Metrics are Revolutionizing Corporate Financial Management

By

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Business schools have long compartmentalized various aspects of financial management into separate classes. Our professors likely discussed financial planning, internal control, internal reporting, and cost accounting as different topics. Today, advances using ***metrics*** are quickly binding these major financial management tasks into an integrated whole. If you want to keep your financial management skills up-to-date you need to have a strong understanding how metrics are causing this to happen.

A ***metric*** is a performance measurement. At one time, metrics discussions focused around ***financial ratios***. A financial ratio is an old-fashioned type of metric, which compares one financial number to another, such as debt/equity or profit/sales.

At one time, limited computing capabilities restricted financial analysis to these primitive metrics derived entirely from the general ledger. However, today's financial management can provide considerably more value by combining both financial and non-financial information. While analysts usually use financial ratios for entire businesses, today companies commonly use metrics for individual responsibility centers as well. Today, organizations often develop metrics for every major activity.

Did a responsibility center do well or poorly last month? If a manager's budget was $100,000 and she spent $120,000, is this a good job or a bad job? To answer these questions, we need to know something about business volume. By calculating cost/unit, and benchmarking this metric against other organizations, financial management can quickly focus performance discussions.

> For example, hospital departmental reports commonly show cost/laboratory test, cost/prescription filled, or cost/inpatient day. Benchmarked against other

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hospitals, the metric allows everyone to know which departments are doing well and which ones are doing poorly.

Once an organization begins using metrics, budget discussions change from what a department spent last year, to what it *should* spend to be efficient. The simple act of benchmarking metrics is a powerful tool, significantly reducing the politics in the budgeting process.

While you can calculate a cost/unit for any activity where you can measure output, profit center's metrics usually include revenue/unit and gross margin/unit in addition.

These simple practices are only the beginning. In addition to financial metrics, today's performance management employs a high proportion of non-financial metrics, looking at the organization from customer, operational and learning perspectives as well. First introduced almost 20 years ago, this ***Balanced Scorecard*** approach has led to the development of ***strategy maps*** tying financial and non-financial metrics into a neat, efficient package.

Experienced financial managers quickly recognize that metrics have broad financial management uses. For example, the same responsibility center metrics generated for financial planning and control also have powerful cost accounting uses. While a short article cannot make you an expert in these techniques, we hope that it has spurred you to ask, "Do I need to learn more about metrics soon?"

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