



Critical number
The key metric to
business success

WALSH

**“What gets measured
gets managed”**



It's hard to argue with that piece of wisdom!

That said, here's another truism to consider:

**“If everything is important, then
nothing is important”**

Between these two valuable quotes is a balance and a guideline for business owners. All businesses have certain numbers that define success. Some figures, like profit, are universal. Every business must take in more than it spends, so an argument could be made that this figure – profit - is a definition of success for every business.

But what about other numbers? There's certainly no shortage of data to measure - sales, costs, margins, cash - the list goes on and on. They're all important, but what are the most important numbers for your business?

Don't forget **“If everything is important, then nothing is important”**

1

What is a Critical Number?

Your company's Critical Number is the one metric, either operational or financial, that represents a weakness or vulnerability that, if not addressed and corrected, will negatively impact the overall performance and long-term security of the business.

This Critical Number is what represents winning. It serves as a common and clearly defined goal that directs employee focus and demonstrates progress and success.

2

How do you determine your Critical Number?

So, how do you sift through the scads of metrics that might be worthy of your undivided attention, and discover the select few that will truly make a difference?

Think about your business as you consider two questions:

- **Are there considerations related to your specific business model that are absolutely critical to ongoing success?** For instance, if you are the low-price leader, then cost of sales is likely a primary area of focus.
- **Are there challenges your business faces right now that deserve attention?** Examples might include issues like declining quality, too much dependence on one large customer, or a high employee turnover rate.

The Critical Number will evolve with the business which means it will be different over time.

Business can have multiple Critical Numbers:

- Profitability
- Strategic

The second Critical Number could be the weakness you are trying to eliminate.

In most cases, the big-picture, corporate-level Critical Number will have underlying "drivers," actions that must be taken to move the number in the right direction.

Your Critical Number is the metric that deserves a significant amount of time and attention.

That's not to say other numbers aren't important. They just don't have as big an impact on the fortunes of your business.

Identify and break out your Critical Number and associated drivers.

Get them on a scoreboard for all to see.

Talk about them.

Teach and learn about them.

Assign responsibility for them.

Track them.

And most importantly, be sure to move them in the right direction.

Your business will be more successful for the effort!

At any given time in your business, **there is one thing** - an operational or financial number that represents a weakness or vulnerability that, if not addressed and corrected, will negatively impact the overall performance and long-term security of the business.

This one thing is known as your company's Critical Number™.

Ultimately, the Critical Number defines winning. It rallies people around a common goal and directs a focus to what's most important to the company's success.

From this definition, it's clear to see why identifying a Critical Number is valuable to your business, but the Critical Number is also very important to your employees. If they do not understand and buy-in to the Critical Number, it is likely that this number will continue to go unnoticed.

Here are three key ways the right Critical Number will strengthen your business:

1 It provides focus

Giving people a never-ending list of goals is like not having any goals at all. Having dozens of performance measures and targets and driving hard to achieve them all won't help you get results.

Measure what matters most by finding a few significant measurements rather than many.

Creating this focus will help you to achieve the large-scale goals that will have the greatest impact on your company.

2 It establishes a common goal

Be sure to give everyone the same set of goals. **We don't want to send people mixed messages on what's most important.**

Turn success into a team effort by giving everyone the same focused objectives, and be sure they have to work together to achieve them. This way, we either win together or lose together.

3 It promotes education

We want goals that keep people focused on the fundamentals of business: **making money and generating cash.**

We also want goals that make the company stronger by eliminating our weaknesses and growing strategically.

Finally, we want goals that educate people about the different aspects of the business and **teach people exactly what it takes to be successful.**

The Critical Number provides a learning opportunity that becomes part of the everyday process of running the business. In order for your team to improve the conditions that impact the Critical Number, they must first understand **what the number is, how it is created, where it is now, and where it needs to be** to create results.

The real magic of the Critical Number isn't in the number itself, it's in the process of getting to the number.

Choosing a Critical Number will provide company-wide focus, establish a common goal throughout the organisation and promote education at all levels of the company.

To begin the process of establishing your own Critical Number, answer these questions:

In the next year, what is the one thing...

- That is going to have the greatest impact on your business?
- You must achieve in order to succeed, or maybe even survive?
- That will clearly define winning for your company?

Establishing and understanding this number is an important step to getting everyone focused and accountable for results in an open-book company.

3 Team input in creating Critical Numbers

People support what they help create – if people don't participate, they don't buy in. If they don't buy in, then they don't commit. And if they don't commit they don't deliver.

Is important to have the team come up with the Critical Number or else they won't own it.

How you get the Critical Number is more important than the Critical Number chosen.

Some examples of Critical Numbers:

- Revenue
- Recurring income
- Retention rate
- Growing gross margin \$ - Qtr by Qtr
- Number of new customers
- New products
- Timesheet compliance
- Hours of overtime
- Wastage
- Rework %
- Web visits

- Lead numbers
- Lead conversions
- Sales appointments
- AR days
- Gross margin %
- Gross margin \$
- Return on assets
- Cash conversion cycle
- Profit per sale
- Revenue per employee
- On time delivery

Inspiration for Critical Numbers can come from a wide variety of places.

Sport is one place to look at for inspiration. Some interesting examples are:

Barcelona FC - worked out whoever controls the ball wins games (they control the ball on average 76%) of the time and are now the winningest team in history. To control the ball longer they focus on recruiting smaller and faster players and even cut the grass a different way.

Oakland A's money ball – found out that the metrics people were using to value players wasn't what was contributing to success – they found other metrics that contributed to their success and went after players who had those attributes and were therefore undervalued by the market.

Southwest Airlines – number of planes in the air – realised they were only making money when they were flying – whole focus of the crew is 'wheels up'.

Walgreens – number of customer visits – explains why they have stores within walking distance from each other in major cities.

Test the critical numbers chosen against this checklist:

- ✓ **Is the CN feasible?** - does the company have (or can they get) the resources, skills, time and support needed to achieve the CN?
- ✓ **Financial impact** - will it keep people focused on the fundamentals of business- making and generating cash?
- ✓ **Strategic impact** - will the CN make the company healthier and stronger by eliminating weaknesses and growing strategically?
- ✓ **Educational impact** - will the CN educate people about the different aspects of the business and teach people exactly what it takes to be successful?
- ✓ **Is the CN timely?** - does it represent something that needs to be done now - or are there other things to be done first?
- ✓ **Line of sight** - to what degree do your people have a clear line of sight to the CN - will they be able to see how they could support the CN?
- ✓ **Impactful** - is it a good use of resources? Will it provide a big bang for the buck?

Critical Number: **People or balance sheet** related:

A great result would be:	
A good result would be:	
An OK result would be:	

Critical Number: **Process or P&L** related:

A great result would be:	
A good result would be:	
An OK result would be:	

How can Walsh Accountants help you?

Should you have any questions or require assistance, contact our **Focus Advisory division** today.

Contact us on 5592 3644 or email info@walshaccountants.com

