Digital Businesses: The Metrics That Really Matter

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User-centric firms should identify and track the core actions that can make or break their businesses.

Traditionally, executives have used standard metrics, such as cash flow, inventory turns and operating income, to get a broad sense of the health of their firm. However, the game has changed with the rise of digital business models centered on the user. New metrics need to be devised based on the core user actions that drive value creation in such models.

Threadless, an online T-shirt retailer, crowdsources its designs from a community of designers and curates the best designs through a social rating mechanism. Threadless relies on two core user actions: the upload of new designs by designers and the voting on designs by the Threadless community. A failure by the community to provide adequate feedback on designs would discourage designers from uploading new ones in the future, leading to a downward spiral. To ensure a healthy and scalable business model, Threadless needs to actively minimise failure and increase repeatability of both core actions as they are intertwined.

In the digital world, users may also generate value without actively creating content, products or services. Netflix built out its DVD rental business model around the core user action of movie queueing. The queueing provided Netflix with the data it needed to predict actual demand across the country and successfully manage its central national inventory. The more titles users added to their instant queue, the better Netflix's logistics performed as it benefitted from information on actual demand. Movie queueing was the core user action that drove value creation in Netflix's business model.

Not all digital businesses are the same

Platforms are a specific type of digital business which often depend on multiple core user actions. To use the example of Facebook, users may post status updates, upload photos and react to content. As these actions cumulatively create value, they must all be highly repeatable. Facebook therefore tracks the ratio of daily active users to monthly active users, a measure of the proportion of its user base that participates daily. This aggregate measure makes sense since no single action accounts for the bulk of value creation. The higher the daily participation rate, the healthier Facebook is as a platform.

In the quest to emulate Facebook's successful execution, many startups embrace this metric directly. However, it may not be as relevant for digital business models whose value creation chiefly relies on one or two specific core actions. A focus on measuring the failure and repeatability of these core actions would allow for a more precise execution.

Measuring core user actions is even more important in the case of multi-sided platforms. In such cases, it is essential to understand how the various participants co-create and exchange value. All sides of the market must succeed for the business to thrive.

Uber enables drivers and passengers to exchange rides for money and needs to manage both sides. Uber drivers perform two core actions: indicating their availability for booking and accepting booking requests. When a passenger opens the Uber application and sees that no taxi is available, or cannot secure a ride, the driver-side core actions are failing. If this happens often, it reduces the likelihood that the passenger will request a ride (i.e. repeat a demand-side core action). In time, this can reduce the number of total users and their level of interactions, or what is called the liquidity in the market.

Digital businesses are not static

Core user actions may evolve as a digital business matures and grows. When users first start interacting with a digital business, they may predominantly participate in acts of consumption. With more experience, they may progressively move towards acts of creation. To effectively guide a user from consumption to creation, a digital business needs to focus on different metrics across the user's life cycle.

Users of Intuit's TurboTax typically start out as consumers of the software, using it to manage their tax filing. Once this is done, some users stay on to help their peers through the tax-filing process, thereby creating value as a crowdsourced customer support for TurboTax. Intuit measures this conversion from consumption to creation to ensure the success of its model.

Firms that want to succeed with user-centric business models need to first identify the few core user actions that drive value creation. In multi-sided markets, these actions need to be isolated for all participants. The next step is to define metrics that help minimise the failure of these core actions and maximise their repeatability. Focusing on these metrics helps firms execute with precision, benefit from a virtuous feedback loop and scale up efficiently. It's all about keeping the business humming.

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