Sparkassenstiftung für internationale Kooperation

5. Revenue KPIs

Introduction to revenue KPIs

In thhis section revenue KPIs are introduced to you. Sales volume is defined its importance explained. Tips to improve sales volume is provided. Additionally, the calculation of two similar KPI's, EBIT and EBITDA and their importance is shown. Finally, some tasks to help you calculate these ratios are provided with the short solution shown in the end of the section.

Revenue

KPIs

Sales Volume

Definition and example:

The quantity of items a business sells during a given period, such as a year or fiscal quarter, equals sales volume. Sales or sales revenue equal the dollar amount a company makes during the period under review. Because total sales equal sales volume multiplied by the unit price these two concepts of sales and sales volume are interrelated. An example is that a firm sold 1 million units of a product at $2 a piece. The corporate sales volume is 1 million, yielding periodic sales of $2 million (1 million multiplied by $2), as a result.[49]

Why is it important?

Sales and sales volume are two of the most important metrics with whom investors and creditors often judge the marketing process and managerial ability of a company's leadership. Senior executives constantly delve into the company's sales data and product portfolio to ensure their credit rating doesn't fall. They look after what competitors are doing with respect to innovation, seize emerging market opportunities and attempt to expand market share.[50]

How can a company increase the sales volume?

In case of your product or service everyone may be considered a prospect. But if you target prospects with the greatest need for what you offer your marketing efforts will produce the best results. Other possibilities are to identify a niche market and customize your promotional material to appeal to their greatest need. As a further step you could multiply your results by defining several other niche markets and slanting your promotional materials to appeal to the biggest need in prospective market.

A Unique Selling Proposition (USP) is the compelling reason why a prospect will do business with you instead of with your competitors. When you offer a benefit your customers cannot get from your competitors you will attract the maximum number of customers. By adding something to your business that you are not already offering you can create a USP, if you don't already have one. In a further step you should convert it into a benefit statement and include this in all your advertising.[51]

Operating Income (EBIT)

Example of calculation of Earnings before interest and tax (EBIT):[52]

EBIT ($ 140)

=

Net income ($ 100) + Interest Expenses ($ 10) + Tax Expenses ($ 30)

GROSS

PROFIT

Why is it important?

COMPANY	BANK
• The EBIT in the example above is $ 140. • It is an indirect measure of a company's efficiency. • The higher the operating income, the more profitable a company's core business is. • Several things can affect operating income (such as pricing strategy, prices for raw materials, or labor costs). As these items directly relate to the day-to-day decisions managers make, operating income is also a measure of managerial flexibility and competency, particularly during rough economic times.[53]	• Operating income provides banking analysts with useful information to evaluate a company's operating performance without regard to interest expenses or tax rates. • These two variables are specific to each company and should be separated when analysing operating profitability as a singular measure of performance. • Such analysis is particularly important when comparing similar companies across a single industry where those companies may have varying capital structures or tax environments.[54]

How can a company increase the EBIT?

- Search for new strategies by assessing the honest position of your business. A helpful process can be to conduct a brainstorming SWOT analysis (the Strengths, Weaknesses, Opportunities and Threats) of your business.
- Plan a coordinated strategy to reduce costs taking into account what was learnt from the SWOT analysis and what is achievable now as well as in the medium and long term.[55]

EBITDA

Example of calculation of Earnings before interest, tax, depreciation and amortization (EBITDA):[56]

$$\text{EBITDA } (\$\ 155) = \text{Net income } (\$\ 100) + \text{Tax Expenses } (\$\ 30) + \text{Interest Expenses } (\$\ 10) + \text{Depreciation } (\$\ 15) + \text{Amortization } (\$\ 10)$$

EBITDA

Why is it important?

COMPANY	BANK
• The EBITDA in the example above is $155. • It is an approximate measure of a company's operating cash flow based on the data from the company's income statement. • This measure is of particular interest in cases where companies have large amount of fixed assets which are subject to heavy depreciation charges. • Or in the case where a company has a large amount of acquired intangible assets on its books and thus subject to large amortization charges.[57]	• Since the distortionary accounting and financing effects on company's earnings do not factor into EBITDA, it is a good way of comparing companies within and across industries. • EBITDA is especially of interest to a company's creditors, since it is essentially the income a company has available for interest payments. • It is a useful measure mostly for large companies with significant assets. • Sometimes it is also called operational cash flow (**Do not mix it up with operational profit**).[58]

How can a company increase the EBITDA?

- Increase sales income! Sales income can be increased by raising the selling price where possible. Often market circumstances are tight and if competition is tough then you may not have this option available. Alternatively, SME's can create new demand and maintain prices by not offering discounts.
- Evaluate the true costs of discounts! Look at recent sales figures and analyse the effect any promotions, sales or free samples had on your profit. What did those discounts really cost you? How can discounts be reduced or eliminated?[59]

Task

Assume you are given the following information on a company:

Price	$ 5
Total sales	$ 20000
Net income	$ 1000
Interest expenses	$ 200
Tax Expenses	$ 300
Depreciation	$ 1000
Amortization	$ 300

Please feel free to solve the following questions in order to practice the contents of revenue key performance indicators:

1) Calculate the sales volume.
2) How could a company increase the sales volume?
3) Calculate the EBIT.
4) How could a company increase the EBIT?
5) Calculate the EBITDA.
6) How could a company increase the EBITDA?

Solution

1) $$\textbf{Sales volume}\ (\mathbf{4000}) = \frac{\text{Total sales}\ (20000)}{\text{Price}\ (\$\ 5)}$$

2) Offer a benefit that your customers cannot get from your competitor, create a unique selling proposition by adding something to your business that you are not already offering, identify a niche market.

3) EBIT ($ 1500) = Net income ($ 1000) + Interest Expenses ($ 200) + Tax Expenses ($ 300)

4) Search for new strategies by assessing the honest position of your business, plan a coordinated strategy for reducing costs taking into account what was learnt from the SWOT analysis.

5) EBITDA ($ 2800) = Net income ($ 1000) + Interest Expenses ($ 200) + Tax Expenses ($ 300) + Depreciation ($ 1000) + Amortization ($ 300)

6) Increase sales volume, evaluate the true costs of discounts.

SOLUTION