BENEFITS OF USING NON-FINANCIAL KPIs

A white paper published by the Professional Accounting Center at the University of Toronto Mississauga found that non-financial key performance indicators (KPIs) that measure efficiency reveal the most about how firms are doing, and that investment strategies taking note of these can deliver excess returns.

This suggests firms could do more to disclose non-financial KPIs, and that analysts and investors would benefit by paying closer attention to them.

Authors: Binxu Fang, Partha S. Mohanram and Dushyantkumar Vyas
Title: "The relevance of non-financial Key Performance Indicators (KPIs)"
Published by: The Professional Accounting Center, University of Toronto Mississauga

WHY USE NON-FINANCIAL KPIs

They can provide insights on the future performance of a company

They are more specific to individual firms than financial metrics

They may capture data from management accounting systems

They can inform internal decision-making to improve performance

Improvement in non-financial KPIs related to efficiency better indicated:

- Future profitability
- Sales growth
- Stock return

Traditional financial statement metrics may not reflect underlying business developments on a timely basis. **Non-financial key performance indicators could provide a leading indicator for analysts and investors to predict future performance or movements in stock prices.**

WHEN TO USE NON-FINANCIAL KPIs?

The study found that stock prices underreact to non-financial KPIs when firms operate in "opaque" environments, i.e. where reporting and analysis are less available. Examples include "small firms, firms with low analyst coverage, and those with low institutional ownership."

CPAs can improve reporting on these measures for the benefit of investors and other stakeholders, as well as to inform internal decision-making to improve performance.

"Firms could do more to disclose non-financial KPIs, and analysts and investors can benefit from paying closer attention to them."

HOW TO BENEFIT FROM NON-FINANCIAL KPIs

As an analyst or investor

Apply similar fundamental analysis and value investing techniques to non-financial data and industry-specific KPIs.

Use efficiency-focused KPIs to generate trading strategies: long-short trading strategies based on non-financial KPIs can deliver outsized returns.

As a CPA in public practice

Prioritise monitoring efficiency-related KPIs: improvements in efficiency-related KPIs involving cost management, sales per unit of assets and activity levels predict better stock performance.

As a policymaker, regulator or standards setter

Standardise KPI disclosures to make markets more efficient: non-financial KPIs could be used in trading strategies delivering excess returns. This suggests that firms may not be effectively communicating relevant information to markets. Greater standardization or transparency in reporting of non-financial KPIs could see stock prices better reflect performance.

Read more: Professional Accounting Centre