E-book

Predictive KPIs for SaaS and Software Companies

Predictive KPIs can help drive success

Sage

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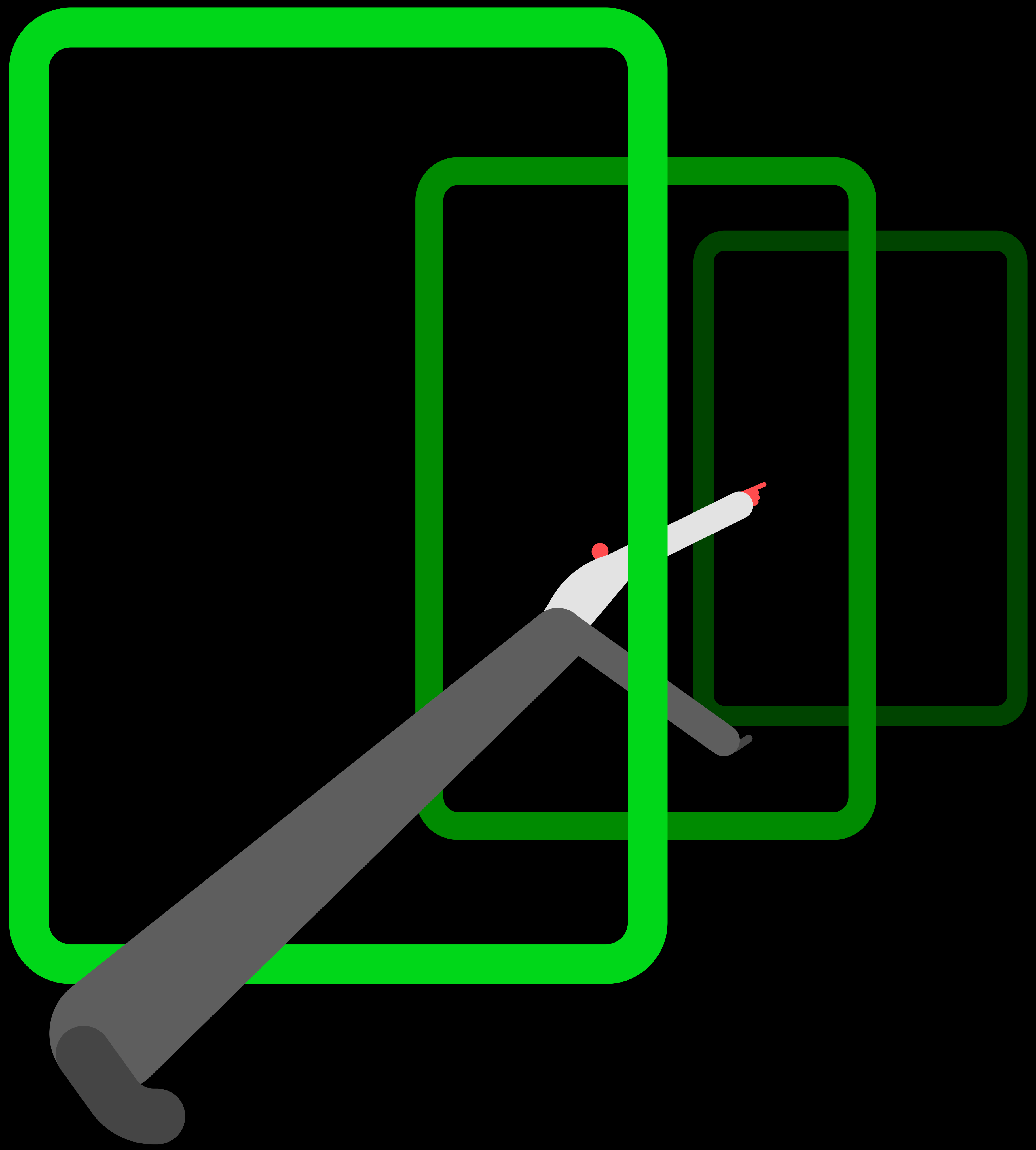

Introduction

Key performance indicators (KPIs) are defined as the quantifiable measures used to determine how well a SaaS or recurring revenue organisation meets its operational and strategic goals. Too often SaaS finance leaders don't look at KPIs through the right lens. CEOs, CFOs, and executives who look at KPIs to answer the question "how did we do" need to ask "how will we do" instead. Rather than a rear-mirror view of performance, the right batch of KPIs can help SaaS providers predict business success and reveal the challenges ahead, and help data-driven technology organisations gain real competitive advantages. Predictive KPIs help executives lead the organisation rather than just manage, shifting the focus from short-term objectives to longer-term visions. Instead of numbers to hit, these KPIs can help drive change.

Predictive KPIs are those designed to inform and influence decision-making. These are not limited to finance and operational KPIs; instead, they should include customer perception and market perception of the organisation. As detailed below, customer perception can be measured by customer behaviour, tracked in platforms such as Salesforce, to predict shifts up or down.

To better understand how predictive KPIs can help drive success for SaaS providers, let's look at the stages that most go through during their lifetime and the strategic focus for each.

Stage	Strategic focus
Start-up	Execution
Adoption	Engagement
Growth	Expansion
Maturity	Efficiency
Reinvention/decline	Perception

Start-up stage

At the start-up stage, the focus is on how well the SaaS company executes its business strategy. Predictive KPIs at this stage might include:

- **Budget variance and the trends over time**: Greater variances would suggest the organisation is not budgeting properly, which could lead to challenges moving forward.
- **The ability to meet project deadlines and speed of implementation** (if applicable): Achieving a high mark on these KPIs shows the organisation can meet its commitments to its customers.
- **Cash flow**: SaaS companies at a break-even point or cash positive are in a much better position to grow. While a 50% margin is acceptable at the start-up stage, break-even or better is a strong predictor of future success.
- **Gross burn rate**: Measures the rate at which the company uses up its available cash to cover operating expenses. The higher the burn rate, the faster the companies with a high burn rate will run out of cash without more funding or financing.

Adoption stage

Once past the start-up stage, SaaS organisations can focus on how well their customers are engaged with the company to measure adoption. These metrics might include:

- **Unique users**: Growth in the number of customers (unique users for digital concerns) would indicate a growing adoption rate.
- **Daily active users**: An increase in active accounts can help predict future success, while a decrease is a warning sign that something is amiss.
- **Committed annual recurring revenue**: This KPI accurately measures the health of a SaaS organisation and shows its monthly annual revenue cadence by recognising signed deals and netting out known or projected churn. Growth in CARR of 100% or better is a solid indication of future performance.
- **Customer acquisition cost**: This is an important metric to track over time. If the customer acquisition cost is decreasing, it may indicate future growth and a predictor of success. If the CAC is increasing, it may indicate a shrinking addressable market or increased competition.
- **Customer acquisition cost payback**: CAC payback measures how long it takes to pay back SG&A on a gross-margin basis. This KPI will vary depending on the type of business and payback range—payments-based businesses run more in the 20% range for gross margin, while SaaS models typically produce 80% in gross margin. These margins will affect how a CAC payback is calculated. Quick payback is a leading indicator of business performance.
- **Click-to-open rates**: Are your customers opening your emails? Are prospects looking at what you send? Click-to-open rates could be a harbinger of difficulties to come.
- **Current accounts receivable (AR) ratio**: Are your customers paying their bills on time? A low ratio might indicate that your customers are dissatisfied and are dragging their heels, or it might indicate that your customers are experiencing cash-flow issues and that might lead to cash-flow challenges for your organisation.

Growth stage

Predictive KPIs for the growth stage of a SaaS organisation's lifecycle typically focus on metrics linked to company expansion, and may include:

- **Net Dollar Retention**: Net dollar retention (NDR), also called net revenue retention (NRR), measures the percentage of your revenue that you're able to maintain from existing customers, inclusive of expansion revenue. SaaS companies often track and report NDR because it can offer insight into revenue growth and customer satisfaction.
- **Customer interaction**: This metric should track the type of interaction; positive, negative and neutral.
- **Churn rate**: Lower churn rates are a good indicator of overall customer satisfaction; conversely high churn rates can show problems ahead. Along with churn rate, it's important to understand what's causing the churn. Are your customers closing their doors? Are they replacing your solution with a competitive offering? Are they not realising the value that your solution brings? Is the market shifting?
- **Annual return rate**: As the company grows, is the annual return rate growing as well, or are the costs of expansion chewing into returns at a higher than projected rate?
- **Number of sales**: A steady growth in the number of sales is healthy. A sharp increase might predict capacity issues (in areas that might include technology infrastructure, professional services and customer support), while a decrease may predict other challenges for the organisation.
- **Average deal size**: Is the deal size going up or down? Do you have the capacity to handle larger deals, or the resources to add more deals if the deal size is decreasing? This number will help you predict what actions you need to take to continue a growth path.
- **Customer lifetime value**: As a predictive KPI, increases or decreases in customer lifetime value can show where the organisation is headed on future return. If the customer lifetime value is decreasing, the company will need to add more customers at a higher rate to achieve its results. A healthy SaaS provider will achieve a 3x on CLTV while best in class achieve a 5x.

Maturity stage

SaaS and software companies that have reached the maturity stage focus on efficiency. Typically, companies look at historical KPIs such as gross profit margin, return on sales/operating margin and net profit margin, which are important metrics to track, but predictive KPIs might include:

- **Average revenue per user**: APRU is a shorter-term way to look at customer revenue. As with customer lifetime value, decreases in ARPU might predict revenue challenges moving forward.
- **Cost savings**: Are cost-saving measures producing the expected results, or is the company bleeding money due to lower-than-expected earnings or inefficiencies?
- **Time-to-market**: How long does it take to get new products to market? The answer to this question will depend on complexity, but there are certain stages of the process that should become more routine over time. If time-to-market is increasing disproportionally to expected effort, this KPI is predicting greater inefficiency.
- **Cash conversion**: The cash conversion score is a calculation of committed-annual-recurring-revenue to capital-raised-to-date (debt and equity) minus the cash on the balance sheet. This measures the return on invested capital and shows how well these dollars convert into recurring revenue. Best-in-class SaaS organisations post a cash conversion score of 1X or better.
- **Gross profit**: Gross profit is the profit a company makes after deducting the costs associated with making and selling its products, or the costs associated with providing its services.
- **Cash conversion score**: Your cash conversion score represents the investment return on the capital you've put into the business. It's the ratio of the CARR to total capital raised to date. The cash conversion score essentially shows how well-invested the dollars have been that convert into CARR.

Reinvent or decline

Following the maturity stage, there comes a time when a company either needs to reinvent itself or face decline. Here predictive KPIs focus on perception, as follows:

- **Net promoter score**: This KPI measures customer loyalty from a range of -100 to +100 based on asking customers how likely they are to recommend the organisation's products or services. A low NPS indicates the company is at a crossroads and must either make some transformational changes or accept future losses and business decay.

- **Number of support requests**: A swing in the number of support requests either up or down could indicate that customers are encountering new problems, however a decrease might indicate that customers are simply giving up and are ready to move on.

- **Days sales outstanding**: This metric measures how quickly customers pay their bills. It is the average number of days required to collect accounts receivable payments. It can be used as a predictive KPI if DSO is going up, which might indicate growing customer dissatisfaction.

Which KPIs are best for you?

The end goal for any company or organisation is growth. We've shared some predictive KPI examples but finding the most useful and meaningful KPIs for your business can be a challenge. Your KPIs will depend on the organisation's goals, business model and processes. Some KPIs are almost universally applicable, while others will vary by delivery and billing model.

We suggest starting by identifying a value outcome—your organisation's guiding north star. For public companies, it may be driving shareholder value. Secondly, identify the strategic drivers, then identify the tactical drivers. Lastly, map financial and operational metrics to the tactical drivers. Start by pulling in organisation leadership and focus on what to measure rather than how. By integrating your ERP with a modern financial management system, you can automate KPIs and then update these in real time. This gives you the ability to create reports and dashboards that automatically combine operating dimensions with financial data so you can analyse KPIs for each operating entity, location, building, region, and other units.

Your KPIs will evolve as the organisation goes through its lifecycle. With this in mind, it's important to pick business systems for KPI tracking that can evolve as well. For example, some companies start with simple bookkeeping software, such as QuickBooks, to measure financial performance, but QuickBooks lacks sophisticated multidimensional reporting and the ability to handle multiple entities. More importantly, QuickBooks does not integrate with ERP systems, so as the organisation grows, this lack of integration severely hampers the systemic tracking of both historic and predictive KPIs. This also makes it much for difficult for SaaS companies to present the data that investors need to make additional funding decisions.

For executives at growing SaaS companies who want to make data-driven decisions, Sage Intacct provides real-time financial insights. Sage Intacct is a true cloud-native financial management system, built in the cloud for the cloud, and offers simplified integration with other cloud-native platforms such as Salesforce. It offers functionality not found in the various versions of QuickBooks Desktop or QuickBooks Online in areas that include core accounting, data entry, inventory management, job costing and reporting. Unlike QuickBooks, Sage Intacct easily handles multiple entities and currencies, simplifies reporting, closing and audit preparation, and helps finance executives share the data needed to make strategic business decisions.

About Sage Intacct

Sage Intacct is the innovation and customer satisfaction leader in cloud Financial Management. AICPA-endorsed and best-in-class, Sage Intacct is a scalable and extensible system that provides multi-dimensional analysis and industry-specific capabilities to automate complex processes and improve company performance, so data-driven finance leaders can focus on strategic initiatives.

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