CEO Guide To SaaS Financial Metrics

As the CEO of a SaaS business, you place most of your focus on growth, sales and marketing. But as those begin to pay off and the business grows, you have to shift that focus to begin thinking about long-term financial operations and goals. SaaS financial operations are anything but basic, but not to worry. In this guide, we'll walk you through the key financial metrics you should be capturing to grow your business today and eventually, satisfy and impress potential investors in the future.

Contents

1. WHY THE OLD SCHOOL APPROACH WILL FAIL EVERY TIME

1. WHY THE OLD SCHOOL APPROACH FAILS EVERY TIME

If you've underestimated the importance of solid financial operations for both short and long-term success, you're not alone. But, it's not too late to set the course straight. As a CEO, accurate and real-time financial metrics are extremely important for a couple of reasons. First, they allow you to make informed decisions that aredriven by insight. Second, they will ensure that when you're ready to seek capital, you can provide the metrics and insight into the financial health of your business that investors and VCs will without a doubt expect.

Without the right financial operations and solution in place, you're stuck making important business decisions based on guesses or inaccurate information and to investors, your business looks like a risky investment. This ultimately will lower your valuation and make it extremely challenging to effectively raise capital.

To get your financial operations headed in the right direction, it's first important to understand that traditional metrics, accounting software and approaches aren't suited for the dynamic SaaS recurring revenue model. Because most robust finance systems that address 100% of what SaaS businesses need are very expensive and simply out of reach for the majority, the typical response has been to cobble spreadsheets together with traditional accounting software to create homegrown SaaS financial operations.

> *Without the right financial operations and solution in place, you're stuck making important business decisions based on guesses or inaccurate information and to investors, your business looks like a risky investment.*

1. WHY THE OLD SCHOOL APPROACH FAILS EVERY TIME

If you are doing this today, you'll soon learn that this approach won't work for long and here's why:

• *The more spreadsheets you create to supplement accounting software, the more you'll need to manually manipulate data*
• *The more you manually touch the data, the greater the risk for error*
• *Increased spreadsheets are disconnected and an error in one calculation can have a devastating domino effect*
• *This approach will not scale and to meet your needs as the business grows*

Spreadsheets are powerful tools, but they are poorly suited for managing a recurring revenue SaaS business. If you rely on them for too many processes, your financial operations are going to suffer. Before long, you're stuck in the spreadsheet vortex and can't get real-time metrics, don't trust the data and your numbers are inconsistently defined.

Think about the message this sends to potential investors if you are slow to deliver numbers and when you finally do turn them over, they contain inaccuracies, are difficult to inspect and don't hold up under scrutiny. This equals risk in the eyes of investors and will make negotiating very difficult because they will do everything they can to control that risk.

To be successful, you need four main things:

1. An understanding of the key metrics you should capture and why.
2. A subscription management solution that will make it easy to capture that information and scale to support the financial operations of your businessthrough every stage as it grows.
3. Quick access to those metrics and the high-quality financial information so you can make smart decisions, properly manage your business and eventually, raise capital with confidence.
4. GAAP financials that, when combined with those metrics, provide the insight and financial maturity you need to successfully run your business and raisecapital.

2. WHERE TO BEGIN

You recognize common problems, but how do you apply solutions to your business?

2. WHERE TO BEGIN

Unfortunately, as CEO you are often the last to learn about the heroics your financial operations team has been pulling to keep pace with your growth. Our advice is to spend some time digging into your processes. If your team is stuck in the spreadsheet vortex, you will likely be very surprised (and disappointed) by what you learn. They are probably dealing with multiple, disconnected tools, and expending a lot of manual effort to keep everything moving. You don't have to turn this into a Six Sigma exercise, but do try to find the constraints and quality problems.

3. THE METRICS THAT MATTER

So, what kind of information is critical? Let's take a look at the must-have metrics.

Monthly Recurring Revenue (MRR)

MRR is a measure of the predictable and recurring revenue components of your subscription business. It is probably the most important SaaS metric of all because it gives you the operational insight to accurately forecast, plan and measure growth. For example, you may have a general idea of your expenses month over month. MRR allows you to gauge if your recurring revenue is covering those expenses so that you can budget more confidently. If there is a little room left in your MRR, you may decide to ramp up your marketing spend. MRR also provides the operational insights you need, regardless of the subscription term length. If your business offers both annual and monthly subscription terms, MRR normalizes the varying term lengths that many SaaS businesses end up with over time and enables you to treat your data consistently, arguably the most important thing to do when dealing with subscription metrics.

Also important to note is that many of the other metrics we cover below are calculated using MRR so if it is incorrect, those metrics are likely to be incorrect as well. It's important to get this right.

Customer Lifetime Value (CLV)

Another critical metric that can be difficult to measure if you don't have the right solution and processes in place is CLV, the lifetime value of a customer or estimate of the average gross revenue a customer will generate before they churn.

This metric is important because resource allocation decisions can flow from CLV.

For example, most CEOs are aware of what it costs to acquire a customer. If that cost is below your CLV, it may be time to scale up sales and marketing. If it is above your CLV, it's time to be more cautious about allocating resources because spending is out of balance. In other words, if you are spending more to acquire an individual customer than the CLV, you need to be aware and scale back. A reliable solution should provide CLV in real-time and allow you to view it by product line so that, if one product line is more valuable than another but you are investing evenly in both, you can use CLV insights to better allocate resources.

Customer Lifetime Value/ Customer Acquisition Cost (CAC) Ratio

CAC is another critical metric because it allows you to determine the CLV/CAC ratio. In other words, what you can expect to get in customer lifetime value for every dollar you spend to acquire that customer. You'll need to calculate CLV and CAC separately to get this ratio. For example, if your CLV is 100 and your CAC is 50, you end up with a CLV/CAC ratio of 2:1. Thus, for every dollar you spend to acquire that customer, you'll get two dollars in CLV. Generally speaking, you want CLV to be higher than CAC. However, depending on your business objectives and funding, you may decide you can run at something less than "ideal" like 1:1. If so, you will at least be doing so explicitly. Some businesses with a lot of funding and the objective of a "get big fast" land grab, might be okay with a ratio of 1:1.5 or even 1:2+. However, in most cases the CLV should be higher than CAC. This can also be a very telling metric for VCs because a customer lifetime value that is greater than the cost to acquire that customer, while not completely conclusive, is a good indication to them that your revenue engine is working and resources are being responsibly allocated.

Cohort Reports

Cohort isn't a metric per se, but is just as important. By definition,

a cohort is a group with a common statistical characteristic such as a common price band or geography.

It is a style of report that not only is useful in indicating churn, but also can be used to test marketing campaigns and resource allocation. For example, if you run a cohort report based on subscriptions initiated during a specific date range, it could show if customers acquired at that time, subject to the same level of product maturity, customer support, on-boarding, pricing & packaging, are growing in MRR contribution or shrinking relative to customers from other cohorts. You're able to correlate performance with marketing actions, sales plans, pricing and support policies that were in effect at that time and can use this information to identify the business practices and processes that maximize the revenue contributions of customers. This prevents the human tendency to automatically say a campaign was successful, without concrete evidence to back it up. Consider asking your team how successful their most recent marketing campaign was and then run a cohort report to see how the reality differs from the perception. Chances are, you'll see a lot of bias. When employees put a lot of effort into a campaign, they tend to see it as successful because it was a good idea and they worked hard to execute it. If the cohort report doesn't show a change in MRR, or worse, if MRR went down,

4. WHERE DO YOU STAND?

4. WHERE DO YOU STAND?

Now that you know the basics, are you making smart, informed decisions and setting yourself up to position your business for high valuation? Can you provide the metrics and accurate financials that investors will expect?

Asking yourself these questions will help indicate if it is time to make a change:

1. How many touches does it take to process a new order? Accurately and efficiently processing a new order shouldn't take longer than 45 seconds.

2. What does it take to process an upgrade/downgrade/early-termination and how many times are you touching the data? If you have to touch the data more than 2 times, it's too many and increases the likelihood of errors.

3. How many touches does it take to correct a new order if there are errors? We all make mistakes but it shouldn't take more than 10 seconds to find and fix order errors.

4. Do I know if invoices, revenues and contract value match? If they don't how many touches does it take to correct them? Failing to have a process by which you know your key financial attributes (contract value, revenues, invoices) are correct for each customer puts your valuation at risk. Further, when you find discrepancies, it should only take a few seconds to fix them.

5. At the end of the month, how long does it take to close the books? The answer to this may surprise you and is often shockingly long so the next question is "Why?" (pretty safe bet it has to do with a spreadsheet).

We know how challenging it can be to manage the financial operations of your SaaS business because we’ve lived it too.

That’s the reason we built SaaSOptics. We offer total subscription management, from order to invoice, and are the only platform that can scale and provide top to bottom in-depth financial metrics and analyses like MRR, ARR, cohort and customer lifetime value. We provide everything you need to run and grow your SaaS business, all in one place. You might not see all of our features as being critical now, but we’ve been in your shoes so we’re thinking ahead for you. That’s why we’ve covered your day-to-day subscription management but also built in all the great, real-time GAAP financial, metrics and analytics reporting that will make it easy for you to gain insight into your business and impress investors. Over 300 customers rely on SaaSOptics to invoice over $1.5 billion in revenue. They trust us because we’ve been in their shoes and used what we learned to create a truly exemplary solution. SaaSOptics can make it easier for you to grow and succeed at any stage of your business, too.

SaaSOPTICS®

Call us today at 678.710.8260 or email us at info@saasoptics.com for more information.

Learn more