**Distinguishing Revenue, Profitability, and Risk Metrics**

All business metrics can be classified into three broad categories. Revenue metrics, profitability metrics, and risk metrics.

One way to help distinguish for a particular metric, which of these three categories it falls into, is to think about what people in the company depend on this information and will ask for it. Revenue metrics relate to sales and marketing. Profitability metrics to efficiency and logistics, production, and operations. And risk metrics to risk management, and are widely used by a company's creditors, and outside investors.

So, revenue metrics are outward facing. They tell us something about how well or badly the company is marketing and selling its products. The company sales force, typically led by a vice president of sales, will want to know how many units of each product were sold over a given time interval and how this compares to the same time interval last year and the year before. They will want to look at sales by region, by product and by new versus repeat customers. And they will want to know about the sales funnel, the potential future customers who have been identified, and where they are in the step by step process of moving towards making a purchase. Much more on the sales funnel later. Meanwhile, the marketing team, typically led by a VP of marketing, will want to know how effective any marketing campaigns may be. How many people have seen a particular advertisement or email marketing piece or mail offer? What percentage have responded, etc.? Everything that relates directly or indirectly to selling is a revenue metric.

Profitability metrics have to do with the efficiency of the processes by which the company creates and delivers its products and services to customers. These are operational metrics, sought after by those people in the company responsible for production. Typically led in a large company by the chief operating officer. Anything that relates to how much cash is tied up in the form of unsold inventory, how much production is unsaleable due to spoilage or wastage, we didn't sell those mangoes in time, and now they're rotten, like that. Or at the other extreme, how often the company is unable to meet urgent customer requests and loses sales because of insufficient production or inventory. What portion of products off a production line are rejected as defective, how much is spent on variable costs, raw materials and labor, per unit product, etc., etc., etc. These are all efficiency metrics. Note that even a company with large and rapidly increasing revenues will fail to be profitable if it cannot deliver its offerings efficiently. Large established companies with relatively little room to increase revenues can often achieve significant increases in profitability by focusing on improving operational efficiencies.

Finally, risk metrics have to do with tracking and where possible reducing the many potential dangers a company faces. For example, if a company is spending a large portion of its net cash flow every month on interest on its debts, then even a small drop in revenues caused by some external shock, like a recession, could cause the company to become insolvent and collapse. Secured creditors have the right to seize a company's assets if they're not paid on time and that would close down the business. Net cash out is always the most important metric to track. How many months can the company survive at the present burn rate? Another example of risk metric is churn, a company with a subscription based revenue model that has a very high churn rate, the rate at which new subscribers drop off within a year, runs the risk that over time, there are fewer targets who have never been customers and it becomes impossible to maintain revenue growth or even hold steady. The greater the reliance on long term recurring revenue customers, the less dependent a company is on constantly successfully converting new prospects into clients and that's a lot less risky. Other examples of risk metrics are specific to the financial industry. Banks that issue credit cards are in the business of tracking how much exposure they have to potential customer defaults at any time and what percentage of their customers are expected to default in the next six months or are in default now. Money managers use volatility of returns and something called the maximum historical drawn down from high water mark, which we'll explain later, as a proxy for their portfolio's risk exposure. I've noticed in general that most risk metrics are related in one way or another to leverage. Anyone whose survival depends on their ability to pay back a large amount of borrowed money faces a magnified risk from any misfortune. Maybe this will help you to remember the categories.