with the data, but on how the user understands the information.

Understanding financial dashboards in terms of the financial aspect of the business is definitely important to support the strategic and operational goals of the company ensure. However, one should not rely on something that you don't understand—just the same way that you should not take medicines that you have no idea of? Of course there are a lot of good books out there that explain what each ratio and financial metrics mean—but at the end of the day, do you understand the underlying information?

While I don't recommend the reliance on financial dashboards unless you have full understanding of its contents, there are a few basic things which you need to understand as an entrepreneur.

Net income

Net income is very simple. It is the bottom line in your income statement. Micro Small Medium Enterprises (MSME) typically follow the cash basis accounting which makes things very straight forward. Net income is the measure of all your incomes and expenses during a specific period of time (typically one year). This gives you a good snapshot of the company's profitability during the period.

Is it bad to have a net loss in your first few years? No since this is the investment period when there's a lot of expenses that you're incurring which will be useful for the long term benefit of the business. Net income or loss is fine—just make sure you benchmark it against your budget.

Cash flows

Cash flows is the heart and soul of MSMEs. It is an indicator of the amount of cash you're expending to sustain your operations. A lot of entrepreneurs actually are not familiar with the cash flow statement since they only see the balance sheet and income statement.

Cash flow statements can show negative cash result specially during the cash heavy years. This typically applies to companies sustaining heavy capital expenditures. There is nothing wrong with having a negative cash flow as long as cash liquidity (amount of cash to sustain immediate cash requirements) is available. Having a large positive cash is actually more problematic as this indicates inefficient cash investments of the business. Cash flows

is an indicator of cash utilization. Use this to forecast cash requirement and build expectation of where cash shocks might arise.

Gross profit

The gross profit is probably the most important information that you want to use but you can't rely upon unless you have full trust with your accountant. Determining a component of gross profit of the cost of sales, cost of service or project cost can be highly judgemental. Those without much experience can result in havoc on their analysis.

Gross profit provides extensive information on how profitable your product or service is. However, the wrong cost analysis can produce highly erroneous information for users. So—take caution, this might not be a good measure unless you're fully comfortable with the gross profit information.

These information should be readily available to you as an entrepreneur. There is no need to make complex calculation to arrive at metrics unless you understand what the metrics mean. Information overload poses a higher risk to an MSME entrepreneur than the lack of understandable metrics.

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This column accepts contributions from accountants, especially articles that are of interest to the accountancy profession, in particular, and to the business community, in general. These can be e-mailed to boa.secretariat@gmail.com.